THE LIBERALISATION OF EUROPEAN ENERGY MARKETS: THE USE OF COMPETITION LAW AS A REGULATORY TOOL

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ABSTRACT

The objective of this thesis is to examine the approach adopted by the European Commission in recently regulated energy markets. Antitrust investigations indicate that the European Commission increasingly tends to implement competition law, in particular through commitment decisions, in order to create a *quasi-ex ante* regulatory effect in the markets. The main conclusion of this thesis is that a lack of legal certainty and insufficient clarification of the law originating from this approach might have detrimental impacts on a single and competitive energy market design in Europe.

This thesis consists of three substantial chapters in addition to the introductory and final conclusion chapters. The first chapter analyses long-term supply contracts concluded in the wholesale markets from both an economic and a legal perspective. The economic analysis of the contracts shows that the functioning of European energy markets remains ambiguous. The European Commission thus seems to adopt a strategy to balance spot market trading with long-term supply contracts and vertical integration through antitrust investigations.

The second chapter aims at examining the tendency of European Commission to assess the foreclosure effects of a preferential use of cross-border energy transmission networks within the new liberalised energy markets. While a pro-entry bias approach of the European Commission is observed in the case law, it is difficult to find recognition by the Commission as well as secondary EU law of the likely pro-competitive effects of long-term cross-border transmission network reservations resulting from the associated long-term cross-border supply contracts. Besides, it can be observed from the case law that the European Commission and the European Courts tend to approve the preferential use of networks as long as the right holder engages in a major investment in these networks. As a consequence, the methodology adopted by the European Commission for the antitrust analyses of priority access rights to cross-border infrastructure might fail to correspond with legal predictability and economic accuracy.

The aim of the third chapter is to show the tendency of the European Commission to finalise antitrust investigations through a public settlement procedure, which seems

to be a convenient tool for the facilitation of market regulation through antitrust enforcement. The increased number of commitment decisions in the energy markets raises a concern regarding the possible detrimental effects of this trend. With the consideration of the importance of legal certainty in the regulated markets in terms of market building and social welfare, the chapter proposes a hypothetical framework guideline including certain measures which may increase the efficiency and sustainability of public settlement procedures and also improve legal certainty in the energy markets.

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CHAPTER 1

INTRODUCTION

I. Background and Research Questions of the Thesis

Before market liberalisation, the European electricity and gas markets mostly consisted of vertically integrated state-owned monopolies, which engaged in generation, transmission through networks and supply. These markets therefore were typically defined within the limits of legal monopolies and geographic demarcation. Until the 1980s the physical characteristics of networks, such as fixed grids and pipelines, seemed to constrain the scope for liberalisation and market-opening. A further constraint was perceived in the high degree of government ownership and control in these industries, especially in much of continental Europe.[1] However, since the idea of liberalisation has emerged, underlying assumptions about these constraints on the scope of competition have increasingly been challenged. As a result, the structure of the electricity and gas industries has been transformed by institutional reforms.

Some drivers for this policy change are listed below. At the economic level, there was a desire to reduce energy prices by promoting national and regional competitiveness within these industries, which have become more interconnected and mutually dependent marketplaces. The important role of economies of scale has radically changed due to the fact that smaller independent operators have managed to provide consumers with cheaper energy. Technological developments have had a significant role as well, particularly in lowering costs and entry barriers in electricity generation. The intense use of information technologies has proved that it is possible to have competition within energy supply markets, even though the supply chain is part of a complex system that has elements of a natural monopoly and needs to be balanced and managed.[2]

[1] P. Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (1st edn., Oxford University Press 2002) p. 20

[2] Since electricity cannot be stored generation and supply must be balanced. Historically, this balance was created through vertically integrated energy companies. However, the development of information technologies has made it possible to balance generation and supply, and this has thus resulted in an improvement in competition in the markets of energy generation and supply. Cameron, *ibid*, 24

The creation of an Internal Energy Market programme in the 1990s was the first step taken towards market integration. Nevertheless, the most significant measures for market liberalisation were adopted through the establishment of the Directives concerning common rules for the electricity and gas industries. The electricity Directive was established in 1996, whereas the gas Directive was enacted in 1998.[3] In 2003, the legislative process took a major step forward with the adoption of the second electricity and gas Directives.[4] Directive 2003/54/EC and Directive 2003/55/EC made a significant contribution towards the creation of a single and competitive internal energy market within the European Union (hereafter the EU).

Although more than two decades have passed since national markets were opened to competition and gradually integrated to create European-wide markets in electricity and gas, the competition in the markets has not reached an 'ideal' level[5] as expected by the European Commission (hereafter the Commission).[6]

In order to overcome the remaining barriers to competition in the energy markets, the Commission, on the one hand, issued a proposal for the so-called third legislative package,[7] which strengthens the regulatory provision in order to reinforce

[3] Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity [1996] OJ L 27/20; Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas [1998] OJ L 204/1

[4] Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity [2003] OJ L 176/37; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas [2003] OJ L 176/57

[5] Commission, 'Making the internal market work' COM(2012)663 final, p. 2

[6] In 2005, in order to identify and address potential shortcomings of the liberalisation process, the Commission launched a sector inquiry into the functioning of the electricity and gas markets. In 2007, the Commission published the final report on the Sector Inquiry, which identified a number of interconnected deficiencies, including: an insufficient level of unbundling between network operations and supply activities; the existence of traditional sale patterns through long-term supply contracts which resulted in vertical foreclosure and thus prevented potential competitors from entering the markets; ineffective and inefficient allocation and use of cross-border transmission network capacities; and finally, a low degree of competition; DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724; See A. Van Hassteren and G. S. Georgiev, 'Commission Launches Inquiries into the Energy and Financial Service Sectors' (2005) 3 Competition Policy Newsletter, Autumn Issues 51; G. Olsen and B. Roy, 'The New World of Proactive EC Antitrust Enforcement? Sector Inquiries by the European Commission' (2007) Vol.21(3) Antitrust 82

[7] Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55; Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94; Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation 1228/2003 [2009] OJ L 211/15; Regulation (EC) No 715/2009 of the European

competition and market integration. On the other hand, the Commission initiated[8] a number of antitrust investigations in the energy markets,[9] as it was clear that achieving greater competition in the energy sector through the legislative process had not been entirely successful and that the benefits for consumers had been rather limited.[10] This action of the Commission caused the occurrence of a substantial body of cases,[11] which seem to have been driven by energy policy objectives, i.e. liberalisation and integration of the energy markets, rather than the aim of addressing illegal past conduct.[12] Indeed, the willingness of the Commission to remove the deficiencies of liberalisation through employing EU competition law as a relevant vehicle can be seen from the declaration of the former Competition Commissioner, Neelie Kroes. She stated that '... I intend to use our competition tools actively to speed up the liberalisation process in gas and electricity markets'.[13]

Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation 1775/2005 [2009] OJ L 211/36

[8] The Commission started these investigations following the Sector Inquiry (see n.6). In this sense, the Sector Inquiry can be defined as a 'curtain-raiser' of antitrust enforcement, which prepared the ground for competition proceedings. Olsen and Roy, *supra* n 6, 83

[9] Commission, 'Competition: Commission has carried out inspections in the EU gas sector in five Member States' MEMO/06/205; Commission, 'Competition: Energy sector inquiry confirms serious problems and sets out way forward' IP/06/174

[10] M. M. Roggenkamp *et al*. (eds.), *Energy Law in Europe: National, EU and International Regulation* (2nd edn., Oxford University Press 2007) p. 55

[11] As seen in the above mentioned declaration, over the last decade the Commission has openly stated its intention to use competition law to foster the liberalisation and integration of energy markets, and thus push forward its energy policy agenda. Besides, as will be seen within chapter 3, the Commission is not limited to antitrust investigations. If Member States are under the obligation to transpose EU laws into their domestic legal systems, the Commission may take procedural steps under Article 258 TFEU in an instance where a Member State fails to fulfil this obligation, in order to bring them before the European Court of Justice. Nevertheless, with the consideration of the content of the Article, the Commission can only ask the Member States concerned to adopt EU laws into the national law system under an infringement procedure. However, under antitrust investigations, commitments proposed by undertakings concerned may go beyond EU laws including *ex-ante* sector-specific regulatory, as will be seen within the discussion chapters. As a result, from a policy objective point of view, antitrust investigations seem to provide the Commission with a broader discretion with which to push market liberalisation one step further.
A list of infringement procedures for non-transposition of the 2nd and 3rd energy packages is provided under the Commission Staff Working Document Energy Markets in the European Union in 2011 COM (2012) 663 SWD (2012) 367 <http://ec.europa.eu/energy/gas_electricity/doc/20121115_iem_swd_0368_part1_en.pdf>, for the list of provisions see <http://ec.europa.eu/energy/gas_electricity/doc/20121121_iem_swd_0368_part3_en.pdf> accessed 15 October 2014.
For recent developments about infringement proceedings see Commission, Staff Working Document, 'Enforcement of the Third Internal Energy Market Package, SWD(2014) 315 final, pp. 1-6

[12] M. Sadowska, *Committed to Reform? Pragmatic Antitrust Enforcement in Electricity Markets* (Intensentia 2014), p. 70

[13] Commission, 'Competition: Commission secures improvements to gas supply contracts between OMV and Gazprom' IP/05/195; M. Monti, 'Applying EU Competition Law to the Newly Liberalised Energy Markets' Speech/03/447

Furthermore, this idea was boosted by the former Energy Commissioner, Andris Piebalgs. He said that, 'in this time of economic and financial crisis, it is simply unacceptable that the European consumers and companies suffer the burden of an ill-functioning energy market. The Commission is determined to take all necessary action to ensure that European consumers can benefit from real choice, better prices, and enhanced security of supply that only an open and competitive market can provide'.[14]

The ultimate research questions of this thesis therefore are: How does EU competition law apply to the newly liberalised energy markets? How does the Commission address regulatory shortcomings in energy through antitrust enforcement? To what extent do the current dynamics of regulatory practices motivate the Commission to engage in EU antitrust investigations? And also, to what extent is the *quasi*-regulatory role of EU competition law within these markets likely to create other market problems? In the light of these research questions, within the discussion chapters, this thesis will investigate the following key themes: (i) the relationship between competition and regulatory goals;[15] (ii) the possibility and danger of the Commission using antitrust enforcement to achieve outcomes that are beyond the regulatory objectives defined under the EU regulatory framework; and (iii) the importance of legal certainty for market operators in the recently liberalised

[14] Commission, 'Commission acts to ensure effective and competitive energy market across Europe' IP/09/1035

[15] Competition law and sector-specific regulation are different tools that the Commission has to shape market structure in Europe; the relationship between them has been discussed in the context of different sectors, particularly telecommunications and energy, and is still a hot topic for many scholars. Because of the fact that this thesis focuses on the tendency of the Commission to use competition law for the purpose of achieving regulatory objectives, this thesis is interested in the interplay between these two tools.
See H. Ungerer, 'Use of EC Competition Rules in the Liberalisation of European Union's Telecommunications Sectors. Assessment of Past Experience and Conclusions for Use in Other Utility Sectors' (2001) COMP/C/2/HU/rdu, available at <http://ec.europa.eu/competition/speeches/text/sp2001_009_en.pdf> accessed 14 October 2014; N. Petit, 'Circumscribing the Scope of EC Competition Law in Network Industries? A Comparative Approach to the Us Supreme Court Ruling in the *Trinko* Case' (2004) Vol.13 Utilities Law Review 6; R. O'Donoghue, 'The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector' (2005) Vol.1(2) Journal of Competition Law and Economics 355; D. Newbery, 'The Relationship Between Regulation and Competition Policy for Network Industries' (2006) Working Paper CWPE 0631 and EPRG 0611 <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/01/eprg0611.pdf> accessed 23 February 2012; P. Larouche, 'Contrasting Legal Solutions and the Comparability of EU and US experiences' (2006) TILEC Discussion Paper 2006-028 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=943615> accessed 24 June 2014; G. Monti, 'Managing the Intersections of Utilities Regulation and EC Competition Law' (2008) Vol.4 The Competition Law Review 2

energy markets regarding changing and developing the regulatory legal environment.

For the purpose of addressing the above-mentioned research questions and key themes, this thesis examines antitrust investigations, including investigations that were initiated by the Commission before and after the modernisation of EU competition law, from both substantive and procedural points of view. The aim of the case analyses is to critically study the role of competition law in the liberalisation of the energy markets. From a substantive point of view, the case law shows that the investigations have been based on long-term supply contracts under Articles 101 and 102 TFEU as well as on the abusive conduct of dominant market players, mainly in the form of refusal to supply access to an essential facility under Article 102 TFEU such as cross-border transmission infrastructures.

For long-term energy supply contracts concluded within Member States, the competition concerns of the Commission mostly stem from anticompetitive foreclosure effects of the contracts, because of either the duration/volume of the contracts or the contract clauses. On the other hand, they pose certain advantages for facilitating investment, market operation and entry. Therefore, from an economic perspective, the main problem in assessing long-term supply contracts under competition law lies in speculative economic analyses of these contracts.[16] The situation may become even more complicated when the Commission needs to offset short- and long-term efficiencies such as entry and investment. The effects of these contracts in the energy markets are thus ambiguous and need to be clearly explained. In addition, from a legal point of view, *ex-ante* sector-specific regulatory rules naturally do not shed light on the status of long-term supply contracts and leave them under the scope of competition law. With the consideration of economic uncertainty as well as the procedural aspects of the investigations, as will be argued below, the Commission's competition decisions regarding long-term supply contracts within the energy markets should be organised methodologically and clarified in

[16] A. De Hauteclocque, *Market Building through Antitrust: Long-term Contract Regulation in EU Electricity Markets* (Edward Elgar Publishing Limited 2013) p. 35

order to draft a framework model for the sake of future antitrust investigations at both the EU and domestic levels.[17]

With regard to abusive behaviours of dominant undertakings in the energy markets, the competition concerns of the Commission derive from preferential cross-border network reservations associated with existing long-term supply contracts concluded among Member States and from strategic network blocking by vertically integrated network companies. In both situations, competition in the relevant downstream markets is jeopardised due to network foreclosure. The problem here arises not only from ambiguous effects of pre-liberalisation long-term supply contracts concluded among Member States (and/or operators) but also from the Commission's approach to preferential network reservations associated with long-term supply contracts. In addition, it stems from a relationship between *ex-ante* energy regulation and *ex-post* competition law. Conceptually, the regulatory legislation provides rules on third party access, vertical unbundling as well as the allocation and management of cross-border transmission networks in order to increase non-discriminatory, transparent and efficient use of cross-border infrastructure. Within this context, the role of EU competition law should be complementary and limited to competition policy and objectives. Nevertheless, in practice, it seems that competition law is used to achieve not only the goals of competition policy but also the objectives of regulatory policy in energy. In this sense, it should be carefully analysed as to whether, in practice, the Commission fulfils its duty regarding competition policy in the EU, or whether the politics of liberalisation have a significant impact on the way in which EU competition law is implemented.

When it comes to the question of how EU competition law is applied within the energy markets, the case law indicates that, from a procedural point of view, the investigations have mostly been concluded through either informal antitrust settlement under former Regulation 17/62[18] or formal antitrust settlement under

[17] Note that, to the knowledge of the author, this methodological clarification has been done by A. De Hauteclocque through his PhD thesis ('Long-term supply contracts in European decentralised electricity markets: an antitrust perspective' (DPhil thesis, University of Manchester, 2009)), yet his analysis mostly reflected the economic aspect of the cases. However, this thesis handles and analyses them from a legal perspective.

[18] Council Regulation (EEC) No 17 First Regulation implementing Article 85 and 86 of the Treaty [1962] OJ 013

Article 9 of Regulation 1/2003.[19] This ultimately raises questions over the proportionality of the commitments proposed by the energy companies concerned, the appropriateness of the arrangements reached through bargains, and the effect of the settlements on legal certainty in the markets, particularly with regard to the Commission's possible regulatory policy motivations when exploring energy markets through antitrust enforcement.

The functioning of energy markets can be improved through the preservation of legal certainty and clarification of the law as much as the substantial analysis and termination of possible competition infringements, given that legal certainty may facilitate the entry of new competitors who already suffer from information asymmetry with respect to the incumbents.[20] Legal certainty may also promote investment in electricity generation technologies as well as the network capacities necessary for security of supply. Thus it will have a positive impact both on short and long-term efficiency criteria. Consequently, it is crucial to develop a critical view of the procedural and substantial aspects of the antitrust settlements pursued in order to bring a swift end to possible violations of EU competition law without impairing legal certainty.

II. Methodology

In dealing with the research questions presented above, this thesis is developed on the basis of various legal and economic analyses, observations, comments and solutions that have been generated by legislators, courts, authorities, academics and practitioners. In consideration of these legal and economic studies and works, this thesis offers its own interpretations, suggestions and solutions, which render it an original doctoral thesis.

As a document-based and doctrinal piece of research, this thesis employs as its main method the examinations and evaluations of primary and secondary documentary materials. The primary materials include EU competition legislation, particularly Articles 101 and 102 TFEU, EU secondary law, particularly energy liberalisation Directives and Regulations, and the decisions and judgments of the European Commission and the European Courts. Although the jurisdictional scope

[19] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty OJ L 1
[20] Hauteclocque, *supra* n 16, 33

and the case analyses are limited to EU law, the EU courts and institutions, references have been made to documents and decisions from other legal systems, authorities and/or courts where these are particularly relevant. The second group of material includes policy documents such as sector inquiries and scholarly literature from different disciplines including law and economics.

III. Structure and Outline of the Thesis

This thesis has three discussion chapters in addition to the introductory and final conclusion chapters. In the light of the clarifications above, the discussion chapters aim to determine potential answers to the key research points and identify a consolidated solution to the main thesis question. Each chapter handles one of the main competition problems in the energy market, and critically analyses the approach that the Commission adopted in order to solve them. In this sense, the second chapter of the thesis deals with the problem of long-term supply contracts concluded within Member States from both an economic and a competition law point of view. While the chapter specifically aims at providing a methodological framework on antitrust investigations regarding long-term supply contracts, it also provides an opportunity to observe that the Commission tends to solve competition problems resulting from long-term supply contracts in the energy markets through formal or informal settlement proceedings. In this regard, the chapter addresses the main question of the thesis, which is, *to what extent does the Commission strategically use competition law in order to achieve the goals of the market regulation?* Similarly to chapter two, the third chapter focuses on another main competition problem in the energy markets, which is the problem of long-term preferential network reservations. The chapter aims to clarify the relationship between EU secondary law and competition law on the basis of preferential network reservations. The chapter points out that the Commission not only handles the above-mentioned problem on the grounds of competition law but it also addresses regulatory deficiencies in the energy markets through antitrust enforcement. Again, the chapter attempts to contribute to the main research discussion of the thesis while analytically addressing the problem of preferential network reservations. Finally, the fourth chapter addresses the question, *what is the cost of the Commission's strategic use of competition law to achieve its regulatory objectives*? In this regard, the chapter critically analyses certain antitrust cases and the proportionality of commitments

offered by the undertakings concerned, and examines the importance of legal certainty in the energy markets for market operators, national regulatory and competition authorities. More specific information about the chapters will be provided below.

The second chapter initially explores the advantages of long-term supply contracts from an economic point of view and shows that the policy recommendations for antitrust authorities remain ambiguous. These economic analyses bring originality to the chapter, as they provide a comparison between the competitive and anticompetitive effects of long-term supply contracts, and highlight the economic ambiguity by mixing economic and legal points of view.[21] It then examines competition decisions made by the Commission over long-term supply contracts concluded within Member States in order to analyse the Commission's perspective, and provide market operators as well as national authorities with framework guidance. The case analysis indicates that the approach of the Commission to long-term supply contracts has evolved according to the objectives of energy liberalisation. With regard to the recent energy cases, it seems that the antitrust investigations of the Commission have been motivated by not only competition policy objectives but also the goals of market regulation in energy.

The third chapter studies the legal, political and institutional parameters that determine how the dimensions of the European competition model, namely vertical

[21] Note that there is significant literature on the economics of long-term contracts; yet, to the knowledge of the author, this literature does not have a legal perspective. See S. E. Masten and K. J. Crocker, 'Efficient Adaptation in Long-term Contracts: Take-or-pay Provisions for Natural Gas' (1985) Vol.75 The American Economic Review 1083; P. Aghion and P. Bolton, 'Contracts as a Barrier to Entry' (1987) Vol.7 The American Economic Review 388; P. L. Joskow, 'Contract Duration and Relationship-Specific Investments: Empirical Evidence from Coal Markets' (1987) Vol.77 The American Economic Review 168; D. M. Newbery, 'Competition, Contracts and Entry in the Electricity Spot Market' (1998) Vol.29 RAND Journal of Economics 726; L. Onofri, 'Contracts, Investment Incentives and Efficiency in the Restructured Electricity Market' (2002) Vol.16 European Journal of Law and Economics 23; A. Cretiand and B. Villeneuve, 'Long-term Contracts and Take-or-Pay Clauses in Natural Gas Markets' (2004) Vol.13 Energy Studies Review 75; A. Neumann and C. Hirschhausen, 'Long-term Contracts for Natural gas Supply- An Empirical Analysis' (ISNIE Conference, Barcelona, 2005); J. M. Petrash, 'Long-term Natural Gas Contracts: Dead, Dying, or Merely Resting?' (2006) Vol.27 Energy Law Journal 545; A. Neuman and C. von Hirschausen, 'Long-Term Contracts and Asset Specificity Revisited: An Empirical Analysis of Producer–Importer Relations in the Natural Gas Industry' (2008) Vol.32 Review of Industrial Organisation 131; J. M. Glachant, and A. De Hauteclocque, 'Long-Term Energy Supply Contracts in European Competition Policy: Fuzzy not Crazy' (2009) EUI Working Papers-Robert Schuman Centre for Advance Studies <http://www.eprg.group.cam.ac.uk/working-paper-eprg0919/> accessed 21 April 2011; G. Meunier 'Imperfect Competition and Long-term Contracts in Electricity Markets: Some Lessons from Theoretical Models' in A. De Hauteclocque, J. M. Glachant and D. Finon, *Competition, Contracts and Electricity markets* (Edward Elgar Publishing Limited 2011)

unbundling and single market integration, have been implemented in the energy sectors. Chapter three shows that the problem of long-term supply contracts concluded across Member States needs to be addressed in a different way given the fact that their effects on competition diverge from the contracts signed within the States due to the necessity of the analysis of long-term priority rights for interconnectors. This chapter thus proposes that the Commission should take the possible positive effects of associated long-term supply contracts into account while assessing preferential network use. Nevertheless, regarding the general approach of the Commission under Article 102 TFEU investigations into objective justification defence, it seems hardly possible to witness that associated long-term supply contracts would be considered objective justifications.

The fourth chapter highlights the termination of antitrust investigations through commitment decisions which result in *quasi*-regulatory effects within the energy markets.[22] It indicates that the generalised implementation of commitment decisions with the purpose of eliminating market deficiencies and improving market regulation might result in detrimental effects on the energy markets in terms of the generation of legal uncertainty. The chapter emphasises the importance of legal certainty as well as the sustainability of it in the light of the evolving regulatory rules and

[22] There is a huge ongoing debate on commitment decisions. Nevertheless, to the author's knowledge, there are no in-depth case studies on the Commission's commitment decisions in energy, although the Commission's interventions in the energy sectors through antitrust investigations over the last decade have provided an opportunity to ascertain whether the concerns over the *quasi*-regulatory use of competition law is well-grounded. On the other hand, a significant number of scholars have referred to these energy cases or examined them to some extent as examples of the use of competition law as a regulatory tool. See J. T. Lang, 'The Use of Competition Law Power for Regulatory Purposes' (2007) Regulatory Policy Institute Oxford Annual Competition Policy Conference <http://www.rpieurope.org/2007%20Conference/JTL%20Paper%20July%2007.pdf> accessed 20 June 2014, pp. 6-9; P. Willis and P. Hughes, 'Structural Remedies in Article 82 Energy Cases' (2008) Vol.4(2) The Competition Law Review 147, pp. 151-153; A. De Hauteclocque and L. Hancher, 'Manufacturing the EU Energy Markets: The Current Dynamics of Regulatory Practice' (2010) EUI Working Papers RSCAS 2010/01 <http://ideas.repec.org/a/sen/journl/v11y2010i3p307-335.html> (accessed 16 February 2013) p. 20-22; J. Tapia and D. Mantzari, 'The Regulation/Competition Interaction' in D. Geradin and I. Lianos (eds.) *Research Handbook on European Competition Law: Substantive Aspects* (Edward-Elgar 2013), p. 588; K. Talus '(More than) 10 Years of Antitrust Enforcement in EU Natural Gas Markets' 2012 Vol.10(3) Oil, Gas and Electricity Law, pp. 17-22; U. Scholz and S. Purps, 'The Application of EU Competition Law in the Energy Sector' (2012) Vol.3(1) Journal of European Competition Law & Practice pp. 76-87
Besides, the instrumental use of merger control in the energy markets has been subject to a significant amount of research. See F. De La Pena Fernandez-Garnelo, 'Has Merger Control Made a Contribution Towards the Liberalisation of the Gas and Electricity Markets in the EU?' (DPhil thesis, King's College 2012); A. Christiansen 'Regulation and EU Merger Control in the Liberalised Electricity Sector' in F. Fichert, J. Haucap and K. Rommel (eds.) *Competition Policy in Network Industries* (Lit Verlag Münster 2007) p. 233; Sadowska, *supra* n 12, 135-191

liberalisation policies. Chapter four is therefore dedicated to providing a proposition to alleviate the legal uncertainty in the energy sector.

To sum it up in a sentence, this thesis addresses the problem of the *instrumental use* of competition law[23] through commitment decisions, particularly in the energy markets with the purpose of regulatory objectives that could not be achieved through market regulation.[24]

[23] 'Instrumental use' has been used by Sadowska in order to describe the strategic use of competition law. See Sadowska, *supra* n 12

[24] It can be argued that this is mostly due to the fact that the energy sectors have a strategic political and economic value because of which energy reforms have been slowed down by the governmental opposition in several countries. For instance, eight Member States, Austria, Bulgaria, France, Germany, Greece, Luxembourg, Latvia and the Slovak Republic, indicated their strong opposition for full ownership unbundling by submitting an alternative model for the provision of ownership unbundling in the third regulatory package. EurActiv, 'Eight EU states oppose unbundling, table 'third way'' (1 February 2008) <http://www.euractiv.com/energy/eu-states-oppose-unbundling-tabl-news-219274> accessed 1 November 2014

CHAPTER 2

THE PROBLEM OF LONG-TERM SUPPLY CONTRACTS IN THE EUROPEAN ENERGY MARKETS

I. Introduction

In the European energy markets, a top-down reform process to initiate a competitive market structure has been pursued by the EU since the early 1990s. As mentioned previously, the goal of the reforms introduced recently was to create a single competitive market by removing national monopolies and introducing competition, supposedly in order to lead to better services for lower prices.[1] However, in practice, long-term supply contracts remain a pervasive characteristic of the electricity and gas markets in most Member States, as the liberalisation process has not been successful in changing many of the traditional trade patterns.

The current market liberalisation and harmonisation among the European markets which were refined in order to end the monopoly era may be pointless if incumbents continue to engage in long-term supply agreements to control the markets.[2] These agreements frequently create anti-competitive foreclosure effects and these effects are likely to be worsened in energy markets where a monopoly supplier was in place for decades. On the other hand, there is also growing acceptance that their positive impacts on market functioning makes them desirable. As a result, there is a tension between the pro- and anti-competitive effects of these contracts. The impacts of long-term supply contracts are thus ambiguous, and there is a need to balance the efficiency-enhancing effects for individual contracting parties with some possible side effects on competition in the markets.[3]

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[1] A. Cretiand and B. Villeneuve, 'Long-term Contracts and Take-or-Pay Clauses in Natural Gas Markets' (2004) Vol.13 Energy Studies Review 75, p.77

[2] A. Neuman and C. von Hirschausen, 'Long-Term Contracts and Asset Specificity Revisited: An Empirical Analysis of Producer–Importer Relations in the Natural Gas Industry' (2008) Vol.32 Review of Industrial Organisation 131; J-M Glanchant and F. Leveque, 'Electricity Internal Market in the European Union: What to Do Next?' in J-M Glanchant and F. Leveque (eds.) *Electricity Reform in Europe: Towards a Single Energy Market* (Edward Elgar Publishing 2009)

[3] A. De Hauteclocque, *Market Building through Antitrust: Long-term Contract Regulation in EU Electricity Markets* (Edward Elgar Publishing Limited 2013), p. 73

Despite their importance in the energy markets, long-term supply contracts are hardly mentioned within the gas and electricity liberalisation packages.[4] Therefore, guidance for them must be sought in case law. The current energy cases handled by the Commission indicate that there is significant uncertainty about the competitive/anticompetitive effects of long-term supply contracts. However, in addition, the decisions on the contracts themselves seem rather ambiguous in terms of a procedural aspect regarding the informal/formal antitrust settlements pursued. This uncertainty will be addressed by showing how the Commission tends to investigate these contracts by taking into account competition policy on the one hand and by considering regulatory objectives within energy sectors on the other.

Prior to the first regulatory Directives, there were few antitrust cases over long-term energy supply agreements. In most of these cases the subject matter was the supply of energy on an exclusive basis by power producers to national incumbents. The Commission concluded these investigations by limiting the duration of the contracts. These decisions did not display any insight into the methodology used for the analysis of the foreclosure effect of the contracts. On the other hand, in the early post liberalisation period, the decisions made by the Commission indicated mainly anticompetitive effects of the contract clauses, and also, possible economic and non-economic efficiency gains such as investment and security of supply in terms of steady availability of the primary energy sources. However, a clear model for assessing long-term supply contracts in the context of liberalised energy markets was still missing. Nevertheless, a new series of cases concerning domestic long-term supply contracts across energy industries started to give some hints regarding building up a methodological framework for the analysis of long-term supply contracts.

[4] Article 37(1)(l) of Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55; Recital 37,42 and Article 32(3) , 41(1)(l) of Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94. Recital 42 of the gas Directive highlights the importance of long-term contracts in the gas sector, and states that such contracts should be maintained as an alternative way of supplying gas for undertakings unless they are not compatible with EU competition law. Moreover, the Directive states that its provisions should not prevent the conclusion of long-term contracts as long as they comply with the European competition rules.

The aim of this chapter therefore is to indicate the ambiguous effects of long-term supply contracts from an economic point of view in order to point out the importance of carrying out a case-by-case analysis of them during antitrust investigations. Also, the chapter aims to build up a clear methodology from the decisions of the Commission regarding these contracts. Since this methodological clarification will shed light on substantive analyses adopted by the Commission the chapter will also provide a prescription for market operators and national competition authorities for the assessment of agreements, in particular regarding ambiguity in the economic structure of the contracts. The chapter is divided into two sections in order to explore both the economic side of long-term supply contracts and the legal side of them from the competition policy point of view. Thus, the first section will explore the negative and positive effects of the contracts from an economic point of view. In the second section, energy cases will be analysed in order to show the assessment of long-term supply contracts from a legal perspective. Finally, the section will attempt to create methodological guidance through the case law.

II. The Appraisal of Long-term Supply Agreements from an Economic Perspective

The objectives of EU competition policy can be briefly explained as the promotion of social welfare with an explicit bias in favour of consumer welfare, and the creation of an integrated single market.[5] These objectives may constrain the freedom of market players in the short-term so as to reach higher social value over a period of time.[6] This is similar to the liberalisation of the energy markets where the commercial activities of pre-liberalisation incumbents should be restricted to facilitate environmentally sustainable and secured energy for affordable prices for everyone, i.e. to promote competition and to increase social welfare.[7] However, the liberalisation process may pose a challenge for the Commission, as it needs to balance the likely efficiency gains deriving from the engagement of the market players in long-term supply contracts and the potential detrimental effects of these

[5] A. Jones and B. Sufrin, *EU Competition Law* (5th edn., Oxford University Press 2014), pp. 33-54

[6] J. M. Glachant and A. De Hauteclocque, 'Long-Term Energy Supply Contracts in European Competition Policy: Fuzzy not Crazy' (2009) EUI Working Papers-Robert Schuman Centre for Advance Studies <http://www.eprg.group.cam.ac.uk/working-paper-eprg0919/> accessed 21 April 2011, p. 2

[7] D. M. Newbery and M. G. Politt, 'The Restructuring and Privatisation of Britain CEGB – Was it Worth it?' (1997) Vol.45 The Journal of Industrial Economics 269, p. 271; Commission, Communication from the Commission, Progress towards Completing the Internal Energy Market, COM(2014) 634 final

contracts on the functioning of the market. Within the next section of the chapter, there will be an assessment of the economic analyses of long-term supply contracts, considering both the negative and positive effects of the contracts on individual market players and society as a whole.

A. Negative Effects of Long-term Supply Contracts: Market Foreclosure and Decrease in Wholesale Liquidity

One of the main problems with long-term supply contracts is the risk of market foreclosure which hinders market entry by market players that are probably more efficient. Market foreclosure may result from the possible strategic aim of one or several operators to limit the ability of potential competitors to enter either upstream or downstream markets. This strategic aim can be achieved in many different ways, including signing up exclusive long-term supply contracts.[8] In a situation where a significant part of the demand is tied for a long time at a wholesale level an output foreclosure might occur. On the contrary, if a generation market is highly concentrated input foreclosure may occur and prevent market entry downstream. Therefore, long-term supply contracts may constitute a barrier to entry and result in a negative effect on competition in the upstream and downstream markets.[9] For example, in the electricity markets, long-term supply contracts concluded within Member States may lead to market foreclosure for potential electricity generators (output foreclosure) as well as potential traders (input foreclosure) since these contracts will reduce the number of open positions that need to be closed by wholesale trading. In the gas markets, on the other hand, existing import contracts cover the production from almost all of the existing gas fields from which gas can be transferred to Europe by pipeline (input foreclosure). Such contracts may make it difficult for new entrants to obtain access to adequate supplies of gas. Thus, upstream long-term supply contracts do not allow for effective *ex-ante* competition in the gas markets.[10] Since the foreclosure of markets is very likely to be a result of the combination of long-term supply contracts and a monopolistic or oligopolistic market structure, most of the investigations carried out by the Commission into long-term

[8] T. G. Krattenmaker and S. C. Salop, 'Competition and Cooperation in the Market for Exclusionary Rights' (1986) Vol.76(2) The American Economic Review' 109, p. 114; K. Talus, *Vertical Natural gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Kluwer Law International 2011) p. 73

[9] Glachant and Hauteclocque, *supra* n 6, 3-6

[10] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 63-75

supply contracts have been based on market foreclosure, as will be seen in the second section of the chapter.

The Sector Inquiry highlights certain negative effects of long-term supply contracts signed within a country on spot market development particularly in electricity markets. As they are likely to affect the volume that is regularly traded in spot markets they may dry out these markets. The Sector Inquiry states that long-term supply contracts diminish the volume to be traded in a spot and forward market(s) within a Member State, which reduces the liquidity in the wholesale market(s). The absence of competitive spot markets is detrimental to social welfare in two ways. First, a liquid and competitive spot market leads to market integration and price formation based on the supply and demand for electricity.[11] The market-based price formation reduces the commercial risk by enabling market players to predict and manage the potential risks, which facilitates market entry. Second, a lack of liquidity in spot markets causes volatility, which encourages market players towards vertical re-integration or long-term contracting. As a result, liquid spot markets reduce the market risk for market players and promote market entry and thus competition in the markets, which promotes social welfare.

Other than the duration and exclusivity of long-term supply contracts, some provisions such as territorial/use restrictions concluded within the contracts pose similar anti-competitive foreclosure effects and endanger market integration. These clauses artificially create multiple dominated markets and increase switching costs through market compartmentalisation, thereby impairing the current market building efforts of the EU.[12] In addition, they reduce competition intensity in the downstream market.[13] Long-term supply contracts concluded between energy producers and wholesalers in the gas markets are mostly subject to competition investigations due to the anticompetitive contract clauses, as will be seen in the case law section. Moreover, long-term supply contracts signed between gas suppliers and end-customers such as large industrial users may include a use restriction, which hinders

[11] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para.377; Within the context of this thesis, liquidity means a level of market activity that ensures that a counter-party can generally be found to enable the buying or selling of gas in sufficient volumes to meet a commercial need, at competitive prices.
[12] J. Faull and A. Nikpay, *The EC Law of Competition* (2nd edn., Oxford University Press 2007) para. 12.174
[13] *Ibid* para. 12.189

the latter from reselling gas to the market. Such a restriction has an evident negative impact on overall market liquidity.[14]

B. Positive Effects of Long-term Supply Contracts

Despite the negative effects that long-term supply contracts may have under some circumstances, they can be useful in particular situations. Furthermore, they have various positive effects that are likely to help realise efficiencies and these may offset the possible negative effects.

1. Limitation of Double Marginalisation, Prevention of Abuse of Market Power, Facilitation of Market Entry

Long-term supply contracts may have a positive impact on consumer welfare by limiting double marginalisation and thereby decreasing final energy prices. Double marginalisation may occur to the detriment of consumers when upstream and downstream market players have their own market power.[15] Both upstream and downstream firms want to maximise their profits by choosing a monopolistic mark-up over their own costs. This profit maximisation increases the final price of the product to more than it would be if instead the upstream and downstream firms maximised their joint profit under a vertically integrated structure, since the final price decision would be taken with only a mark-up over the total cost. However, different types of vertical restraints such as quantity fixing can be instruments to control this vertical externality.[16] As a consequence, in the presence of market powers at both levels (upstream and downstream) of the markets, such as electricity and gas, long-term supply contracts might contribute to decreasing prices and increasing efficiencies by preventing the double marginalisation problem if the contracts include certain vertical restraints.[17]

Besides, long-term supply contracts may bring some advantages for individual market players such as price and quantity risk reductions, if the contracts are sufficiently long and cover sufficiently high volumes, as will be analysed below.

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[14] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para.377

[15] S. Bishop and M. Walker, *The Economics of Competition Law* (3rd edn., Thomas Reuters Limited 2010), pp. 187-211

[16] Commission Notice Guidelines on Vertical Restraints SEC(2010) 411 Final, para. 106-109

[17] L. Onofri 'Electricity Market Restructuring and Energy Contracts: A Critical Note on the EU Commission's NEA Decision' (2005) Vol. 20 European Journal of Law and Economics 71, p.78

2. Decrease in Transaction Costs, Improvement in Risk-Sharing Mechanism, and Encouragement to Invest

One of the main advantages of long-term supply contracts for market players is that they hedge price and quantity risks and therefore they may facilitate investments.[18] During the monopoly era, reliability and investment were guaranteed through vertical integration, but in return there was a hidden cost for society.[19] Yet, with the liberalisation of the energy markets, risk-averse investors seem to under-invest in generation capacities in electricity markets, as a result of under-developed spot markets.[20] This is because the illiquid and unstable spot markets do not enable firms to sink their fixed cost investments based on reliable investment signals. This is the fact for European spot markets, which are still under-developed. As a result, energy companies tend to make more durable vertical arrangements such as long-term supply contracts, since these contracts increase certainty and provide an insurance device, which reduces the risks for market operators.[21]

By the same token, according to transaction cost theorists, long-term supply contracts can help to minimise transaction costs that are linked to the uncertainty, identified above and economise on significant asset specific investment.[22] These

[18] A. Boosm and S. Buehler, 'Restructuring Electricity Markets When Demand is Uncertain: Effects on Capacity Investment, Prices and Welfare' (2007) CIE Discussion Paper 2007-09 <http://www.econ.ku.dk/cie/dp/dp_2010/2007-09.pdf/> accessed 23 June 2011; For an opposing argument please see S. Buehler, A. Schmutzler and M. A. Bezh, 'Infrastructure Quality in Deregulated Industries: Is there an Underinvestment Problem?' (2004) Vol.22(2) Journal of Industrial Organisation 253, pp. 265-267; P. L. Joskow, 'Vertical Integration and Long-Term Contracts: The Case of Coal-Burning Electric Generating Plants' (1985) Vol.1(1) Journal of Law, Economics, & Organization 33, pp. 33-35

[19] J. Stern, 'UK Gas Security: Time to Get Serious' (2004) Vol.32 Energy Policy 1967, p. 1970

[20] K. Neuhoff and L. De Vries, 'Insufficient Incentive for Investment in Electricity Generations' (2004) Vol.12 Utilities Policy 253, pp. 253-256

[21] D. Finon and Y. Peres, 'Investment Risk Allocation in Restructured electricity Markets: the Need for Vertical Arrangements' (2008) Larsen Working Paper No.12 <http://www.gis-larsen.org/fr/travaux/working-paper/investment-risk-allocation-in-restructured-electricity-markets/> accessed 11 May 2011, pp. 16-23

[22] O. E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (Masmillan Publishing Co.,Inc. 1975); B. Klein, R. G. Crawford and A. A. Alchian, 'Vertical Integration, Appropriable Rents, and the Competitive Contracting Process' (1978) Vol.21 Journal of Law and Economics 253, pp. 253-255; P. L. Joskow, 'Contract Duration and Relationship-Specific Investments: Empirical Evidence from Coal Markets' (1987) Vol.77 The American Economic Review 168, pp. 184-185

According to Williamson, a dilemma in making contracts is that, on the one hand, it is technically impossible and prohibitively costly to make complete contingent claims contracts by considering each possible circumstance that may arise in the future. On the other hand, if a contract is seriously incomplete, the diverged interests of the contracting parties will lead them to engage in individually opportunistic behaviour and joint losses. Therefore, Williamson argues that vertical integration can be a better solution to possible opportunistic behaviours of contracting parties, as vertical integration harmonises interests and permits an efficient decision process to be utilised. O.E Williamson, 'The

theorists argue that if a long-term agreement between a seller and a buyer involves a relationship-specific investment, the contracting parties may have a tendency to benefit from circumstances that may arise in the future such as fluctuations in supply or demand by increasing the costs or reducing the revenues obtained by the other party.[23] This uncertainty or 'opportunistic behaviour' can be eliminated through long-term contracts, as they may provide flexibility in terms of price and quantity via contract provisions such as take-or-pay,[24] price indexation[25] or redetermination clauses.[26] Therefore, long-term contracts with flexible contract conditions may help to solve the problem of counterparty credibility.[27] The price and quantity risks that parties face depend on their positions in the supply chain and the technology they use. Long-term contracts then enable the parties to allocate the risk to the party that is best able to manage it.[28]

Regarding the market positions of the contracting parties, long-term supply contracts display different results in terms of surplus and risk management depending on the contract's characteristics.[29] For instance, tacit renewal and exclusive purchase clauses may decrease the transaction costs for both parties, whereas reduction

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Vertical Integration of Production: Market Failure Consideration' (1971) Vol.61 American Economic Review 112, pp. 112-115

However, it is also argued that contracts that are incomplete, in the sense that they do not specify the obligations of each party in every possible state of nature, yet, which have certain provisions, can minimise the problem of opportunistic behaviours of the parties. M. Hviid, 'Relational Contracts, Repeated Interaction and Contract Modification' (1998) Vol.5 European Journal Law and Economics 179, pp. 179-185; M. Hviid, 'Long-term Contracts and Relational Contracts' in B. Bouckaert and G. De Geest (ed) *The Encyclopaedia of Law and Economics Vol. III* (Edward Elgar 2000) p. 46

[23] Joskow *supra* n 18, 168-175; A. Neumann and C. Hirschhausen, 'Long-term Contracts for Natural Gas Supply- An Empirical Analysis' (ISNIE Conference, Barcelona, 2005) Also see Commission Notice Guidelines on Vertical Restraints SEC(2010) 411 Final, para. 106-109

[24] Take-or-pay provisions force a buyer to pay for energy subject to a long-term contract regardless of the delivery of it and even if he does not purchase any more. In this way, possible opportunistic behaviour by the buyer resulting from a decrease in demand can be prevented. In other words, take-or-pay provisions allocate risks related to the quantity of energy sold to the buyer. If the buyer purchases less than the contractual minimum quantity during each period, he is obliged to pay for the shortfall in the full contractual price, or some proportion, for instance 90% of the contractual prise, pursuant to the provisions of the contract.; S. E. Masten and K. J. Crocker, 'Efficient Adaptation in Long-term Contracts: Take-or-pay Provisions for Natural Gas' (1985) Vol.75 The American Economic Review 1083, p, 1085; G. Coop, 'Long-term Energy Sale Contracts and Market Liberalisation in New Member States- Are They Compatible?' (2006) Vol.2 International Energy Law & Taxation Review 64, pp. 64-69

[25] In such contracts an initial price constitutes a floor for the value of the contracts. Besides, this initial price changes as a result of price escalators, like pre-defined increases per year or oil price index. In those contracts, another clause can be a most-favoured-nation, whereby the price is tied to the highest price paid in the same region.

[26] Creti and Villeneuve, *supra* n 1, 79

[27] Klein, Crawford and Alchian, *supra* n 22, 253-254

[28] Finon and Peres, *supra* n 21, 25-26

[29] Glachant, and Hauteclocque, *supra* n 6, 5-6

clauses allow the buyer to reduce the volume that must be bought under the terms of the contract in case the supplier starts reselling in its commercial area; this protects the buyer's market share. Volume clauses including rebates may reduce the price for the buyer. Take-or-pay clauses may provide enough flexibility to avoid a breach and thus expensive renegotiation of contracts.[30] Thus incomplete long-term supply contracts might be the most efficient governance structure for the contracting parties, as they provide them with flexibility regarding renegotiation and solve the counterparty credibility problem. Yet, at the same time, they may result in market foreclosures due to certain characteristics of these contracts, as will be seen in the next section.

Regarding the technology involved in energy markets, the advantages of long-term supply contracts can be observed in the longer term. If long-term supply contracts are long enough and cover enough volume of commodity they may facilitate market entry and promote market building while spot markets remain under-developed.[31] In electricity generation markets, long-term supply contracts may improve fuel mix diversity by enabling new entrants to invest in base-load technologies with high-fixed costs such as nuclear or coal.[32] As these technologies require high-fixed costs, the price and quantity risks are relatively greater than for other types of electricity generation plants, such as combined cycle gas turbines (CCGT).[33] Therefore, investments in more capital-intensive technologies are more risky for generators, in particular for new entrants, since unstable spot markets do not help them to hedge their risks. In order to make an investment in capital-intensive technologies they therefore need to allocate part of their investment risk to their consumers or suppliers through vertical agreements such as long-term supply contracts.[34] Consequently, the application of long-term supply contracts may encourage potential competitors to invest in high-fixed cost technologies for electricity generation by reducing their risk.

[30] Masten and Crocker, *supra* n 24, 1091
[31] D. M. Newbery, 'Competition, Contracts and Entry in the Electricity Spot Market' (1998) Vol.29 RAND Journal of Economics 726, p. 730
[32] Finon and Peres, *supra* n 21, 22
[33] F. A. Roquea, 'Technology choices for new entrants in liberalized markets: The value of operating flexibility and contractual arrangements' (2007) EPRG 0726 & CWPE 0759 <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2008/11/eprg0726.pdf> accessed 21 April 2011, p.17
[34] Neuhoff and Vries, *supra* n 20, p. 255; Finon and Peres, *supra* n 21, 17

European energy case law could be a significant indicator of the role of long-term supply contracts in facilitating investment in generation capacity. In fact, the *Scottish Nuclear* and *Synergen* cases[35] might be given as examples to show the positive effects of long-term supply agreements in terms of removing the problem of counterparty credibility.[36] As will be evaluated in the case law section, the facilitation of investment in energy generation was recognised as an economic efficiency gain by the Commission.

Up to now the chapter has discussed the effects of long-term supply contracts from the economic point of view. In the next section, these effects will be analysed. Before that Table 1 will provide a summary of the effects of long-term supply contracts.

[35] *Scottish Nuclear, Nuclear Energy Agreement* (IV/33.473) Commission Decision 91/329/EEC [1991] OJ L 178/31; *Synergen* (Case COMP/37732) [2002]; Commission, 'Commission clears Irish Synergen venture between ESB and Statoil following strict commitments' IP/02/792

[36] The problem of counterparty credibility can be defined as the risk that each party to a contract takes with regard to the counterparty not fulfilling its contractual obligations.

Table 1: The positive and negative effects of long-term supply contracts

POSITIVE EFFECTS	NEGATIVE EFFECTS
Double marginalisation can be limited through vertical restraints included within the contracts such as maximum resale prices, quantity fixing, and non-linear pricing.	The duration and volume of long-term supply contracts, and contract clauses such as exclusive supply obligations may result in input/output foreclosure.
Relationship-specific investment might be encouraged as a result of the minimisation of transaction costs and the decrease in the hold-up problem and also, in the counter party credibility risk for individual market players.	The European energy market can be compartmentalised by anticompetitive clauses such as territorial/use restrictions included in long-term supply contracts.
Investment in high-fixed cost technologies could be facilitated through the allocation of price/quantity risks, and hedge-price.	The division of Europe into national energy markets may limit the objective of the creation of a single European energy market.
Market entry and competition in the energy markets may be improved as a result of the increase in investment.	If individual market players do not have the ability to effectively negotiate, incomplete long-term supply contracts might facilitate losses for them in the long term.

*Source: Own illustration but expired by A. De Hauteclocque, *Market Building through Antitrust: Long-term Contract Regulation in EU Electricity Markets* (Edward Elgar Publishing, 2013)

C. Analysis of Economic Effects of Long-term Supply Agreements

Although the economic literature on long-term contracts provides useful insights, theoretical ambiguities over the effects of long-term supply contracts remain. In other words, they can be both pro- and anti-competitive. Therefore, the effects of these contracts are highly context specific.[37] This makes it difficult to appraise them from a competition policy point of view. The contracts might, for instance, cause input/output foreclosure, thereby preventing market entry. Yet, at the same time, they may facilitate investment, which may improve competition and encourage market entry. As a consequence, it is hardly possible to conclude that there are 'net pro- or anti-competitive effects' of long-term supply agreements.

However, these effects may vary depending on various factors, namely the market positions of the contracting parties, the structure of the agreement itself, the level of competition in the market, and the general level of vertical integration.[38] Hence, these factors should be taken into account by the Commission in order to explore the competitive effects of these agreements during antitrust investigations. On the other hand, these factors are deficient with regard to indicating either how to measure the efficiencies of long-term supply agreements or how to balance them from a dynamic long-term efficiency perspective.[39] Dynamic efficiency creates an appropriate incentive, in the long-term, for a dominant undertaking to invest in its business, develop new ways of delivering better services and engage in efficiency-enhancing transactions, as the undertaking is allowed to benefit from a restrictive agreement.[40] Therefore, it seems difficult to assign precise values to dynamic efficiencies regarding this existing restrictive agreement.[41] Nevertheless, it might be helpful to consider that the objective of the assessment of these kinds of efficiencies is the same as for static efficiencies: to ascertain the overall impact of the agreements on the consumers within the relevant markets.[42] Apparently, this is a subject of case

[37] Hauteclocque, *supra* n 3, 73
[38] G. Meunier 'Imperfect Competition and Long-term Contracts in Electricity Markets: Some Lessons from Theoretical Models' in A. De Hauteclocque, J. M. Glachant and D. Finon, *Competition, Contracts and Electricity markets* (Edward Elgar Publishing Limited 2011), p.175
[39] Glachant and Hauteclocque, *supra* n 6, 11-12
[40] D. L. Rubinfeld, 'Evaluating Antitrust Enforcement: Economic Foundations' in B. E. Hawk (ed.), *International Antitrust Law & Policy: Fordham Competition Law* (Juris Publishing 2009), pp. 457-469
[41] Communication from the Commission, Notice Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C 101/97, para.103
[42] Even though the static and dynamic efficiency policies seem different, the standard of proof is similar. (Static efficiencies are short-terms gains that flow from a behaviour lowering prices.) In both

law, as the Commission needs to consider the negative and positive effects of long-term supply contracts in order to appraise the dynamic or static efficiency gains that may stem from the contracts.

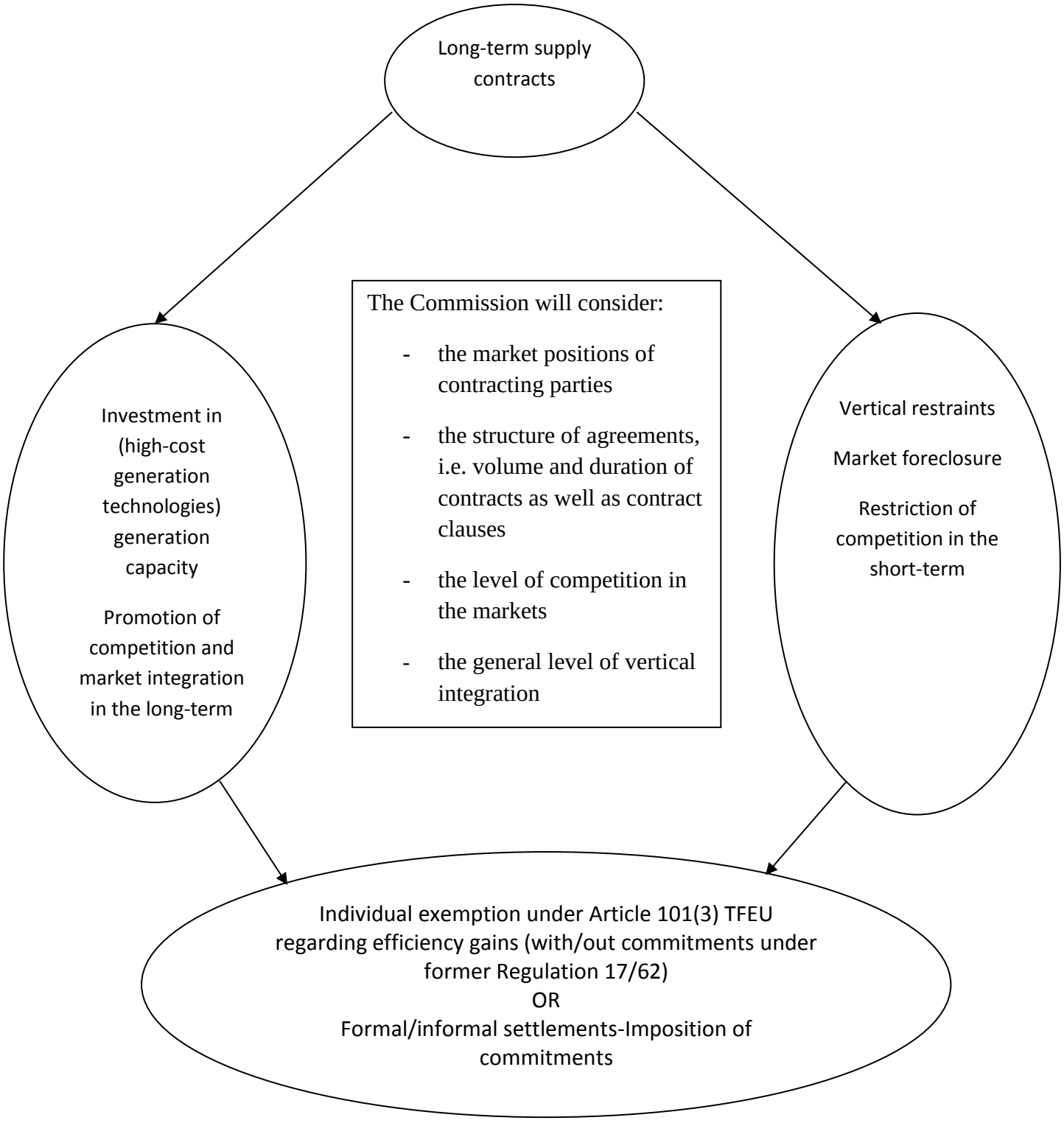
To sum up, long-term supply agreements appear both as barriers to entry and as a solution to the problem of counterparty credibility and a lack of investment.[43] Consequently, it seems reasonable to encourage long-term supply agreements when it is likely that the negative effects will be outweighed by the positive effects. However, this advice may change in less competitive markets, since strong anticompetitive results may derive from the long-term supply agreements in these markets.[44] Thus, it is necessary to examine these agreements individually on a case-by-case basis to see whether long-term supply contracts are anti- or pro-competitive in each case. Diagram 1 below shows certain criteria that are considered by the Commission during antitrust investigations, and the possible outcomes of the assessment of long-term supply contracts.

cases, an efficiency claim must be substantiated so that the nature of the efficiency, the link between the agreement and the efficiency, the magnitude of the efficiency and how it has been or will be achieved can be proved. L. Kjolbye, 'The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81' (2004) Vol.25(9) European Competition Law Review 566, p. 570

[43] Hauteclocque, *supra* n 3, 108

[44] *Ibid*

Diagram 1: The assessment of long-term supply contracts from a competition law point of view



*Source: Own illustration

III. The Appraisal of Long-Term Supply Agreements from a Legal Perspective

As mentioned previously long-term supply contracts may be detrimental to the improvement of effective competition and the development of a single European energy market. On the other hand, they can pose efficiencies for individual market players by having a direct effect on social welfare in terms of encouraging energy investment and the development of new energy resources. Thus, the Commission and other national competition authorities might encounter considerable challenges when assessing the effects of long-term supply agreements. This section will explore how the Commission deals with the problem of long-term supply contracts and reaches solutions to decrease the detrimental effects of them. In addition, the drivers that may shape an antitrust strategy in energy will be observed. First, early case law will be evaluated in order to see the way in which long-term contracts were examined during the monopoly era. Later, certain antitrust investigations that were initiated by the Commission with regard to the possible anticompetitive effects of long-term supply contracts after market liberalisation will be explored in order to develop a methodological model out of these decisions.

A. Early Cases-Monopoly Era

In its early decisions, the Commission, within the limits of the legal environment, aimed to improve the energy markets in terms of security of supply[45] rather than

[45] Energy supply security can be broadly defined as a concept which is 'geared to ensuring the proper functioning of the economy, the uninterrupted physical availability at a price which is affordable while respecting environmental concerns. Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence, but aims to reduce the risks linked to such dependence'. Commission, 'Towards a European Strategy for the Security of Energy Supply' (Green Paper) COM (2000) 769 Final, pp. 2-3

Three main elements that can be identified from this definition are: access to primary energy sources; a reasonable price; and an uninterruptable energy supply. Furthermore, the definition indicates possible risks that are associated with dependence.

The policy of security of energy supply, from the point of risks related to dependence, can be divided into two groups. The first group includes risks that endanger short-term supply availability such as bad weather, and risks that endanger long-term supply availability such as a failure in major supply sources as well as external relations with energy suppliers. The second group categorises the security measures both on the demand side and on the supply side. While the former involves measures such as energy savings and energy efficiency, the latter deals with measures for guaranteeing access to energy. S. S. Haghighi, *Energy Security: The External Legal Regulations of the European Union with Major Oil and Gas Supplying Countries* (Hart Publishing 2007), p. 9

Long-term supply contracts might result in two different types of efficiency gains on the basis of the policy of security of supply. These are economic efficiencies such as investment in order to facilitate an uninterruptible supply of energy from different energy sources, and non-economic efficiencies that enhance energy supply security without investments. For instance, in *Electrabel*, the case was concerned with an exclusive right granted to Electrabel to supply the distribution company with the

through the introduction of competition or the development of integrated European energy markets. Therefore, as can be seen from these decisions, the Commission was happy to let incumbents make exclusive long-term supply contracts for 15 years or so due to the efficiencies that could be gained from these contracts such as improvements in the generation, transmission and distribution of energy as well as the diversity of primary energy sources.

In *Scottish Nuclear*,[46] two long-term contracts concluded between Scottish Nuclear and Scottish Power and Scottish Hydroelectric were notified to the Commission by the former pursuant to the previous Regulation 17/62.[47] The Commission authorised these two long-term supply contracts, although they restricted competition in the market in three ways.[48] First, Scottish Nuclear was not allowed to supply the nuclear electricity produced to any parties other than Scottish Power and Scottish Hydroelectric, unless the contracts between those companies were terminated. Second, an exclusive purchase obligation was imposed on Scottish Power and Scottish Hydroelectric for 74.9% and 25.1% respectively of the production of Scottish Nuclear. Third, the price at which nuclear electricity was purchased was fixed under the contracts and was identical for both companies. In addition, the contracts were signed for an initial period of 30 years.

Despite the anti-competitive features of the contracts, the Commission deemed that the conditions under which an individual exemption for each contract under Article 101(3) TFEU could be obtained were satisfied.[49] The objective economic benefit

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electricity required for resale to its final consumers for a 20 to 30-year period. The Commission ended the investigation with final commitments, which were to reduce the duration to 14-years and to gradually decrease the volume of the power supplied. In this case the Commission sought to balance free competition and the principle of security and continuity of supply. See Commission, 'Electrabel: the European Commission obtains satisfaction on the revision of the statutes of mixed intercommunal electricity distribution companies in Belgium' (IP/97/351)

[46] *Scottish Nuclear, Nuclear Energy Agreement* (IV/33.473) Commission Decision 91/329/EEC [1991] OJ L 178/31

[47] Council Regulation (EEC) No.17 First Regulation implementing Articles 85 and 86 of the Treaty [1962] OJ 013

[48] As will be clarified below, before the modernisation of EU competition law, according to former Regulation 17/62, the contract parties were supposed to notify the Commission of their contract for a negative clearance. The Commission could finalise this notification process in three ways: first, by negative clearance; second, through the application of an individual exemption; and third, by making the contracts invalid. The Commission could also require the parties to modify their contract in order to render it compatible with competition law or to benefit from an individual exemption under Article 101(3) TFEU.

[49] Article 101(3) TFEU gives the parties to an agreement that is against competition law an opportunity to escape from Article 101 TFEU liability under the following conditions: (1) the agreement

arising from the contracts was the improvement in the generation and distribution of electricity. Also, the second criterion of Article 101(3) TFEU was satisfied through a fair share of the benefit for consumers as a result of the gradual introduction of competition into the energy market. However, the Commission shortened the duration of the contracts from 30 to 15 years. A sufficient timeframe was therefore provided to Scottish Nuclear for long-term planning and necessary adjustments in the new situation after the start-up period. To sum up, the Commission considered an investment in electricity generation as an efficiency gain that outweighed the foreclosure effects of the long-term supply contracts.

In another case, *Jahrhundertvertrag*,[50] through a set of long-term supply contracts, German electricity generating utilities and industrial producers of electricity undertook to purchase a specific amount of German coal in order to produce electricity. The first was a supplementary agreement on the sale of German coal up to 1995, concluded between the General Association of the German Coalmining Industry (GVSt) and the Association of the German Public Electricity Supply Industry (VDEW). The second was a supplementary agreement on the sale of German coal to industrial producers of electricity up to 1995, signed between GVSt and the Association of Industrial Producers of Electricity (VIK). The problems with these contracts were exclusive purchase and supply obligations imposed on the coal and electricity companies who were members of the Associations. The importance of the case stems from an argument that was put forward by the Associations. The argument was that the agreements could not be caught by Article 101 TFEU, as the application of competition rules was precluded by Article 106(2) TFEU[51] because the

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will improve the production or distribution of goods or promote technical or economic progress, (2) consumers will have a fair share of the resulting benefit, (3) the anticompetitive restrictions concerned will not be indispensable to the attainment of these objectives, and (4) competition will not be eliminated in the substantial part of the product market.

[50] *Jahrhundertvertrag* (IV/33.151) and *VIK-GVSt* (IV/33.997) Commission Decision 93/126/EEC [1992] OJ L 50/14

[51] Article 106 TFEU: '(1) In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 101 to 109.

(2) Undertakings entrusted with operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interest of the Community.

(3) The Commission shall ensure the application of the provision of this Article and shall, where necessary, address appropriate directives or decisions to Member States.' Also see Commission

competition rules could prevent the electricity generators and coalmining companies from performing the services of general economic interest[52] assigned by law and the Federal Government for the purpose of safeguarding energy. Therefore, the agreements were not within the scope of the competition rules. However, the Commission deemed that there was an infringement of Article 101 TFEU. In addition, Article 106(2) TFEU was not applicable in the case, since, as long as the application of competition law did not preclude the undertakings entrusted with the operation of the services of general economic interest from performing these services, they were under the scope of the competition rules.[53] Besides, the final decision on the case was in line with the decision given in *Scottish Nuclear* regarding the application of Article 101(3) TFEU. Although the contracts restricted competition among the electricity generators for primary energy resources, the Commission considered that the contract contributed to improving electricity generation and coal production, and safeguarded the procurement of primary energy sources. In addition, the agreements secured the energy supply in the Federal Republic of Germany. Thus, the consumers had a fair share of the resulting benefits.[54]

In other cases, namely *Pego*,[55] *REN/Turbugas*,[56] *Isab Energy*,[57] *Rosen*,[58] *Api Energia*,[59] *Sarlux*[60] the Commission approved the contracts with a condition that their durations should be reduced to 15 years, although no explicit explanation about the duration was provided. There was however one exception. In the *Transgas/Turbogas*[61] decision, the Commission approved a 25-year supply contract with a take-or-pay provision concluded between Transgas (a Spanish Power station)

'Green Paper on Services of General Interest' COM(3003) 270 Final, and Commission, 'White Paper on Services of General Interest' COM(2004) 374 Final

[52] Services of general economic interest can be defined as economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied if there were no public intervention, for example, transport networks, social services and so on. It has also been stated that to be of a general economic interest a service should be uninterrupted, for the benefit of all consumers in the relevant territory. In addition, there should be continuity, universality and equality, with transparency and affordability. See also R. Whish and D. Bailey, *Competition Law* (7th edn., Oxford University Press 2012), pp. 222-244

[53] *Jahrhundertvertrag* (IV/33.151) and *VIK-GVSt* (IV/33.997) Commission Decision 93/126/EEC [1992] OJ L 50/14

[54] *Ibid*

[55] *Electricidade de Portugal/Pego* (IV/34.598) Commission Decision 93/C 265/03 30 [1993]

[56] *REN/Turbogas* (IV/E-3/35.485) Commission Decision 96/C 118/05 [1996]

[57] *Isab Energy* (IV/E-3/35.698) Commission Decision 96/C 138/03 [1996]

[58] Commission, *XXVIth Report on Competition Policy 1996*, SEC(97)628 final, p.134

[59] *Ibid*

[60] *Ibid*

[61] *Ibid,* 135

and Sonatrach (Algerian gas producer). Here, the longer contract duration was balanced with the facilitation of security of supply resulting from the development of new Algerian supplies. In all these cases the objectives of the Commission were almost the same. They were to facilitate the development of generation technologies, improve electric supply conditions and to develop primary energy sources that had a favourable impact on the environment.

The cases handled by the Commission in the monopoly era imply that the Commission was willing to support the development of generation and supply, and the improvement of security of supply through long-term supply contracts. It was accepted that these efficiencies provided the ability to be exempted under Article 101(3) TFEU. However, none of these cases display a methodological model that was used by the Commission while investigating the long-term supply contracts.

Nevertheless, in the cases handled by the Commission after the liberalisation of the energy markets started, the alleged anticompetitive effects of long-term supply contracts have been addressed. The Commission seems to tend to remove these anticompetitive effects through antitrust enforcement. These differentiations in the substantive appraisal of the contracts and the procedure used in the investigations have resulted from both the market liberalisation and the modernisation of competition law in the EU. The investigations into long-term supply contracts carried out by the Commission since the market liberalisation will be evaluated below.

B. Some Changes in Methodology after Liberalisation Started in the Energy Markets

In this section, decisions given by the Commission will be divided into two groups according to the level of the relevant product markets in which the long-term supply contracts were signed: upstream and downstream cases. However, before analysing the decisions, it is crucial to mention two facts that have caused significant changes in the Commission's approach to energy cases: the liberalisation of the energy markets as well as the modernisation of EU competition law culminating in the enactment of Regulation 1/2003.[62] These steps pose some notable issues.

[62] Council Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1; Before the adaptation of Regulation 1/2003, the Commission was given monopoly power to apply the competition rules by Regulation 17/62; A. De Hauteclocque,

i.) Before the liberalisation process started, all segments of the energy markets, including generation/importation, and network and supply, were run by national and very often state-owned monopolies. During the 1980s and 1990s, the Commission started to scrutinise long-term supply contracts concluded between energy incumbents with a monopoly power under EU competition law.[63] The decisions made by the Commission regarding long-term agreements in energy are remarkable because they show the Commission's approach to energy cases under different economic structures. The Commission's approach seems to have changed with the market liberalisation.

The first energy regulatory Directives, which were in force between 1996 (1998 for gas) and 2003, aimed to create a partially open market in that the largest consumers were able to choose their suppliers.[64] With the adoption of the second energy package a major step forward was taken to creating a fully open competitive internal market.[65] Finally, in 2009, the third energy package was enacted with the objectives of delivering real choices for all consumers and creating a competitive single energy market in Europe.[66] In addition, the package aimed to create new business opportunities and more cross-border trade in order to achieve competitive prices and higher standards of service. The evolution of the regulations and the level of liberalisation directly affected the Commission's approach to energy cases. For instance, as will be seen below, the Commission has tended to significantly decrease the duration and volume of contracts in the cases that it has handled recently compared with the cases investigated in the early 2000s. Furthermore, the Commission has started to build its decisions upon the objectives of competition policy as well as the goals of regulatory policy. Case law indicates that while

'EC Antitrust Enforcement in the Aftermath of the Energy Sector Inquiry: A Focus on Long-term Supply Contracts in Electricity and Gas' in B. Delvaux, M. Hunt, and K. Talus, *EU Energy Law and Policy Issues* (Euroconfidentiel 2008), pp. 205-234

[63] C. W. Jones (ed.), *EU Energy Law: Volume III – EU Competition Law and Energy Markets* (3rd edn., Claeys & Casteels 2006), para. 3.187

[64]Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity [1996] OJ L 27/20; Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas [1998] OJ L 204/1

[65] Directive 2003/54/EC concerning common rules for the internal market in electricity [2003] OJ L 176/37; Directive 2003/55/EC concerning common rules for the internal market in natural gas [2003] OJ L 176/57

[66] Directive 2009/72/EC concerning common rules for the internal market in electricity [2009] OJ L 211/55; Directive 2009/73/EC concerning common rules for the internal market in natural gas [2009] OJ L 211/94

applying general competition law, the Commission takes the specific regulatory choices into consideration such as third party access and ownership unbundling. This approach not only underlines the clash between the objectives of EU competition law and those of the sector-specific regulations, such as promoting free competition in order to generate efficiencies in favour of consumers,[67] it also indicates that the Commission attempts to balance competition objectives with regulatory objectives. This attitude generates a question regarding the extent to which the Commission intervenes in market regulation through antitrust enforcement pursuant to the market liberalisation agenda and whether there is a possible danger of using competition law as a regulatory tool. These questions will be discussed within Chapter 4.

ii.) The structure of the implementation of competition rules was changed with the announcement of Regulation 1/2003. Under the previous regulation, Regulation 17/62, the Commission was the only authority that could exempt long-term supply contracts under Article 101(3) TFEU.[68] With the enactment of Regulation 1/2003, the 'notification system' was replaced by the 'legal exception' regime.[69] Accordingly, long-term supply agreements falling within Article 101(1) TFEU but meeting criteria in Article 101(3) TFEU are directly valid and enforceable without any prior decision. Undertakings have therefore become more responsible under the 'self-reliant' system for making a competition assessment of their agreements or commercial behaviour as well as their potential efficiencies pursuant to Article 101(3) TFEU.[70] Besides, the Commission has started sharing its monopoly power to apply the

[67] However, at this point, the differences between the two sets of rules should be regarded. The main objectives of competition law are the enhancement of a competitive market economy and the enhancement of integration of the common market, whereas the objectives of market regulation may include other and broader social objectives including consumer protection and the development of society. These differentiated objectives may define and limit the scope of competition law and sector-specific regulation.

[68] Articles 3, 4, 5 and 6 of Regulation No.17 First Regulation implementing Article 85 and 86 of the Treaty [1962] OJ 013

[69] Articles 3 and 4 of 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 [2003] OJ L 1/1

[70] D. Roitman 'Legal uncertainty for vertical distribution agreements: the Block Exemption Regulation 2790/1999 (BER) and related aspect of the new Regulation 1/2003' (2006) Vol.27(5) European Competition Law Review 261, pp. 261-268; Commission, Communication from the Commission to the European Parliament and the Council Report on the Functioning of Regulation 1/2003 [2009] SEC(2009) 574, para. 19-22

competition rules to bilateral anticompetitive behaviour of market operators with national competition authorities and national courts.[71]

This new system has apparently brought some advantages in terms of saving time and economic resources for other tasks such as the pursuit of cartels and abusive behaviour, which are of much greater significance for the public interest than dealing with notifications, many of which concern agreements that have no serious anticompetitive effects.[72] Nevertheless, in the recently liberalised energy markets, it might be difficult to assess possible efficiencies, since the appraisal of long-term supply contracts that could result in vertical restraints from both the legal and economic aspects is complicated.

Another novelty that came with the enactment of Regulation 1/2003 was the introduction of commitment proceedings into the enforcement of competition law.[73] Accordingly, the Commission can impose a binding decision through commitments proposed by the parties to address the concerns of the Commission without clarifying the existence of any infringement of Articles 101 or 102 TFEU.[74] As will be seen below and particularly within Chapter 4, in most of the energy cases handled by the Commission, the investigations were concluded through commitment proceedings under Article 9 of Regulation 1/2003. Consequently, the observation of Article 9 itself

[71] Articles 5 and 6 of Council Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1. There are some concerns that the new system might increase uncertainty in the application of Article 101(3) TFEU, since non-binding guidelines might not be followed by national competition authorities or national courts. In addition, national courts may not have enough expertise and investigation power to assess the anticompetitive effects of vertical contracts as well as the possible efficiency gains resulting from them. However, this argument might be rebutted by the report on the functioning of Regulation 1/2003, which shows that no major difficulties with the direct application of Article 101(3) TFEU have been indicated by either national enforcers or firms or their legal counsels following the change in the system of notification and administrative authorisation. Commission, Communication from the Commission to the European Parliament and the Council Report on the Functioning of Regulation 1/2003 SEC(2009) 574

[72] Whish and Bailey, *supra* n 52, 166

[73] Article 9 Council Regulation 1/2003 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty [2003] OJ L1:
'(1) 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 concerns expressed to them by the Commission in its preliminary assessment, the Commission may by decision make those commitments binding on the undertakings. Such a decision may be adopted for a specified period and shall conclude that there are no longer grounds for action by the Commission.
(2) The Commission may, upon request or on its own initiative, reopen the proceedings:
(a) where there has been a material change in any of the facts on which the decision was based;
(b) where the undertakings concerned act contrary to their commitments; or
(c) where the decision was based on incomplete, incorrect or misleading information provided by the parties.'

[74] Whish and Bailey, *supra* n 52, 255-261

may give some insights into undertakings' and the Commission's attitudes to these cases. Since this issue will be discussed in detail within Chapter 4, for now just an abstract will be given. One of the reasons to invoke commitment proceedings for both parties is convenience in terms of using time and economic resources efficiently. Since a preliminary assessment is sufficient to initiate commitment proceedings, the Commission does not have to clarify the existence of an infringement of competition rules, which decreases its workload. Besides, this yields a sort of guarantee mechanism for undertakings not to be subject to any financial punishment as long as they do not breach the commitments imposed. In addition, from the regulation policy point of view, imposing commitments on the undertakings concerned can be more effective as they push the liberalisation of the energy markets further. Commitment proceedings also enable the Commission to reduce the anticompetitive effects of vertical contracts, for instance by reducing their length as well as their volume. Yet, at the same time, possible economic efficiencies can be still gained from these contracts such as investment in energy generation plants or in transmission infrastructure. Furthermore, on the one hand, commitment decisions give undertakings an opportunity to by-pass negative publicity as well as possible private enforcement. On the other hand, commitments proposed by undertakings concerned under Article 9 might go beyond possible remedies that could be imposed under prohibition proceedings.[75]

In the next section, the cases will be explored with consideration of the changes in both the energy regulation process and competition law in order to observe the impact of these in case law.

1. Long-term Supply Contracts: Anticompetitive Contract Clauses

The most important aim of this section is to show that the Commission, particularly after the first regulatory Directives came into force, started investigations in the energy markets on the basis of competition policy. The focus of the Commission apparently shifted from improvements in energy generation and supply to the enhancement of competition and the creation of a single market in Europe.

[75] J. T. Lang 'Commitment Decisions under Regulation 1/2003: Legal Aspect of a new kind of Competition Decision' (2003) Vol.24 European Commission Law Review 347, p. 350; C. J. Cook 'Commitments Decision: the Law and Practice under Article 9' (2006) Vol. 29 World Competition 209, pp. 211-214; W. Wils, 'Settlement of EU Antitrust Investigations: Commitment Decision under Article 9 of Regulation No. 1/2003' (2006) Vol. 29(3) World Competition 345, p. 358

Besides, given the strategic importance of long-term supply contracts,[76] particularly in the gas sectors in terms of the security of gas importation from non-EU states, the Commission seems to take into account energy supply security when dealing with competition problems and considers balancing trade-offs between competition policy and the security of supply.[77] Regarding the increased dependence on gas imports, long-term supply contracts may limit the risks linked to this dependence and enhance the security of supply.[78] Apparently, even though it is not explicitly displayed, commitment decisions are useful instruments in the hands of the Commission to balance the objectives of competition policy and sector-specific regulation.[79]

With regard to long-term supply contracts signed between energy producers and importers/wholesalers, possible anticompetitive outcomes seem to be mainly resulted from the contract clauses. Thus, in most of the competition investigations the concerns of the Commission are over these anticompetitive contract provisions that strengthen the market power of historical monopolies by dividing the markets into the regions, i.e. the compartmentalisation of the relevant markets. For instance, *territorial restriction (or destination clauses)* prevents a buyer from reselling the product concerned outside of a specified country or area, whereas *use restriction* forces a buyer to use the product purchased for certain purposes decided within the contract. These restrictions not only contribute to price maintenance, but also reduce

[76] Long-term supply contracts have traditionally been accepted as one of the cornerstones of security of supply in the EU.

[77] Within the context of this chapter security of supply should be considered as a non-economic gain such as steady availability of primary energy sources, and long-term supply. Generally speaking, it cannot be avoided that the policy of security of supply has a significant impact on the Commission when it is dealing with competition concerns in terms of the diversification of sources of supply as well as the routes for transportation through investment.

[78] This special role of long-term contracts has also been recognised by the Interim Report of the Parties to the EU-Russia Energy Dialogue. This states that long-term contracts are having an important role in facilitating investment in exploration, production and transport of gas. <http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/2006_05_25_interim_report_en.pdf> accessed 14/12/2012, pp. 1-4

[79] K. Talus, 'One Cold Winter Day? EC Competition Law and Security of Supply' (2007) Vol.5(4) Oil, Gas and Energy Intelligence <http://www.ogel.org/article.asp?key=2667> accessed 5 June 2013, pp. 3-5; O. Adu, 'Competition or Energy Security in the EU Internal Gas Market: An Assessment of European Commission Decisions on Long-term Gas Contracts' (2011) Vol.9(1) Oil, Gas and Energy Intelligence <http://www.ogel.org/article.asp?key=3071> accessed 13 April 2013, pp. 7-8; For a discussion of economic and non-economic efficiency gains of the policy of security of supply, as well as the approach of non-economic efficiency gains of the Commission under Article 101(3) TFEU see K. Talus, 'Security of Supply Argument in the Context of EU Competition Law' (2010) Vol.8(1) Oil, Gas and Energy Intelligence <http://www.ogel.org/article.asp?key=2986> accessed 21 February 2012, p.5

liquidity in the European energy markets through facilitating collusion between market players.[80] The idea behind the provisions is that by dividing the market into regions or Member States, buyers/wholesalers are precluded from engaging in commercial activities with other buyers/wholesalers; in other words, energy-to-energy competition (mostly gas-to-gas competition) is hampered. This clearly undermines the creation of a common market.[81] Article 4(b) of the block exemption regulation on Vertical Agreements and Concerted Practices identifies territorial restrictions as hard-core restrictions and states that the exemption provided by the Regulation does not apply to vertical agreements that contain any provisions that have the direct or indirect effect of territorial restrictions.[82] Therefore, these agreements need to be handled under Article 101(3) TFEU.

The Commission has dealt with territorial restrictions contained within long-term supply agreements in a number of cases. The contracts signed between Gazprom (Russian gas producer) and ENI (Italian oil and gas company), OMV (Austrian oil and gas company), and E.ON Ruhrgas (German gas company), were investigated by the Commission due to territorial restriction provisions included in the contracts.[83] As a result of the settlements between the parties and the Commission, the investigations were closed. The parties agreed to delete the territorial restrictions and other clauses such as a right of first refusal[84] and most favoured customer,[85] which infringed EU competition law on restrictive business practices (Article 101 TFEU). Another remarkable commitment proposed by ENI and OMV was to promote increased capacity in Trans Austria Gasleitung (hereafter TAG), and to improve third

[80] K. Neuhoff and C. Hirschhausen, 'Long-term vs. Short-term Contracts: A European Perspective on Natural Gas' (2005) CPWE 0539 and EPRG 05 Working Paper <http://www.dspace.cam.ac.uk/bitstream/1810/131595/1/eprg0505.pdf> accessed 29 April 2011, p. 4

[81] Faull and Nikpay, *supra* n 12, 547

[82] Article 4 of Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practice [2010] OJ L 102/1; Commission Notice Guidelines on Vertical Restraints SEC(2010) 411 final, para. 47-59

[83] *ENI/Gazprom* (Case COMP/37011) [2003]; Commission, 'Commission reaches breakthrough with Gazprom and ENI on territorial restriction clauses' IP/03/1345; *OMV/Gazprom* (Case COMP/38085) [2005]; Commission, 'Competition: Commission secures improvements to gas supply contracts between OMV and Gazprom' IP/05/195; *E.ON Ruhragas*/*Gazprom* (Case COMP/38307) [2005]; Commission, 'Competition: Commission secures changes to gas supply contracts between E.ON Ruhragas and Gazprom' IP/05/710

[84] 'Right of first refusal' limits the ability of the energy generator/provider to sell the product to other buyers who operate in the same geographical market, a Member State, as the incumbent buyer. The clause obliges the generator to offer gas to the incumbent buyer before his rivals.

[85] 'Most favoured customer' puts an obligation on the energy provider to offer similar conditions to the incumbent buyer as it would have offered to his competitors in a certain Member State.

party access, which would facilitate efficient and effective use of TAG as a transit pipeline.[86] The commitments also included the introduction of an effective congestion management system, the introduction of a secondary market, and the regular publication on the Internet of the available capacity.[87] The commitments were apparently suggested to achieve non-discriminatory and transparent capacity allocation and congestion management systems, which were directly related to neither the territorial restriction clauses nor long-term supply agreements.[88] These settlements show that the commitments given by the parties indicate that the aim of the Commission is to intervene in the energy markets via antitrust investigations, as claimed by former Competition Commissioner, Neelie Kroes: '... I intend to use our competition tools actively to speed up the liberalisation process in gas and electricity markets'.[89] As a consequence, these three settlements between the Commission and the parties concerned, and the general approach of the Commission to the energy cases raise the question of whether the Commission should undertake such expanded responsibility in the energy markets, and whether it should pursue the scheme of energy regulation.

Other significant decisions were *GDF/ENEL* and *GDF/ENI*.[90] In most of the cases related to territorial restrictions, the Commission closed the investigations through settlements between itself and the undertakings concerned. Nevertheless, in *GDF/ENEL* and *GDF/ENI*, the Commission concluded the investigations through prohibition proceedings. Regarding the contract signed between GDF and ENEL, GDF was supposed to deliver gas purchased by ENEL from NLGN at the delivery point Oltingue, on the border between Switzerland and France. According to the contract, the gas carried from Nigeria by GDF was only to be used in Italy. Similarly, within the contract signed between GDF and ENI for the transportation of liquefied natural gas (thereafter LNG) purchased by ENI in Northern Europe, it was specified

[86] *OMV/Gazprom* (Case COMP/38085) [2005]; *ENI/Gazprom* Commission 'Commission reaches breakthrough with Gazprom and ENI on territorial research restriction clauses' IP/03/1345
[87] *ENI/Gazprom* (Case COMP/37011) Commission 'Commission reaches breakthrough with Gazprom and ENI on territorial research restriction clauses' IP/03/1345
[88] These systems were actually introduced by the second regulatory package under Regulation (EC) No 1775/2005 (on conditions for access to the natural gas transmission networks) which came into force on 1 July 2006. Thus, Commitments imposed through these settlements were far beyond what the Commission could have achieved through sector-specific regulation.
[89] Commission, 'Competition: Commission secures improvements to gas supply contracts between OMV and Gazprom' IP/05/195
[90] *GDF/ENEL* and *GDF/ENI* (Case COMP/38662) Commission Decision [2004]

that the LNG could only be re-sold in France. After the investigations started the parties terminated the infringement. However, this did not help to bring the investigations to an end. At the final stage of the investigations, although there was no fine to be imposed, the Commission adopted a decision indicating the existence of an infringement of Article 101 TFEU. These were the first actual decisions in a string of cases arising from the same anticompetitive concerns. Apparently, the aim of the Commission was to provide clear guidance regarding the legal assessment of territorial restriction clauses within the recently liberalised energy markets.

However, the approach of the Commission in *GDF/ENEL* and *GDF/ENI* was criticised on the basis of discrimination between EU and non-EU companies, particularly regarding the settlements reached with Norwegian Statoil and Norsk Hydro (2002), Nigerian NLNG (2002), and Russian Gazprom (2003 and 2005), and specifically with Algerian Sonatrach (2007).[91] In the *Sonatrach* decision, the problem was Sonatrach's insistence on replacing the territorial restriction clauses with *profit splitting mechanisms* within the long-term supply contracts signed between itself and several Member States including Italy, Spain and Portugal (gas) and France, Belgium, Italy, Spain, the UK and Greece (LNG).[92] Profit splitting mechanisms impose an obligation on the buyer to share with the seller a certain part of the revenue gained from reselling the product outside of an allocated territory, typically a Member State, or using the product for a purpose other than that agreed upon.[93] Again, similar to territorial and use restrictions, the mechanism helps a seller to save each geographic market within its portfolio by preventing gas-to-gas competition between buyers. In this way, the seller will be better off from an economic point of view by maximising its profit by for instance, protecting its wholesale outlets or imposing different prices on different purchasers. After seven years of at times

[91] In 2000, the Commission started to investigate territorial restriction clauses in gas contracts, with the aim of increasing supply competition. A number of contracts concluded between external suppliers and the European importers were examined and several cases were opened. E. Waktare, 'Territorial Restrictions and Profit Splitting Mechanisms in the Gas Sector: the Algerian Case' (2007) Competition Policy Newsletter 19, pp. 19-22

[92] The other one is a change in the delivery point for the products concerned. Since this clause does not create anticompetitive outcomes as profit splitting mechanisms do, it will not be covered by the paper. See also H. Nyssens, C. Cultrera and D. Schnichels, 'The Territorial Restrictions Case in the Gas Sector: a State of Play' (2004) Vol. 2 Competition Policy Newsletter 48, pp. 48-51

[93] Waktare, *supra* n 91,19-21; Faull and Nikpay, *supra* n 12, 367

Profit splitting mechanisms may also force a purchaser to share commercially sensitive information such as resale price and the volume of energy resold in a downstream market with an upstream supplier, as the supplier has an interest in knowing how much of the product is diverted into other territories or to other users, and how much of the profit should be split.

discussions the Commission and the Algerian Ministry for Energy and Mines reached a common understanding with regard to the clauses dealing with profit sharing mechanisms.[94] This long lasting negotiation might indicate the enthusiasm of the Commission to end investigations through settlements rather than by making infringement decisions. This approach of the Commission could be justified through energy supply security, particularly given that Algeria was the third largest external gas supplier after Russia and Norway in 2006, with in total 54.6 BCM of gas and an LNG supply that was 11% of the EU's total consumption.[95] After long lasting negotiations, former Commissioner Kroes remarked that: 'the agreement reached constitutes a major breakthrough in our relations with one of Europe's most important suppliers for natural gas and eliminates an important obstacle for the creation of a single EU-wide market in gas'.[96]

The situation of non-EU energy companies can also be ascertained from the aspect of extraterritorial application of EU competition law.[97] According to the Court of Justice, with regard to the universally recognised territoriality principle, an anticompetitive agreement can be considered partially or wholly invalid if it enters into force in the EU, although the contracting parties are non-EU energy

[94] According to the settlement between the parties, Sonatrach committed to deleting territorial restriction clauses from all existing contracts and to not introducing such clauses into new contracts. Sonatrach also committed to deleting profit sharing clauses from existing pipeline contracts (for gas) and agreed that these would not be inserted into future pipeline contracts or transit contracts where the gas runs through another Member State prior to arriving at its final destination.
Regarding LNG contracts, the parties agreed that profit sharing mechanisms can only be applied in DES contracts, because in DES contracts the title and risk pass to the buyer at the port of destination. (However, under CIF and FOB contracts this is not the case. For this reason, Sonatrach agreed not to include these mechanisms in these types of agreements.) If the gas should be diverted from its initial destination while still underway a change of contract would be required. In addition, as the gas still belongs to the seller, it is difficult to speak of a resale restriction in such circumstances.

[95] Waktare, *supra* n 91, 19-21

[96] Commission, 'Commission and Algeria reach agreement on territorial restrictions and alternative clauses in gas supply contracts' IP/07/1074

[97] Despite many non-EU undertakings being subject to EU competition law the Court of Justice has not ruled on whether there is an effects doctrine under EU law, as the decisions of the Court have been based on different grounds such as the economic entity doctrine (See the *Dyestuffs* decision of the Court of Justice in which the Court held that three non-EU companies had engaged in illegal price fixing within the EU through their subsidiary companies based in the EU. The Court assessed the parent undertakings and their subsidiary companies as one economic entity and considered that the parents exercised decisive influence over the conduct of the subsidiaries. Case C-48/69 *ICI v. Commission* [1972] ECR 619) and/or the fact that the implementation of an agreement entered into outside of the EU occurred within it (Whish and Bailey, *supra* n 52, 495-500). In the *Wood Pulp* decision (*A Ahlström Osakeyhtiö and Others v Commission* (Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85, C-125/85, C-126/85, C-127/85, C-128/85 and C-129/85) [1988] ECR 5193), the Court of Justice stated that, regarding the facts of the case it was not necessary to have an effects doctrine. In fact, the universally recognised territoriality principle was sufficient to deal with the problem, as the agreement was implemented within the EU.

undertakings.[98] Nevertheless, the extraterritorial application of EU competition law to external energy companies seems difficult with regard to the dependency of the EU on non-EU gas supply. This can be observed in the case law, in particular in settlement proceedings with non-EU companies such as Sonatrach. As a result, it seems that antitrust enforcement can be a solution for anticompetitive contract clauses only if politics permit.[99]

Other provisions that restrict the commercial activities of market operators are *exclusive supply obligations* and *reduction clauses*.[100] Exclusive supply/purchase obligations require a generator to sell the product concerned only to a wholesaler in an agreed territory, normally a Member State. This reduces the ability of the generator to sell the product to other market operators such as the rivals of the wholesaler, distributors or end users. Consequently, entry barriers are rendered for wholesalers or retailers who want to participate in upstream or downstream markets.[101] As mentioned before, the foreclosure effect of the provision is detrimental to competition in the energy markets due to the fact that it strengthens the dominant position of the wholesaler. Moreover, this provision may aggravate the position of the generator itself by preventing him from selling the product to end users in the downstream market. Thus, the market power of the wholesaler is further protected. Likewise, reduction clauses give the wholesaler the right to reduce the annual volume to be purchased from the generator if the latter starts selling the product concerned into the territory in which the former operates.

These anticompetitive provisions namely exclusive supply obligations and reduction clauses were addressed by the Commission in the *DONG/DUC* decision.[102] The concerns of the Commission in the case were, first, the joint marketing of North Sea gas by the Danish Underground Consortium (DUC-constituted by gas producers

[98] K. Talus, *EU Energy Law and Policy: A Critical Account* (London Oxford University Press 2014), pp. 283-285
[99] *Ibid*
[100] 'Exclusive supply obligations' are defined as 'any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only to one buyer inside the Community for the purposes of a specific use or for resale' within Article 1(3) of Commission Regulation No 2790/1999 on the application of vertical agreements and concerted practices [1999] OJ L 336.
[101] Faull and Nikpay, *supra* n 12*,* 370
[102] *DONG/DUC* (Case COMP 38187) [2003]; Commission, 'Commission and Danish competition authorities jointly open up Danish gas market' IP/03/566; *Wingas/EDF Trading* (Case COMP/36559) [2002]; Commission, 'Commission clears gas supply contracts between German gas wholesaler WINGAS and EDF-Trading' IP/02/1293

Shell, A.P Moller, and Chevron Texaco), and second, anticompetitive clauses included in long-term supply contracts concluded between DONG, the incumbent Danish gas supplier, and the DUC partners. According to the joint marketing arrangement, the DUC partners were supposed to sell DONG enough gas to satisfy the entire Danish demand and supply additional volumes to Sweden and Germany. After the investigation started the DUC partners agreed to cease their joint marketing arrangements and market their gas individually. In order to facilitate the establishment of new supply relationships the DUC partners also offered 17% of the total gas production on an annual basis for sale to new customers over a period of five years. Since this commitment would bring competition to the Danish market as well as increase competition in neighbouring Netherlands and Germany, DONG and the DUC partners decided to build a new pipeline linking the Danish gas fields with the existing infrastructure on the European continent in order to increase the network capacity for potential competitors.

According to the provisions of the gas supply agreements concluded between DONG and the DUC partners, DONG was obliged to report to the DUC partners the volumes sold to certain categories of customers so as to obtain a discount or special prices. In return, the DUC partners were supposed to offer all of their future gas finds to DONG first. In order to bring an end to the investigation the parties undertook to exclude anticompetitive clauses from the contract. To facilitate the market entry of the DUC partners and potential other suppliers, DONG also committed to introducing an improved access regime for DONG's offshore pipelines linking the Danish gas field with the Danish mainland. In this respect, DONG undertook to increase the transparency of the system by publishing information on the available capacity, to allow for short term trading in line with the access regime, and to introduce interruptible transport contracts. This decision is another example in which the settlement between the parties and the Commission was not limited to the boundaries of the anticompetitive elements of the contracts but was extended to improvement of the access regime as well as the facilitation of investment in new pipelines.

Furthermore, the contract granted DONG the right to reduce the volumes bought from the DUC partners in a situation where they started selling gas into the Danish market. DONG argued that the reduction clauses were needed for the protection of

the Danish market in respect of the take-or-pay obligations. The Commission accepted this argument because of the limited ability of DONG to sell the gas outside Denmark due to the scarce capacity of the interconnector.[103] In this respect the Commission gave a 6-month transitional period in which reduction clauses could be imposed until a new pipeline was commissioned linking the gas fields on the Danish continental shelf with other continental European countries.

From a competition policy point of view, the decisions explored above highlight possible anticompetitive effects of long-term supply contracts such as market compartmentalisation and market foreclosure stemming from the provisions included within the contracts. Besides, the effect of market regulation on competition investigations can clearly be seen particularly from settlements, i.e. from the commitments proposed by the undertakings concerned. The Commission apparently not only removed the anticompetitive clauses from the long-term supply contracts through competition law, but also addressed technical and legal obstacles such as scarce network capacity and inefficient access regimes preventing further liberalisation of the markets and the improvement of competition. These decisions, thus, demonstrate the Commission's aim to use competition rules as vehicles to achieve the objectives of market liberalisation, as it seems to be more appropriate to conclude investigations on the basis of commitments in order to motivate or force undertakings to operate in a way which may be necessary to create conditions facilitating competition and market integration in the EU.[104]

Nevertheless, these decisions do not provide any insights into the methodology used for the investigations into long-term supply contracts. Nor do they explain the economic perspective of these contracts. These two missing parts will be traced in the next section.

[103] *DONG/DUC* (Case COMP/38187) [2003]
[104] Commission, 'Competition: Commission secures improvements to gas supply contracts between OMV and Gazprom' IP/05/195

2. Long-term Supply Contracts: Volume and Duration of the Contracts

a) The Steps Followed for the Investigation of Long-term Supply Agreements

The long-term supply agreements concluded between wholesalers or importers and large industrial customers can be seen as structural reflections of the long-term supply contracts examined above. However, the focus within the competition investigations of the agreements that will be analysed below is mostly placed on the duration and volume of the contracts. In particular, long-term supply contracts having *de facto* or *de jur*e exclusive purchase character are investigated by the Commission due to their foreclosure impact on the markets.[105]

The decisions explored in this section give some hints regarding the creation of a clear model for the investigation of long-term supply agreements. Basically, the Commission divides the investigation into four sections. In general the Commission first defines the relevant product and geographic markets. Second, the Commission states its concerns about possible anticompetitive outcomes of the contracts. Third, the Commission examines the commitments proposed by the parties to remove the anticompetitive results of the contracts. Finally, in order to render the commitments binding on the undertakings concerned, the Commission assesses the effectiveness and proportionality of the commitments pursuant to Article 9 of Regulation 1/2003.

More specifically, in order to estimate the detrimental effects of the long-term supply agreements, the Commission adopts a more analytical and comprehensive process by pursuing a path specified in the Sector Inquiry.[106] The Sector Inquiry points out four features that should be considered: (1) the volume tied under the individual contracts, (2) the duration of the contracts, (3) the cumulative market coverage of the contracts, and (4) the efficiencies claimed by the parties.[107] The first three factors are examined in order to find evidence to indicate whether new entry barriers have been created by the contracts. The aim of the assessment therefore is to reach a decision showing whether entry by potential competitors has been made more difficult from a

[105] Article 3 of Commission Regulation (EU) 330/2010 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practice [2010] OJ L 102/1; G. Kuhne 'Long-term Gas Contracts in Germany: An Assessment of the German Competition Authority' in U. Hammer and M. M. Roggenkamp, *European Energy Law Report III* (Intersentia 2006), p. 72

[106] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 770

[107] *Ibid*, 771

factual point of view rather than to define any certain forms in which Article 101 and 102 TFEU may be infringed.[108] With regard to the application of commitment proceedings under Regulation 1/2003, on the whole the Commission tends to emphasise and support its concerns about possible anticompetitive outcomes of contracts through examining these factors, without finding any particular proof pointing to the existence of any breach.

In downstream energy markets, the Commission initiated a number of competition investigations with regard to the volume and duration of long-term supply contracts. These investigations have become key cases that illustrate the significant lines of inquiry pursued by the Commission during the investigation.[109] These cases are *Gas Natural*,[110] *Synergen*,[111] *Distrigas*,[112] and *EDF*.[113]

In the *Gas Natural* decision, the Commission investigated a long-term gas supply agreement signed between Gas Natural, a dominant company in the gas market, and Endesa, the market leader in the electricity business in Spain.[114] The Commission was concerned about the impediment of the contract to market entry at a particularly crucial moment in the early stages of liberalisation of the energy market in Spain. According to the Commission, the duration and volume of the agreement, which posed *de facto* an exclusive purchase obligation, could have raised market entry barriers for entrants into the Spanish gas market, as electricity generators were one of the largest customers for gas suppliers. The agreement may also have segmented the market to the benefit of the dominant firm through use and resale restrictions obliged on Endesa.[115] In addition, it would have resulted in discrimination against Spanish gas purchasers by providing Endesa with better treatment than other future clients of Gas Natural. In order to remove the Commission's concerns Gas Natural and Endesa proposed some amendments to the gas supply agreement.

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[108] *Ibid*, 771
[109] Hauteclocque, *supra* n 3, 46; Talus, *supra* n 8, 229
[110] *Gas Natural* (Case COMP/37542); Commission, 'Commission closes investigation on Spanish company GAS NATURAL' IP/00/297
[111] *Synergen* (Case COMP/37732) [2002]; Commission, 'Commission clears Irish Synergen venture between ESB and Statoil following strict commitments' IP/02/792
[112] *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]
[113] *Long-term Contracts France* (Case COMP/39386) Commission Decision [2010]
[114] *Gas Natural* (Case COMP/37542); Commission, 'Commission closes investigation on Spanish company GAS NATURAL' IP/00/297
[115] M. F. Salas 'Long-term Supply Agreements in the Context of Gas Market Liberalisation: Commission Closes Investigation of Gas Natural' (2000) Vol.2 Competition Policy Newsletter 55, pp. 55-58

The volume of the agreement was reduced by around 25% in order to free Endesa's purchasing capacity as well as to eliminate the exclusivity of the contract by creating an available customer for potential entrants.[116] The duration of the contract was reduced to 12 years so as to avoid excessive long-term dependence of the customer on the supplier. This is still rather long compared to other decisions by the Commission given later on. This may be justified through the evaluation of the Commission's thinking and the different level of market opening.[117] Moreover, the parties undertook to delete the use of restriction and other price differentiations compartmentalising the market. This would contribute to competition in both the gas and electricity markets, because, on the one hand, the access of power generators to gas as a substitute for coal would develop a competitive electricity market and, on the other hand, gas would also be a product that electricity purchasers could offer to final consumers.[118]

Although *Gas Natural* did not provide tangible guidance for the industry, several interesting issues such as *de facto* exclusivity and energy release were pointed out in the decision. In addition, this case is a good indicator of the Commission's approach to long-term supply agreements in the early 2000s.

In the *Synergen* case,[119] in 2000, ESB, a dominant company that effectively controlled 97% of electricity production in Ireland and more than 60% of the supply market for eligible customers, and Statoil, a powerful company with gas reserves inside and outside Ireland, and electricity activities in other countries, notified three agreements related to the construction and operation of a 400 MW gas fired electricity generation plant, Synergen, in Dublin, Ireland. According to the joint venture agreement, ESB would hold a 70% stake in the company while Statoil would hold the remaining 30%.[120]

Regarding the joint venture agreement, the concern of the Commission was over whether the creation of the joint venture would remove Statoil as a potential competitor from the highly concentrated Irish power market, since the agreement

[116] *Ibid*
[117] A. De Hauteclocque, 'Long-term Supply Contracts in European Decentralized Electricity Makrets: an Antitrust Perspective' (PDhil Thesis, University of Manchaster 2009), pp. 151-158
[118] Talus, *supra* n 8*,* 229
[119] Commission, 'Commission clears Irish Synergen venture between ESB and Statoil following strict commitments' IP/02/792
[120] Commission, Notification of a Joint Venture (Case Comp/E-3-37732) 2000/C 255/06

imposed an obligation on Statoil that prevented it from participating in any power project in Dublin or entering the electricity market independently. During the settlement process, the parties undertook to delete this provision.

The second contract was a 'supply agreement' that foresaw that a subsidiary of ESB, namely ESBIE, would market electricity generated by Synergen for 15 years. The Commission deemed that the supply contracts would have strengthened the market power of ESB. The parties committed to making 600 MW of electricity available (400 MW generated by ESB, 200 MW generated by Synergen), by means of auctions or direct sales, which would be used by new market entrants to build up a customer base when constructing a new power plant.[121] Also, ESBIE was excluded from the Synergen sales.[122]

Finally, the third contract was a 'gas supply agreement' that provided that Statoil would supply gas to Synergen for electricity generation for 15 years. The gas supply agreement was cleared by the Commission, which considered that it would improve the effective competition in the gas supply market through increasing the market share of Statoil slightly above the so-called *de minimis* threshold.[123] Furthermore, the Commission took into account that Statoil offered a special price discount for its gas, which it would not have offered unless it had been assured long-term exclusivity. Apparently, the Commission exempted the contract under Article 101(3) TFEU as it considered that an objective economic benefit arising from the contract would be shared by consumers as well as the contracting parties.

Overall, the Commission deemed that the commitments would facilitate market entry into the Irish electricity markets. Not only would the traders be able to purchase electricity from different sources, but also the new producers would have the opportunity to build up a customer base for their future power plant.

This case demonstrates the importance of investments in energy, and also, how the Commission handles a long-term supply contract when it contributes to an

[121] Commission, *XXXIInd Report on Competition Policy 2002*, SEC(2003)467 final, pp. 192-193
[122] *Ibid*
[123] Commission, Notice on Agreements of Minor Importance Which do not Appreciably Restrict Competition under Article 81 [2001] OJ C 368/07. According to Article 7 of the Notice 'agreements between undertakings which affect trade between Member States do not restrict competition if the market share held by each of the parties to the agreement does not exceed 15% on any of the relevant markets affected by the agreement (...)'. Therefore the market share of Statoil in the Irish energy market was less than 15%.

investment decision given by the parties to the contract concerned. In *Synergen*, the Commission first considered the special price offered by Statoil as a cost efficiency, which would not have been given if it had not been for the exclusive character of the contract, and counted it towards exemption under Article 101(3) TFEU.[124] In contrast, the price difference in *Gas Natural* was appraised as anticompetitive because of the segmentation of the market, and because it put Endesa in an advantageous position against its competitors. It point out that the Commission is apt to grant an individual exemption under Article 101(3) TFEU in an instance where an undertaking concerned makes an investment.[125] Second, the reinforcement of an incentive to invest through an exclusive long-term supply contract was taken into account by the Commission. The *Synergen* decision is, thus, a significant example which shows that the Commission considers an investment as an efficiency while granting an individual exemption under Article 101(3) TFEU.

In the *Distrigas* case, the Commission launched an investigation into the long-term gas supply contracts concluded between Distrigas (the largest gas importer and supplier in Belgium) and its variety of large gas customers such as industrial users, electricity generators and resellers.[126] The concerns of the Commission were over the market foreclosure for potential competitors of Distrigas and the obstruction to the development of competition in the gas markets following the liberalisation. The long-term supply agreements concerned would have tied a significant part of the market demand to Distrigas for a long period and thereby prevented alternative suppliers from entering the market and building up a viable customer base (output foreclosure). The Commission was therefore concerned that the combined effect of the agreements would have been to significantly close off the market to potential market entrants.

The importance of the case derives from two different angles. First, the Commission clarified all of the steps of the investigation. This disclosed a substantive model used by the Commission for the examination of long-term supply contracts. Second, while evaluating the commitments proposed by Distrigas under an Article 9 procedure, i.e. commitment proceedings, the Commission took the principle of proportionality into

[124] *Synergen* (Case COMP/37732) [2002];Hauteclocque, *supra* n 62, 205-234
[125] Hauteclocque, *supra* n 62, 205-234
[126] *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]

consideration, which was recently interpreted by the General Court in the *Alrosa* case.[127]

For the assessment of a long-term supply contract, the Commission listed five elements that should be considered: (1) the market position of the supplier, (2) the share of the customer's demand tied under the contracts, (3) the duration of the contracts, (4) the overall share of the market covered by the contracts, and (5) efficiencies.[128]

In its consideration of the first element, the Commission pointed out not only the role of having a dominant position but also the cumulative effects of several contracts. This approach, which considers the actual economics of a given situation, was also adopted in the *Repsol* case.[129] Its subject matter was exclusive long-term supply contracts signed between an oil company, Repsol, and service station operators in Spain.[130] Repsol's market share was only around 30%, which hardly exceeded the dominance threshold. However, the Commission deemed that, because of their cumulative effects and the weak position of the retailers and final customers as compared to Repsol, the contracts would have blocked market entry. In both cases the foreclosure effect of a network of long-term contracts employed in the supply markets was highlighted.[131]

Regarding the second (the share of the customer's demand tied under the contracts) and fourth (the overall share of the market covered by the contracts) elements, the Commission took several important tools into account in order to appraise the contracts such as the total volume sold by a supplier and the proportion of that total

[127] Case T-170/06 *Alrosa v. Commission* [2007] ECR II-260. This judgment will be discussed in-depth within Chapter 4.
[128] Commission, 'Antitrust: Commission increases competition in the Belgian gas market – frequently asked questions' MEMO/07/407
[129] *Repsol C.C.P.* (Case COMP/B-1/38348) Commission Decision [2006]; Although it is an oil case the Commission's approach is quite similar to gas and electricity cases. In order to address the anticompetitive results of the contracts, Repsol submitted a set of commitments to the Commission including the reduction of the duration of the contracts that were from 25-40 years, to 5 years, as well as a commitment to offer concerned service stations a concrete financial incentive to terminate the existing long-term supply contracts. Following the commitments the Commission closed the investigation, as they were sufficient and necessary to address the concerns as well as to improve competition in the market. Also see E. Gippini-Fournier 'The Modernisation of Europe Competition Law: First Experiences with Regulation 1/2003' (2008) Vol.2 Community Report, Fide Congress 41
[130] The Commission stressed the foreclosure effects of the long-term exclusive supply contracts with the numerical values. The tied market share of Repsol's sales was deemed considerable at around 25-35%, the length of the contracts was between 25 and 40 years.
[131] *Repsol C.C.P.* (Case COMP/B-1/38348) Commission Decision [2006]

volume to the total demand in the relevant market, as well as the percentage of a customer's demand tied to the supplier. According to the Commission, when a customer is obliged to buy all or a good part of its requirements from a particular supplier for a certain period of time, the customer is no longer available as a potential customer to other suppliers. Such contracts can therefore render market foreclosure. For this reason, Distrigas committed to reducing the volumes of gas sold in Belgium, and therefore other gas suppliers could compete with it for the demand that was freed up. For industrial users and electricity generators for instance, Distrigas undertook to ensure that on average 70% of the gas contracted to supply to the consumers concerned would return to the market every year.[132] Besides, the Commission claimed that when consumers are bound to a particular supplier through long-term contracts that cover only a small part of the total demand, competitive concerns such as market foreclosure are unlikely to arise. The Commission considered that, given the market power of Distrigas, there would not be a significant anticompetitive effect as long as it met less than 20 to 30% of the total market demand. Thus, the effect of these commitments was to ensure that Distrigas did not tie up an excessive proportion of consumers for more than one year ahead, while they allowed Distrigas as much flexibility as possible in managing its portfolio of contracts.[133]

Furthermore, in considering the third condition (the duration of contracts), in order to speed up the return of customers to the market, Distrigas undertook not to conclude new long-term supply contracts with industrial users and electricity producers for a duration of longer than 5 years, and with resellers for a duration of longer than 2 years, which is far shorter than the duration specified within the Commission's guideline on vertical restraints.[134] In the decision, the Commission divided customers into two groups. Such an approach can be justified by the differentiated effects of the customer groups on the competitiveness of the market due to their attractiveness to a new entrant. The main aim of the commitments was therefore to ensure that Distrigas did not modify its behaviour to cherry-pick the most attractive customers

[132] *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]
[133] UNSPECIFIED, *Report on Competition Policy 2007 – Including Commission Staff Working Document* (EU Commission – Working Document), p. 46
[134] Commission Notice Guidelines on Vertical Restraints SEC (2010) 411 Final, para. 66

with long-term contracts.[135] Distrigas was to be bound by these commitments as long as its market share did not fall below the 40% market share threshold.[136]

A very similar approach to the restriction of contract duration was adopted in the *E.ON Ruhrgas* case by Bundeskartellamt. As compared with the *Distrigas* decision it is clear to see that the Commission accepted and endorsed the substantive assessment of *E.ON Ruhrgas*.[137] In the *E.ON Ruhrgas* decision, Bundeskartellamt limited the duration of the contracts to within 2 and 4 years under which respectively more than 80%, and between 50% and 80% of a customer's total demand was supplied. Reflecting the *Distrigas* decision by the Commission, the duration of the contracts signed with resellers was restricted to a time period of 2 years by Bundeskartellamt.[138] Transaction costs could be a reason behind leaving at least 20% of customer demand remaining untied by the long-term supply contracts. Providing a certain amount of gas, such as less than 20% of the total customer demand, might be uneconomic for an alternative supplier. Therefore, 20% of the total customer demand could have been considered as a threshold by Bundeskartellamt to attract a second supplier to enter into a relationship with a buyer.[139]

Regarding the final element (efficiency gains), the Commission found that the likely positive effects of the long-term supply contracts that were concluded between Distrigas and newly established electricity generation companies seemed to outweigh their possible negative effects. As a result, the commitments did not cover newly constructed power plants, given that new generation capacity would promote competition in the market. Also, the investment would not go ahead, unless greater

[135] *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]; These commitments do not have to be applied under two conditions: first, the market share of Distrigas will not exceed 40%, and, second, the market share of the closest competitor of Distrigas will not be 20% less than the market share of Distrigas.
[136] The threshold for these commitments is 40% market share, which complies with the threshold defined as an indicator for a dominant position in a relevant market within the guidance on the application of Article 102 TFEU. Commission, Communication form the Commission - Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 45/7, para. 14
[137] Commission, 'Antitrust: Commission increases competition in the Belgian gas market-frequently asked questions' MEMO/07/407
[138] *Ibid*; *E.ON Ruhrgas* (Case COMP/B 8-113/03)
[139] Hauteclocque, *supra* n 62

predictability of prices and possible increased security of supply were guaranteed for the investor, i.e. the elimination of quantity and price risks.[140]

In its consideration of the principle of proportionality, the Commission assessed the necessity and sufficiency commitments by taking into account a number of factors. First, the obligation to return an adequate volume of gas was necessary and sufficient to reduce the level of foreclosure of the customers, thereby enabling alternative suppliers to build up a significant customer base in the gas market. Second, the reduction of the duration of the contracts improved the level of competition in the market by facilitating market entry, as attractive customers such as electricity generators, industrial customers or gas resellers would not be tied for a long-period of time. Finally, the application of commitments was limited to a total period of four years, which was crucial to promote gradually developing competition and liberalisation of the market.[141]

The approach adopted by the Commission and Bundeskartellamt in these gas cases can be seen in electricity cases as well. In the *EDF* decision, the Commission investigated the exclusive long-term supply contracts concluded between EDF and its large industrial customers by taking into account the factors clarified in *Distrigas*.[142] Similarly to other long-term supply cases, the concerns of the Commission were the foreclosure effects stemming from the *de facto* exclusivity of the contracts and the imposition of resale restrictions on large industrial customers. Under the settlement proceedings, several commitments addressing these concerns were proposed by EDF. First, EDF undertook to ensure that at least 65% of the electricity contracted with large customers would return to the market every year. The main objective of the set of commitments was to enable consumers to meet their electricity demand from alternative suppliers, and to make it easier for alternative suppliers to enter the market or to expand their market power. In addition, EDF pledged that the duration of its contracts with industrial customers would not exceed 5 years. However, given the interests of industrial customers, and on the grounds of greater cost transparency, the Commission highlighted that in a situation where the customer wanted to make a supply contract for more than 5 years, they could do so,

[140] Commission, 'Antitrust: Commission increases competition in the Belgian gas market-frequently asked questions' MEMO/07/407
[141] *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]
[142] *Long-term Contracts France* (Case COMP/39386) Commission Decision [2010]

as long as EDF provided them with a termination right without any penalty at least every five years. Similarly to *Distrigas*, EDF would be released from its commitments only if its market share fell below the 40% market share threshold.

b) The Analysis of the Decisions: Economic Efficiency Gains

Although the investigations examined in this section seem respectively clearer and more detailed it is still hard to find effective guidance for possible investigations about long-term supply in the future. Nevertheless, by considering all of the related cases investigated by the Commission a brief formative guideline might be created.

Broadly speaking, it can be stated that, from a procedural point of view, the Commission follows a general structure for settlement proceedings by dividing investigations into four stages: (i) the definition of the relevant product and geographic markets as well as the identification of the market positions of the companies under investigation, (ii) the specification of competition concerns of the Commission, (iii) the examination of the commitments proposed by the parties, and (iv) the assessment of potential efficiency gains which may offset the anticompetitive effects of the contracts.

More specifically, it can be seen from the case law that the Commission adapts a more economic-based approach for the first and second stages. This observation could be captured from the matters indicated by the Commission during the investigations. For instance, the Commission takes the market shares of the companies under investigation into consideration in order to see whether they have market power or are likely to strengthen their market power. This consideration is clearly based on economic principles regarding the fact that anticompetitive effects will be correlated with the market power.[143] Similarly, the cumulative effects of parallel contracts are also based on economic principles as the Commission appraises the share of market demand tied by each single contract to measure a cumulative effect.[144]

In addition, the volume and duration of contracts are significant factors considered by the Commission during its investigations. The Commission tends to force the firms concerned to reduce the volume and duration of the contracts, given that the greater

[143] Hauteclocque, *supra* n 3, 107
[144] Hauteclocque, *supra* n 3, 107

volume and duration of the contracts the more likely it is that market foreclosure will occur. Regarding the volume of the contracts, it seems that the Commission wants to be sure that a significant amount of the demand for electricity and/or gas from large industrial customers and/or electricity generators is returned to the market every year so that other market players have an opportunity to enter the energy markets (i.e. the elimination of output foreclosure). Likewise, the duration of the contracts tends to be shortened to 5 years or less.

Even though the market shares of firms, and the durations and volumes of contracts are certain elements that are considered by the Commission during its investigations, the outcomes of each investigation are different depending on the specific circumstances of each case. For instance, while the Commission cleared contracts with durations of more than 10 years in *Gas Natural* and *Synergen*, in *Distrigas* and *EDF* the duration was shortened to 5 years or less depending on the volume of the contracts and to whom the electricity or gas was supplied. Similarly, the threshold set by the Commission for the volume of the contracts that should be returned to the market was different in the *Distrigas* and *EDF* decisions. Overall, although there are no defined thresholds for either the volume or duration of contracts, the Commission follows general principles, which are based on economic grounds, and which are observed within the guidelines on vertical restraints.[145] Besides, if there is a relationship-specific investment or an objective economic benefit deriving from long-term supply contracts, the contracts could benefit from an exemption provided under Article 101(3) if a number of the conditions listed within Article 101(3) are satisfied.[146] For instance, as demonstrated by the *Synergen* and *Distrigas* decisions, an investment in electricity generation capacity was recognised as a releasing efficiency by the Commission.

Finally, the case law shows that since the modernisation of EU competition law with the enactment of Regulation 1/2003, commitment proceedings under Article 9 of the Regulation seem to be used to replicate in effect the functioning of the notification system for agreements under former Regulation 17/62, which was abolished by the

[145] Commission, Notice Guidelines on Vertical Restraints SEC(2010) 411 Final
[146] Commission, Communication from the Commission, Notice Guidelines on the application of Article 81(3) of the Treaty [2004] OJ C 101/97, para. 40-116

new Regulation.[147] In this sense, in particular regarding the *Distrigas* and *EDF* decisions, it looks as though the Commission has cleared the long-term supply contracts by adapting necessary changes in order to make them comply with competition law as well as to eliminate possible anticompetitive effects of the contracts. In this way, while ensuring the compliance of the contract with EU competition law, the Commission guarantees the legitimacy of the contracts that generate economic efficiencies. The case law also indicates that the Commission and energy companies have an increased tendency to use the settlement procedure under Article 9 of Regulation 1/2003 within the energy markets.

IV. Conclusion

This chapter attempted to draw a general frame around long-term supply agreements in two perspectives: economic and legal. First, the economic outcomes of the agreements were examined in terms of their negative and positive effects. In this part of the chapter, it was found that although there are a great number of academic works on long-term supply contracts there is no certain and unambiguous clarification regarding their net anti- or pro-competitive effects.[148] Consequently, it is crucial to analyse each single long-term supply contract concluded in the energy markets with respect to its own market conditions such as the market positions of the contracting parties, the structure of the agreement itself, the intensity of retail competition and the general level of vertical integration, in order to properly assess the impact of them on competition in the relevant market.

Second, the chapter drew a methodology adopted by the Commission for the investigation of long-term supply agreements through an analysis of case law. It was found that under monopoly market conditions, the Commission tended to support the application of long-term supply contracts regarding efficiencies, in particular the development of generation and transmission technologies and capacities, and improvements in security of supply. However, the early cases did not spell out a clear and certain methodology in terms of an analysis of the anti- or pro-competitive effects of long-term supply agreements. Even though there is a lack of explanation as to why and how these decisions were reached, the Commission intimated that

[147] N. Dunne, 'Commitment Decisions in EU Competition Law' (2014) Vol.6(3) Journal of Competition Law and Economics 399, p. 407
[148] Hauteclocque, *supra* n 3, 105-107

long-term supply contacts of less than 15 years would benefit from an exemption under Article 101(3) TFEU given the market conditions, and the high up-front investment cost in energy markets.[149]

In contrast, since the liberalisation of the energy markets in the EU, the Commission has tended to focus on the likely detrimental effects on competition and market integration. Within the first group of decisions the Commission mostly pointed out the anticompetitive contract clauses such as territorial restrictions and non-compete obligations. In most of the decisions, the investigations were brought to an end following the undertakings concerned proposing to delete the contract clauses from the agreements. Yet, still the decisions examined within this group did not draw out a clear methodology. Besides, it was highlighted that the antitrust settlements reached after long-lasting negotiations between the Commission and non-European energy incumbents or relevant national authorities had a significant role particularly in the wholesale gas markets.

With regard to the second group of the decisions, there are more detailed investigations and clarifications regarding the process of examination of the long-term supply contracts. Although the decisions do not individually provide proper guidelines regarding the methodology they may help to create formative guidance. Therefore, it can be drawn out that the Commission examines long-term supply contracts in four stages: in the first step, the Commission analyses the undertakings and the relevant market subject to investigations by considering the market power of the contracting parties and the competition degree in the markets. In the second step, possible anticompetitive effects of long-term supply agreements are examined, and in the third and fourth stages, the Commission assesses efficiencies that could possibly arise from the agreements and accepts the commitments proposed by the parties to bring the investigations to an end. Then, the Commission attempts to eliminate the anticompetitive effects and protect or enhance the efficiency gains (if there are any) through the commitments, which are mostly energy-specific.

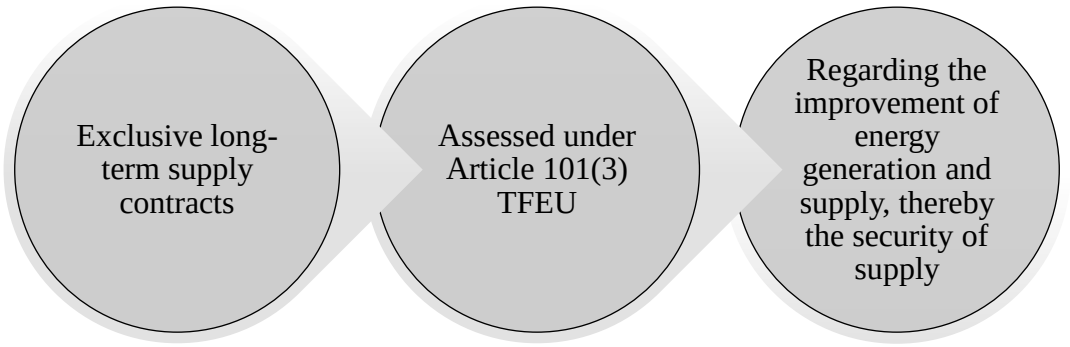
One of the most remarkable points in the case analysis is the Commission's tendency to use competition law to eliminate the anticompetitive parts of the contracts and the deficiencies of market regulation through commitment

[149] Talus, *supra* n 8,150-158

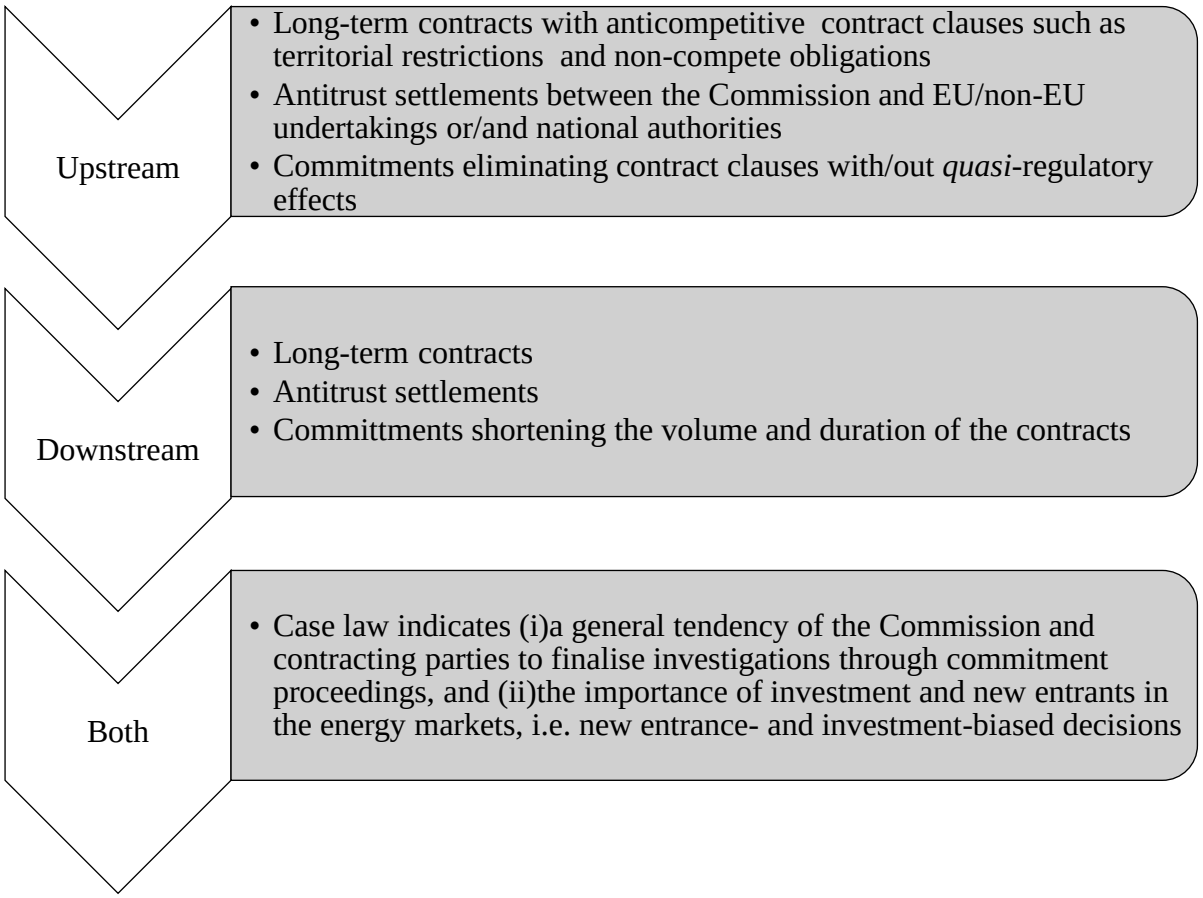
proceedings. This problem will be discussed within Chapter 4. But, before that, the findings of Chapter 2 are summarised in a diagram below, and within the next chapter, the problem of preferential network reservations made by dominant undertakings on the basis of long-term supply contracts will be highlighted.

Diagram 2: Different types of treatments for different types of anticompetitive contracts clauses (*Source: Own illustration)

Pre-liberalisation:



After-liberalisation:



CHAPTER 3

THE PROBLEM OF PREFERENTIAL CROSS-BORDER TRANSMISSION NETWORK RESERVATIONS IN THE EUROPEAN ENERGY MARKETS

I. Introduction

Energy regulatory reforms in Europe are based on a significant objective, which is to create an integrated single European market with a level of effective competition, as the gains from liberalisation would increase within a single and competitive market. Cross-border transmission networks with optimal capacity within and outside the EU are thus desirable for both the enhancement of competition and market integration. Cross-border networks increase the number of competitors and thus limit the market power of the incumbents by generating a connection between otherwise isolated areas for both the electricity and gas markets. Integrating energy markets in the EU is thus a legitimate objective.

Historically the level of cross-border interconnections has been low due to the national structure of energy markets. Energy production and supply were considered national issues and were owned or at least tightly controlled by the States. Cross-border transmission of energy was therefore necessary only for security of supply. Hence, transmission networks were built for centralised power generation by and for national monopolies. With liberalisation, however, the demand for the use of interconnectors has increased, usually because energy as a commodity, in particular electricity, might be cheaper on one side of the interconnector than on the other.[1] Given this increased demand for access to cross-border transmission networks, the capacity of interconnector and cross-border gas pipelines is becoming increasingly insufficient. Besides, this insufficient capacity seems to be monopolised through long-term network

[1] H. P. A. Knops, L. J. de Vires and R. A. Hakvoort 'Congestion Management in the European Electricity System: an Evaluation of the Alternatives' (2001) Vol.2 Journal of Network Industries 311, pp. 319-327

reservations. This monopolisation ultimately raises competition concerns under the essential facilities doctrine.[2]

The competition concerns stemming from the use of cross-border transmission networks could be grounded on two different variables. First, vertically integrated undertakings may foreclose the relevant markets through blocking cross-border transmission infrastructures. Since energy is a network-based sector, vertically integrated energy companies may protect and/or strengthen their market positions in generation and supply by preventing potential competitors from entering the relevant markets through providing only limited network capacity. Second, long-term supply contracts signed among Member States may result in the monopolisation of cross-border transmission networks. This is because the obligations arising from these supply contracts, such as the transmission of the commodities, can only be fulfilled through preferential cross-border network reservations given the volume and duration of the contracts. However, although these contracts could result in the monopolisation of interconnectors, they could be beneficial from an economic point of view, since they may increase the liquidity of a wholesale market in an importing Member State. In both situations, the reservations do not seem to be made pursuant to a transparent and non-discriminatory method as identified by sector-specific regulation. Therefore, the problem of scarcity of interconnectors is getting worse due to the combination of (i) preferential network reservations either for strategic anticompetitive purposes or on the grounds of associated long-term contracts, and (ii) the non-implementation of sector-specific regulatory rules. In this regard, long-term cross-border network reservations are under the scope of both EU competition law and EU secondary law.

Given the two dimensions of the problem of long-term network reservations, it is clear that the Commission handles this problem on the basis of *ex-ante* sector specific regulation and *ex-post* competition law. Therefore, it is crucial to investigate these preferential reservations from two angles: first, the reflection of this problem within the scope of *ex-ante* market regulation, in particular under the provisions related to vertical

[2] Commission, 'Role of Interconnectors in the Electricity Market: A Competition Perspective' MEMO/01/76

unbundling and third party access.[3] The second angle is the case law including both certain judgments of the European Court of Justice (hereafter the Court of Justice) and certain competition decisions of the Commission. The judgments of the Court provide clarification over *ex-ante* regulatory rules, whereas the competition decisions of the Commission show the impact of market regulation on antitrust investigations. In this sense, the *VEMW*[4] and *Republic of Slovakia*[5] judgments of the Court of Justice are corner stones in terms of showing the approach of the Court to long-term preferential network reservations on the basis of both market regulation and competition law. Regarding these judgments, the Commission seems to adopt a rather rigid approach for the assessment of long-term preferential network reservations. Accordingly, as will be seen in *GDF Suez, E.ON Gas* and *Marathon*,[6] the Commission is likely to pursue regulatory objectives within antitrust investigations. For instance, the Commission tends to introduce or improve the implementation of third party access through antitrust investigations. Moreover, the competition decisions show that, similar to the energy regulatory policy of the EU, the Commission, under antitrust investigations, is inclined not to accept any kinds of efficiencies as objective justifications for preferential network reservations other than major investments in networks by the holder of the priority access rights. It seems that the reason behind this tendency is to balance the tension between the objective of the creation of a single energy market and the objective to increase scarce network capacity through investments.

The main goal of this chapter is to indicate a strategic approach of the Commission in the energy markets: to achieve regulatory objectives through competition law. Thus, the chapter will first attempt to reflect on the extent to which *ex-ante* sector specific regulation deals with the problem of access to cross-border transmission networks. Then, it will demonstrate that, in its handling of antitrust investigations, the Commission

[3] Vertical unbundling aims at eliminating the connection between the segments of a vertically integrated energy company, whereas the goal of third party access is to provide for non-discriminatory and transparent access to cross-border transmission networks. The common and main objective of these provisions is to create a level playing field for all market participants.
[4] Case C-17/03 *VEMW* [2005] ECR I-4986
[5] Case C-264/09 *Slovak Republic v Commission* [2011] ECR I-8065
[6] *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]; *Marathon/Ruhrgas/GDF et alia* (Case COMP/36246) [2004]

aims to achieve regulatory objectives. Therefore, the discussion of the Commission's decisions will mainly be based on the disposition of the Commission in achieving its regulatory objectives through antitrust investigations, particularly by considering investments in transmission networks as object justifications for network reservations under Article 102 TFEU investigations. The second aim of this chapter is to discuss the relationship between long-term supply contracts among Member States and preferential cross-border network reservations. Furthermore, it aims at analysing these contracts from an economic perspective in order to show possible competitive effects that they may have, which could be assessed as efficiency gains. Finally, the last goal of the chapter is to analytically discuss the possibility of the consideration of associated long-term supply contracts as an objective justification for preferential reservations under Article 102 TFEU, because of the fact that they may actually generate economic efficiency gains.

Hence, the structure of the chapter is as follows. The first section of the chapter will evaluate the provisions of *ex-ante* sector specific regulation, namely vertical unbundling and the third party access regime, which address the problem of inefficient allocation and use of cross-border transmission networks. In this section it will be observed that the anticompetitive investigations of the Commission are mostly finalised pursuant to the objectives of market regulation. The second section of the chapter will focus on long-term supply contracts among Member States from an economic point of view, and their relationship with preferential interconnector reservations. This section aims at showing that the Commission may take into account associated long-term supply contracts during antitrust investigations of preferential network reservations, particularly when the former results in economic efficiency. The final section of the chapter will analyse the case law, and provide a hypothetical example in order to critically examine whether there are other possible objective justifications, other than investments, for preferential network reservations, which could be claimed as an objective justification defence under Article 102 TFEU investigations.

II. The Reflection of Preferential Network Reservations within the Sector-specific Regulation

Given the vertically integrated structure of energy markets and the shortcomings of market liberalisation,[7] different legal and institutional measures have been adopted by the Commission in order to confront the problem of preferential cross-border network reservations. These measures have two main purposes: first, to solve cross-border issues *ex-ante* through an improved regulatory framework; and second, to fight anti-competitive market conduct *ex-post* through EU competition law.[8] Regarding the first measure, the problem of preferential network reservations is handled within the scope of market regulation under vertical unbundling and third party access regimes. While vertical unbundling promotes the efficient and effective management of transmission networks by breaking the link between network and supply/generation companies, the third party access regime facilitates transparent and non-discriminatory allocation of network capacities. Therefore, there is a complementary relationship between these regulatory tools. They improve competition and market integration in energy. Similar to EU secondary law, the monopolisation of cross-border transmission networks has been subject to several investigations under EU competition law. In the next section, the problem of long-term priority access rights within market regulation will be highlighted. Later, the chapter will continue with an examination of the relationship between long-term contracts and preferential access reservations. This will be followed by analyses of the case law including certain judgments of the Court of Justice and the antitrust investigations of the Commission, in order to see the approaches adopted by the European Courts and authorities to eliminate cross-border problems in the EU using different tools.

[7] The Sector Inquiry identifies the shortcomings of energy markets as follows: an insufficient level of unbundling between network operations and supply activities; the existence of traditional sale patterns through long-term supply contracts which resulted in vertical foreclosure preventing potential competitors from entering the markets; an ineffective and inefficient allocation and use of cross-border transmission network capacities; and finally a low degree of competition. See DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724

[8] A. Palatsthy, 'Third Party Access in the Electricity Sector: EC Competition Law and Sector-Specific Regulation' (2002) Vol.20 Energy and Natural Resources Law 1, p. 8; J. Ashe-Taylor, 'EU Competition Law and Third-party Access to Gas Transmission Networks' (2004) Vol.14 Utilities Law Review 105, p. 109 ; A. Kotlowski, 'Third-party Access Rights in the Energy Sector: A Competition Law Perspective' (2006) Vol.16 Utilities Law Review 101, pp. 101-109

A. The Problem of Vertical Integration between Network and Supply Activities in the Energy Markets

Vertically integrated energy companies, as mentioned before, have traditionally been active in wholesale, network (including cross-border interconnectors and transmission pipelines), and retail activities within Member States. With the liberalisation of the energy markets, however, this traditional market structure has been considered as an obstacle to the well-functioning of the energy markets, given that, in a situation where a holding company which is active in both non-competitive (network activities) and competitive (generation and supply) segments of the energy sector may misuse its transmission network by blocking access to it or by providing its supply chain with a competitive advantage over other market operators. *Ex-ante* market regulation thus aims at obtaining vertical de-integration in order to diminish the possible harmful effects of vertical integration on competition and market integration within the EU. Pursuant to this aim, EU secondary law states that energy transmission networks should be separated from other activities. In this way, an internal conflict of interest within a vertically integrated company would be eliminated or reduced, as would anticompetitive foreclosure behaviour of dominant companies operating within the network segment of the industry.

Ex-ante regulatory rules require the unbundling of transmission networks from generation and supply so as to improve access and reduce the risks of discrimination and cross-subsidy. The current regulatory package provides three different models that can be transformed into domestic regulatory systems within Member States in order to achieve the vertical separation of transmission services from supply activities at different levels.[9] The three alternative models are: ownership unbundling, independent system operator and independent transmission operator.[10] Under ownership

[9] The European Commission originally offered two models within its proposal, which were full ownership unbundling and independent system operator as a second-best solution. However, due to the resistance, in particular from France and Germany, the full ownership unbundling offer was diluted with the addition of independent transmission operator into the third energy package.

[10] Articles 9-23 of Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55 and Articles 9-23 of Directive 2009/73/EC of the European Parliament and of the Council of

unbundling, an entity that is fully unbundled from generation and supply owns and operates transmission assets. This means that it has no further claim in generation and retail.[11] The independent system operator model implies that the transmission assets are owned by a vertically integrated undertaking; in other words the owner of the transmission network is a part of the vertically integrated group. Yet, the transmission system is operated by a system operator, which is independent in ownership from this vertically integrated company. Finally, under the independent transmission operator model, similar to the independent system operator model, the vertically integrated firm is allowed to maintain ownership of transmission assets. Yet, unlike the independent system operator model, there is no ownership unbundled system operator. The neutrality and independence of the transmission operator is ensured through a set of detailed conditions such as independent management and a supervisory board (legal unbundling).[12]

Despite the fact that EU secondary law provides three alternative models for vertical unbundling, the case law, in particular the *E.ON*,[13] *RWE*[14] and *ENI*[15] decisions, shows that the Commission has adopted a strategy through antitrust enforcement to force private companies to divest their network assets and achieve ownership unbundling through competition law decisions. By means of this strategy, as will be examined in-depth in the next chapter, the Commission seeks to control the impact of sector-specific regulation regardless of the choice left to the Member States.[16]

Regarding these alternative unbundling models, there is a general discussion about which one of them delivers more effective and non-discriminatory access, as well as

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13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94

[11] C. Growitsch and M. Stronzik, 'Ownership Unbundling of Gas Transmission Networks-Theoretical Background and Empirical Evidence' (Verein Fur Socialpolitik, The Annual Meeting of the Association for Social Policy, Magdeburg 2009) <http://www.socialpolitik.ovgu.de/sozialpolitik_media/papers/stronzik_marcus_uid552_pid493.pdf> accessed 21 January 2013, p. 2

[12] K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013), pp. 193-200

[13] *German Wholesale Market* (COMP/39.389) and *German Electricity Balancing Market* (Cases COMP/39.388) Commission Decision [2008]

[14] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]

[15] *ENI* (Case COMP/39315)Commission Decision [2010]

[16] Talus, *supra* n 12, 199

more efficient and timely investment into network capacity. While the economic literature, as will be seen below, provides ambiguous observations, the Sector Inquiry favours full ownership unbundling. According to the Sector Inquiry, the main problems related to the vertically integrated market structure in energy stem from (i) a lack of adequate incentives for transmission system operators to invest in transmission networks, as this investment would increase the competition against the generation and supply branches of vertically integrated undertakings, and (ii) the provisions of preferential capacity reservations and privileged treatments in favour of affiliated generation and/or supply chains.[17] Therefore, if the ownership link is fully broken between transmission systems and generation and supply, the incentives for the network operators to support the competitive position of their associated companies or to invest in transmission networks will change. They will seek to optimise their network businesses as opposed to acting in the overall interest of the vertically integrated groups.[18] As a consequence, the Sector Inquiry stresses that full ownership unbundling is crucial in order to create a level playing field and improve investment incentives.[19]

However, the economic literature provides more ambiguous observations with regard to this discussion. Unbundling can have several advantages, yet at the same time a number of potential disadvantages.[20] Although the costs and benefits deriving from structural separation differ from country to county, depending on the market structure and the level of competition, generally speaking unbundling may bring the following advantages.[21] Vertical de-integration, depending on the degree of unbundling, reduces incentives for cross-subsidisation and distorting actions of the network company due to

[17] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724 para.497
[18] *Ibid*, 155, 156 and 157
[19] *Ibid,* 171
[20] M. Mulder, V. Schestalova and M. Lijesen, 'Vertical Separation of the Energy Distribution Industry: A Cost-benefit Analysis' (2005) CBP Document No.84 <http://ideas.repec.org/p/cpb/docmnt/84.html> accessed 30 May 2014, p. 2; B. Baarsma *et al*, 'Divide and Rule. The Economic and Legal Implications of the Proposed Ownership Unbundling of Distribution and Supply Companies in the Dutch Electricity Sector' (2007) Vol.35(3) Energy Policy 1785, pp. 1785-1787; M. Pollitt, 'The Arguments For and Against Ownership Unbundling of Energy Transmission Networks' (2007) CWPE 0737 and EPRG 0714 <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/01/eprg0714.pdf> accessed 01 March 2013, p. 10
[21] As a result of market liberalisation, it is expected that increasing competition horizontally will decrease commodity prices and increase customer welfare. On the other hand, vertical de-integration may raise final prices by introducing double marginalisation (Chapter 2).

the proper allocation of tasks between network activities and generation/supply. It also increases the transparency of the costs and returns of the network company, which has a direct impact on the effectiveness and efficiency of regulation. The increased transparency helps the regulator to set appropriate access tariffs for the network firm, which increases the performance of the network. The transparency also improves the regulator's ability to monitor the markets. Due to the reduction in incentives for strategic behaviour, regulation becomes less complicated and hence more efficient. Both improved network performance and more efficient market regulation enhance competition. The network performance leads to less allocative distortion caused by high network tariffs as well as to better options for new entrants for using the grid.[22]

On the other hand, vertical unbundling brings certain disadvantages. Briefly, unbundling may cause the problem of double marginalisation and increase transaction costs. Unbundling may also have a detrimental impact on economies of scope as network and other commercial activities are closely related to each other, particularly in electricity, given that, as it is a non-storable commodity, it is necessary to have close connectivity between generation, transmission, distribution and supply in order to keep demand and supply in balance. Finally, unbundling may result in the emergence of high capital costs for the vertically de-integrated generation firms. As a consequence, investment in new power plants by these firms could reduce. The outcomes stemming from vertical unbundling will be analysed in detail below.

1. Advantages of Vertical Unbundling

a) Performance of Transmission Networks

One of the direct effects of unbundling is more independent management and financing of transmission networks. More efficient and effective network management without the need for compromising regarding the other needs of an integrated holding company can be created under vertical unbundling, since different network management requirements will be met.[23] In particular, when the network is fully unbundled from generation and

[22] Mulder, Schestalova and Lijesen, *supra* n 20, 10
[23] OECD, 'Report on Structural Separation' (2006) Vol.8(2) OECD Journal: Competition Law and Policy, pp. 12-21

supply, the network company concentrates on its own profit rather than on the profit of the group. As a result, it responds better to regulatory incentives and is more likely to invest in the network, which will further facilitate competition, since it will not aim at maximising joint profit.[24]

With regard to the financing of networks, vertical unbundling seems more appropriate, as it is more likely to prevent cash flow generated by transmission activities from being diverted to other activities. In this way, the returns of the network company will be spent efficiently in its interests. In this respect, full ownership unbundling seems more effective than the other two options regarding the performance of transmission networks as it fully secures operational and financial independence.

b) Effectiveness and Efficiency of Regulation

As mentioned before, unbundling improves the transparency of the costs and returns of network firms and thus makes it more difficult for undertakings to engage in cross-subsidisation and other distorting activities. While unbundling hinders the strategic reallocation of the internal costs of a network company, a vertically integrated company can shift the costs of commercial activities to the network firm and shift resources from the latter to the commercial part of the group. The financial transparency improves the efficiency and effectiveness of regulation, as it erodes informational and transactional regulatory constraints.[25] The transparency of costs and returns also enhances the informational position of a national regulator, which helps the regulator to set tariffs

[24] C. Hirschhausen, 'Infrastructure, Regulation, Investment and Security of Supply: A Case Study of the Restructured US Natural Gas Market' (2008) Vol.16(1) Utilities Policy; T. O. Leautier, 'Transmission Constraints and Imperfect Markets for Power' (2001) Vol.19 Journal of Regulatory Economics 27, p. 3
For an opposing view see H. Cremer, J. Cremer, and P. De Donder, 'Legal vs. Ownership Unbundling in Network Industries' (2006) CEPR Discussion Papers 5767 <http://ideas.repec.org/p/ide/wpaper/5853.html> accessed 09 February 2013. Cremer *et al.* in their paper, which investigates the impact of legal and ownership unbundling on the incentives of network operators to invest, the authors argue that investment incentives are higher under legal unbundling than ownership unbundling. The reasoning of the authors stems from the asymmetric information between the grid company and other parts of the sector, which may cause over or under estimation of the size of the investment that should be made. This problem can be mitigated by allowing the transmission operators to own part of the downstream industry, as the transmission operators can better decide on the size of the network by taking into consideration the future demand and supply conditions. However, the paper is criticised as it neglects the possible intention of the transmission operators to discriminate in favour of their own affiliates downstream.
[25] Mulder, Schestalova and Lijesen, *supra* n 20, 19-22

more appropriately.[26] Furthermore, the surveillance of the regulator becomes easier and more effective as vertical separation decreases or completely eliminates the incentive for the network company to favour its supply chain.

Again, full ownership unbundling seems the best option, as it eliminates cross-subsidisation and other distortions that could be present under other types of vertical unbundling regimes. Only full ownership unbundling can remove the risk of an information exchange between the members of a vertically integrated company. In this regard, only ownership unbundling can create the most effective 'Chinese Walls' between the network and generation/supply. In addition, only full separation of transmission activities from the rest of the system can provide the best result in terms of the development of the effectiveness of regulation by removing the asymmetric information in the markets and increasing the tendency of the network firm to comply with sector-specific regulation.

c) Development of Competition

No doubt one of the most significant advantages of unbundling is the creation of a level playing field in the competitive segment of the energy sector. Improved network performance, more effective regulation and fewer incentives for network owners to engage in cross-subsidisation and other distortions result in the promotion of competition in the wholesale and retail energy markets. With the improved allocation of tasks in network firms, network activities become better managed and separated from wholesale/retail activities, thereby reducing incentives and opportunities for discrimination in favour of the affiliated generation and supply companies by, for instance, margin squeezing or network foreclosing.[27]

A vertically integrated company could have the incentive and opportunity to strategically affect competition in the wholesale market. In this sense, this type of company may hinder new entry to the wholesale market and/or harm entrants' operations in the

[26] D. P. Baron and D. Besanko, 'Regulation, Asymmetric Information, and Auditing' (1984) Vol.15 RAND Journal of Economics 447, p. 466

[27] When the price for access to the essential facility is regulated, the network firm may find it attractive to restrict access to it in order to restrict entry into unregulated markets in which the owner of the essential facility is also a competing supplier. R. Beard, D. Kaserman and J. Mayo, 'Regulation Vertical Integration and Sabotage' (2001) Vol.49 Journal of Industrial Economics 319, pp. 331-332

wholesale markets through high fees for access to the interconnector. Nevertheless, an effective national sector regulator might be able to control the access price so that such anticompetitive behaviour by the holding company can be prevented. Yet, in spite of regulatory measures over access prices, this type of holding company can still interrupt competition through non-price discrimination, for instance, by delaying a network connection or necessary repair, or by providing asymmetric information on balancing needs. Vertical separation is therefore likely to facilitate entry into electricity wholesale, which will lead to an increase in competition, as well as to improvements in productive efficiency.

Under the independent system operator and transmission system operator models, the incentive for integrated undertakings to engage in anticompetitive conduct is not completely eliminated, as anticompetitive behaviour by an undertaking increases the total profit of the vertically integrated company.[28] Only full ownership unbundling can entirely eliminate the incentive of the vertically integrated firm to impede competition in order to protect or strengthen its market position in the competitive segments of the energy markets.

2. Disadvantages of Vertical Unbundling

a) Double Marginalisation

As discussed within Chapter 2, double marginalisation may occur when both upstream and downstream market operators have market power and when they separately maximise their profits. The opportunity to eliminate the double marginalisation problem in the energy markets increases the incentives for vertical integration.[29] This tendency however may reduce competition for the unintegrated firms. Thus, final prices may rise,

[28] For an opposing view see F. Hoffler and S. Kranz, 'Legal Unbundling can be a Golden Mean between Vertical Integration and Ownership Unbundling' (2011) Vol.29 International Journal of Industrial Organisation 576, pp. 600-604

[29] If there is perfect competition in the downstream markets double marginalisation may not occur; yet this is not the case in energy markets.

and the effects of vertical integration on social welfare may become more ambiguous, depending on how the intensity of competition is affected by vertical integration.[30]

b) Economies of Scope and Transaction Costs

In the energy sectors the integrated management and/or operation of different types of activities by a holding company could reduce the average cost due to economies of scope.[31] The unbundling of network systems from commercial businesses would lead to losses of synergy between these activities as unbundling decreases the options for their integrated and combined operation.

The literature on vertical economies in the electricity industry shows that there are certainly scope economies in the joint operation of transmission networks and generation.[32] In addition, it is indicated that integration between industrial segments leads to a greater reduction in the costs of coordinated economic activities relative to the unbundling models and long-term supply/purchase contracts.[33] However, the cost efficiency of vertical integration might be countervailed by possible negative effects of integration on competition.

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[30] M. A. Salinger, 'Vertical Mergers and Market Foreclosure' (1988) Vol.103 Quarterly Journal of Economics 345, p. 355; M. Riordan, 'Anticompetitive Vertical Integration by a Dominant Firm' (1998) Vol.88 American Economic Review 1232, p. 1246; K. U. Kuhn and X. Vives, 'Excess Entry, Vertical Integration and Welfare' (1999) Vol.30 RAND Journal of Economics 575, pp. 585-590

[31] The loss of synergy between different types of activities, i.e. economies of scope, arises when the incremental costs for a second service are less when a first service is already on offer.

[32] D. L. Kaserman and J. W. Mayo, 'The Measurement of Vertical Economies and the Efficient Structure of Electricity Utility Industry' (1991) Vol.34 Journal of Industrial Economics 483, pp. 496-500; K. Gilsdorf, 'Vertical Integration Efficiencies and Electric Utilities: A Cost Complementary Perspective' (1994) Vol.34 The Quarterly Review of Economics and Finance 261, p. 278; B-L. Lee, 'Separability Test for the Electricity Supply Industry' (1995) Vol.10 Journal of Applied Econometrics 49, p. 59; Nemoto and M. Goto, 'Technological Externalities and Economies of Vertical Integration in the Electric Utility Industry' (2004) Vol.22 International Journal of Industrial Organisation 67, p. 80

For instance, the literature on organisational economics recognises that under vertical unbundling firms seeking to complete transactions must be ready to face a variety of potential transaction costs, and contractual and organisational hazards. These transaction costs include the direct cost of writing, monitoring and enforcing contracts as well as the cost associated with the *ex-ante* investment and *ex-post* enforcing performance inefficiencies that may arise as a result of contractual hazards (Chapter 2). There is significant evidence that unbundling can raise transaction costs, as a result of the reorganisation and physical separation of the business. For example, the costs of finding a suitable salesperson and acquisition costs may increase. There could also be significant contract renegotiation costs. Clearly the transaction costs may increase as the degree of unbundling is increased.

[33] R. J. Michaels, 'Vertical Integration and the Restructuring of the U.S. Electricity Industry' (2006) Cato Institute Policy Analysis Series No.572 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=975682> accessed 5 November 2014, pp. 3-5

Since the existence of economies of scope is connected with the degree of market liberalisation, when comparing the three policy options for unbundling the main cost of losing economies of scope arises with the introduction of proper task allocation, i.e. an independent system operator. The cost tends to stay almost the same if full ownership unbundling is implemented after the adoption of an independent system operator.

c) Insufficient Investment in Generation

From a theoretical perspective, unbundling can have a detrimental effect on commercial parts of the energy industry. Unbundling may increase the cost of capital in generation, which may adversely impact generators' investment incentives.[34] This argument is based on the financial capabilities of a generator, namely the possibility of it using the network as collateral. This detrimental effect is more likely to happen under full ownership unbundling as this fully separates financing.

In a vertically integrated firm, the combined risk of all activities could be lower than the risk of commercial activities, as the relatively low risk of network management would be associated with the risk of generation. Therefore, it can be stated that vertically unbundled companies have higher capital cost than integrated firms. In other words, unbundling would reduce the financing capabilities of generators and hence investment.[35] Nevertheless, the effect of vertical separation on the cost of capital is uncertain. If generators became smaller this effect could emerge. However, if they became more focused and merged with similar firms the cost of capital may fall. Besides, this effect of vertical separation on generation could be eliminated through long-term supply contracts as they may increase the incentive for market operators to invest in generation capacities by minimising the price and quantity risks (Chapter 2).

Clearly a careful social cost/benefit analysis should be done for each country so as to estimate the size of the costs relative to the benefits. For instance, the costs of unbundling are likely to be greater than the benefits in small countries where the scope

[34] Pollitt, *supra* n 20, 11
[35] Michaels, *supra* n 33, 4

of competition is limited and managerial expertise is insufficient.[36] The two tables below compare the advantages and disadvantages of vertical integration with the three unbundling models.

[36] J. E. Besant-Jones, 'Reforming Power Markets in Developing Countries: What Have We Learned?' (2006) Paper No.19 Energy and Mining Board Discussion Paper <http://siteresources.worldbank.org/INTENERGY/Resources/Energy19.pdf> accessed 03 June 2014, pp. 83-85

Table 2: The advantages of vertical unbundling under the alternative regulatory models compared to vertical integration

Advantages / Models	Performance of Transmission Networks	Efficiencies and Effectiveness of Regulation	Development of Competition
Vertical Integration	Dependent on holding firm	Inefficient and ineffective regulation	Underdeveloped competition
Independent Transmission Operator	More independent than vertical integration yet still might be affected by a holding company	Relatively more efficient and effective regulation compare to vertical integration	Improved competition yet dominant company in the wholesale market can abuse its market power via network activities
Independent System Operator	Better focus and more secure finance	Due to more transparent information on costs and benefits, more efficient regulation	Due to more effective separation between commercial and network activities, more competitive markets
Ownership Unbundling	Fully independent and solely focused on network business and its own profit	Larger improvement in effective and efficient regulation	Even larger improvement in the competition level in the markets

*Source: Own illustration

Table 3: The disadvantages of vertical unbundling under the alternative regulatory models compared to vertical integration

Disadvantages / Models	Double marginalisation	Economies of Scope	Insufficient Investment in Generation
Vertical Integration	No double marginalisation problem	Welfare from economies of scope	No increased cost of capital due to the integration-so theoretically sufficient investment in generation
Independent Transmission Operator	Unlikely to occur	Welfare decrease	(Un)Likely to change
Independent System Operator	Likely to occur	Welfare decrease	(Un)Likely to change
Ownership Unbundling	More likely to occur	Larger welfare decrease	(Un)Likely to change

*Source: Own illustration

B. Third-party Access Regime

Generally speaking, the third party access regime is built on three levels of regulation with differentiated levels of detail.[37] The core and basic framework is introduced in the general internal market Directives, which provide the basic rules and principles for third party access. Then, access Regulations for electricity and gas establish the content of the regime and the principles in order to specifically focus on access issues and complement the more general Directives. Finally, the EU energy *acquis* includes the

[37] Talus, *supra* n 12, 180

network codes and guidelines, which are the third and most detailed level of regulation adopted on the basis of access Regulations.

Following this hierarchical evolution, the third regulatory energy Directives[38] provide the three fundamental principles of third party access: (i) non-discriminatory access to national and cross-border infrastructure; (ii) a strong regulatory overview for the tariffs and methodologies used for capacity allocation; and (iii) unbundled transmission systems, as discussed above, so as to reinforce non-discrimination and transparency.[39] In addition, there are provisions addressing many related issues such as balancing, publishing requirements, and fixing or approving the tariffs or methodologies for capacity calculations.

In order to complete the first level of regulation, access regulations for electricity and gas were enacted by the Commission.[40] These regulations further developed the basic rules for third party access by focussing preliminarily on access issues. The Regulations defined the main objective of the regime, which was to improve wholesale energy trade in spot and forward markets among Member States in order to enhance market integration, competition and security of supply. In order to reach this objective, the third party access regime covers: (i) transparent and non-discriminatory cross-border capacity allocation and congestion management; (ii) the harmonisation of cross-border

[38] Directive 2009/72/EC concerning common rules for the internal market in electricity [2009] OJ L 211/55; Directive 2009/73/EC concerning common rules for the internal market in natural gas [2009] OJ L 211/94

[39] Third party access as a regulatory measure was first enacted under the first regulatory energy Directives (Directive 96/92/EC for electricity [1996] OJ L 27/20; Directive 98/30/EC for natural gas [1998] OJ L 204/1). Since the Directives reflected the limits of the political boundaries of the time, they could only bring regulated third party access with an addition, negotiated third party access, and could not cover the international infrastructure. Thus, they should be considered as the first step towards more market oriented regulatory model. The second energy regulatory package (Directive 2003/54/EC for electricity [2003] OJ L 176/37; Directive 2003/55/EC for natural gas [2003] OJ L 176/57; Regulation (EC) No 1228/2003 for access to the network for cross-border exchange in electricity [2003] OJ L 211/15; Regulation (EC) No 1775/2005 for access to the natural gas transmission networks [2005] OJ L 289/1) improved the market regulation one step further by enacting regulated third party access as a single regulatory regime and by enhancing its applicability to cross-border interconnectors.

[40] Regulation (EC) 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15; Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the national gas transmission networks and repealing Regulation (EC) No 1775/2005 [2009] OJ L 211/36

tarifications; and (iii) promoting new cross-border infrastructure by both transmission system operators and third party market operators.[41]

As the physical interconnection capacity is undersized, efficient mechanisms to allocate the existing capacity and manage congestion have become crucial in order to facilitate cross-border trade. To maximise the use of the scarce transmission networks in an efficient manner, the Regulations[42] require Member States to adopt non-discriminatory and transparent market-based mechanisms such as explicit and implicit auctions for capacity allocation and congestion management.[43] Furthermore, in order to reduce contractual congestion in cross-border transmission networks, the Regulations provide a use-it-or-lose-it principle, which is based on the freeing up of unused capacity. Accordingly, unused allocated capacity, otherwise re-allocated by transmission system operators, can be freely tradable on a secondary basis by the capacity owners.[44] Given the large proportion of existing capacity reservations and the need to create a true level

[41] Article 12 of Directive 2009/72/EC concerning common rules for the internal market in electricity [2009] OJ L 211/55, Article 17 of Regulation 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15, and Article 22 and 36 of Directive 2009/73/EC concerning common rules for the internal market in natural gas [2009] OJ L 211/94

[42] Article 12 Regulation 714/2009 on conditions for access to the network for cross-border exchanges in electricity [2009] OJ L 211/15 and Article 13 of Regulation (EC) No 715/2009 on conditions for access to the national gas transmission networks and [2009] OJ L 211/36

[43] Congestion management can be based on two different mechanisms, namely non-market-based and market-based. While the former is usually less transparent and more prone to discrimination, the latter provides more efficient economic signals to the market participants and transmission system operators involved. Non-market-based methods such as first-come-first-served and pro-rate rationing were used in some Member States, namely France and Switzerland. These mechanisms resulted in inefficient use of interconnector capacity. This is due to the fact that first-come-first-served and pro-rate rationing do not necessarily allocate capacity to the participants that value the interconnection capacity the most. It can be allocated to participants that do not value it at all.

The usual criticism of the first-come-first-served method is the potential for discrimination to the advantage of the parent company. In the case of a lack of adequate publicity and sufficient advance notice informally sent to the parent company to ensure it applies on time, discrimination will occur. With the pro-rate rationing method, all requests are accepted but capacities effectively granted ex-post are limited according to a percentage relating to the over-subscription, the obvious problem here being strategic over-subscription. It can be noted that a liquid and transparent secondary trading market could limit these shortcomings. However, secondary capacity markets remain immature.

See DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724 para. 180

[44] Commission Decision 2006/770/EC amending the Annex of Regulation No 1228/3003 on conditions for access to the network for cross-border exchanges in electricity para. 2; Recital 21 of Regulation (EC) No 715/2009 on conditions for access to the national gas transmission networks [2009] OJ L 211/36

playing field between the users of new and existing capacity, the use-it-or-lose-it principle should be applied to all reserved capacities.[45]

The access Regulations, as the most detailed legal framework for the third party access regime, bring innovation to the institutional side by creating an Agency for the Cooperation of Energy Regulators (hereafter ACER) and the European Networks of Transmission System Operators for Electricity and Gas (hereafter ENTSO-E for electricity and ENTSO-G for gas),[46] which are obliged to develop non-binding Framework Guidelines as well as legally binding and directly applicable Network Codes. While the Framework Guidelines set out clear and objective principles for the Network Codes, the latter cover the following areas in detail: capacity allocation and congestion management, transparency, and the harmonisation of transmission tariff structures within the EU. In September 2012 the ENTSO-E and the ENTSO-G developed Network Codes on capacity allocation and congestion management, which comply with the principles of the relevant framework guidelines prepared by the ACER in 2011.

With regard to the objectives of the Regulations, logically the Framework Guidelines for electricity and gas deal with the integration, coordination and harmonisation of the congestion management regimes so as to support the completion and functioning of the internal market and cross-border trade. The main objective of the Framework Guidelines is to complement, where necessary, the access Regulations and to specify the detailed aspects to be implemented in the Network Codes. As a result, the Framework Guidelines aim at ensuring more efficient allocation of capacity on the interconnection points between two or more Member States and/or adjacent entry-exit points for gas transmission within the same Member State.[47]

[45] Recital 21 of Regulation (EC) No 715/2009 on conditions for access to the national gas transmission networks [2009] OJ L 211/36

[46] Regarding harmonisation among the Member States in terms of the operation of the networks, the establishment of the ENTSOs is significant. According to Article 8 of Regulation 714/2009 for access to the network for cross-border exchanges in electricity [2009] OJ L 211/15 and Regulation (EC) No 715/2009 for access to the national gas transmission networks [2009] OJ L 211/36 the ENTSOs should adopt namely common network option tools to ensure the coordination of network operation in normal and emergency conditions, and a non-binding Community-wide ten-year network development plan.

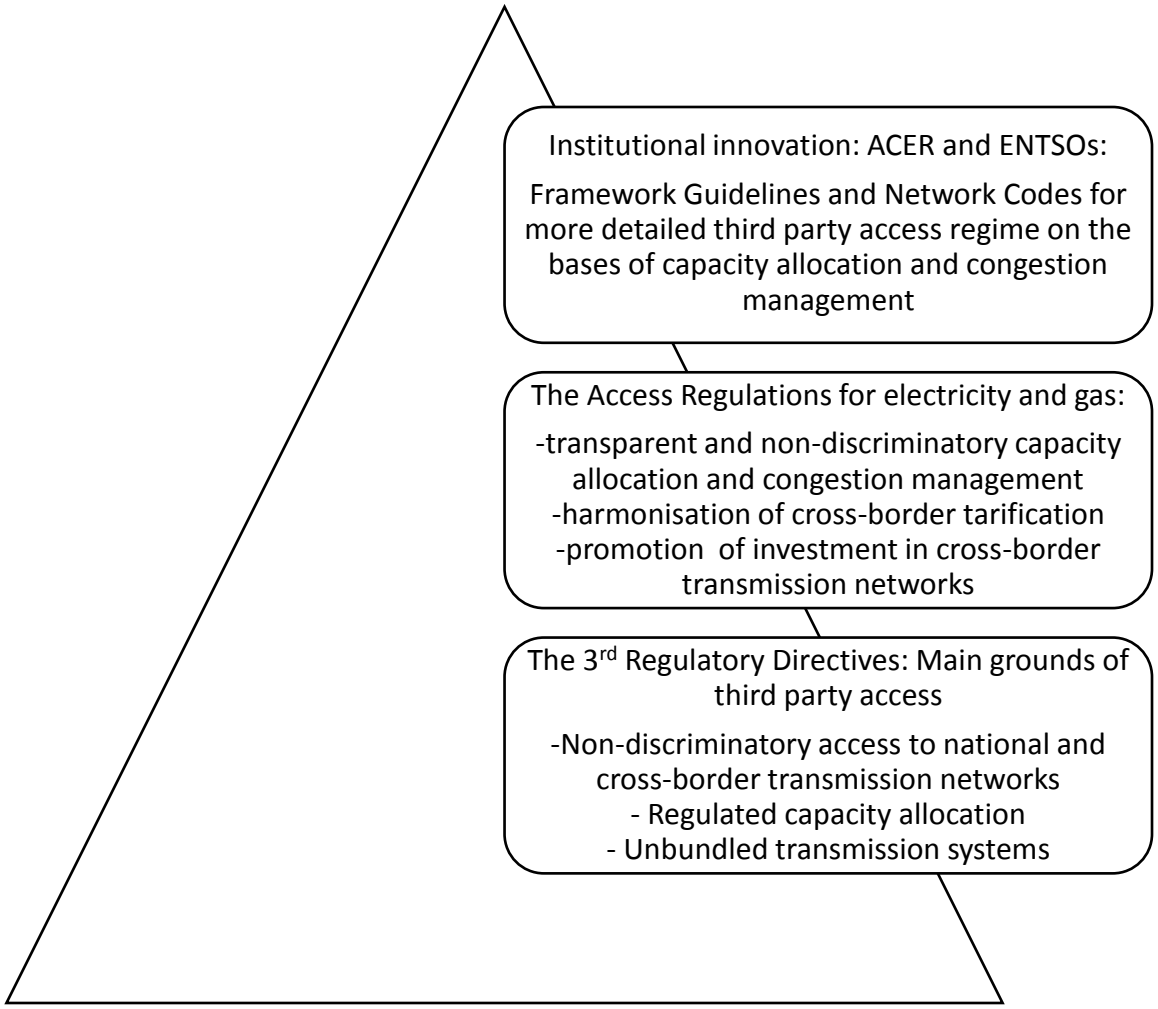
[47] ACER, The Framework Guidelines on Capacity Allocation Mechanisms for European Gas Transmission Network, 2011, FG-2011-G-001, p. 12

In line with the Framework Guidelines, the objective of the Network Codes for electricity and gas is to support the completion and functioning of the internal energy market as well as the improvement of cross-border trade, including delivering benefits to consumers. In order to achieve this objective, they aim at harmonising the market rules for calculating and allocating capacity on the basis of yearly, quarterly, monthly, daily and within-day timeframes. Additionally, the Network Codes point out the necessity of using a common set of remedial actions, such as the establishment of common methodologies for determining the volumes of capacity available between regions, to deal with the congestion problems that can occur in cross-border interconnections.[48]

To sum up, the third party access regime was introduced through three different regulatory sets of rules. The structure of this three dimensional provision is illustrated below in a diagram.

[48] ENTSO-E, Network Code on Capacity Allocation and Congestion Management, 27 September 2012, p. 2

Diagram 3: The illustration of the three dimensional structure of third party access



*Source: Own illustration

In addition to the regulatory provisions which reinforce cross-border energy trade through efficient use of transmission network capacities, the market regulation aims to increase the capacity of cross-border infrastructures. Accordingly, EU secondary law identifies new major investments in cross-border transmission networks as a cause of the interruption in the implementation of third party access. Regarding the scarce capacity of interconnectors in the EU, sector-specific regulation covers a provision by which investors could have a priority access right if they fulfil certain conditions for a

defined period of time.[49] It seems that the objective behind this provision is to improve the insufficient interconnectors in order to facilitate competition and market integration in the long-term, although this exemption seems to block competition and market liberalisation for a limited period of time in the short-term. Thus, this provision demonstrates the tension between the two regulatory objectives covered by the EU energy *acquis*: the creation of a single energy market by promoting third party access and the improvement of scarce cross-border network capacity by granting an exemption from the implementation of third party access. It seems that both contribute to the development of a competitive integrated and single energy market in the EU but within different timeframes. While the former delays the above mentioned regulatory objectives for a while in order to increase facilities for cross-border energy transmission in the future, the latter provides all kinds of opportunities to reinforce market integration and competition among Member States in the short run. By the same token, new investments have been taken into account by the Court of Justice and the Commission as objective justifications during judgments of the former and antitrust investigations of the latter, as will be seen within the next section.

Overall, generally speaking, the regulatory rules on vertical unbundling and third party access under *ex-ante* sector-specific regulation aim at creating a market design based as much as possible on short-term capacity allocation with liquid secondary trade platforms.[50] The right portfolio of capacity periods is crucial to achieve a well-functioning energy system. The proper implementation of third party access and vertical unbundling provisions within domestic markets is significant since the structure of most energy markets in Europe still remains vertically integrated, which provides the incumbent undertakings with the ability and incentive to use cross-border network infrastructures for a long-time in favour of their supply chains.

[49] This provision related to new investments in cross-border transmission networks is covered by the second and third energy regulatory packages. According to Article 7 of Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchange in electricity and Article 17 of Regulation 714/2009 on conditions for access to the network for cross-border exchanges in electricity [2009] OJ L 211/15, and Article 22 of Directive 2003/55/EC for natural gas and Article 36 of Directive 2009/73/EC for natural gas major new gas and electricity infrastructure including interconnectors may be exempted, upon request, for a defined period of time, from the third party access regime under certain conditions. See n.135 for more information.

[50] Talus, *supra* n 12, 192

Besides, the *ex-ante* regulation does not contain a comprehensive provision regarding existing long-term priority access rights. It only states that long-term access rights can only be provided to facilitate investments in networks.[51] This raises uncertainty about the future of long-term network reservations. The case law, on the one hand, seems to shed some light on this uncertainty at some points. First, the Court of Justice, under infringement proceedings, has assessed the legitimacy of long-term priority access rights granted on the basis of pre-liberalisation long-term supply contracts, with the consideration that the provision of these rights can be regarded as discriminatory under the scope of sector-specific regulatory rules. Second, the Commission has investigated long-term priority access rights under the essential facilities doctrine. On the other hand, the case law shows that the Court of Justice and particularly the Commission have reflected the regulatory tools and objectives in their competition investigations and decisions. In this sense, the case law indicates that competition law may substitute the EU energy *acquis* under some circumstances. Nevertheless, covering regulatory objectives within antitrust investigations might be detrimental to the market as it may increase legal uncertainty, which will be discussed within the next chapter.

The next section will first evaluate the long-term supply contracts concluded among Member States in order to show the relationship between long-term supply contracts and granting priority access rights. It will also analyse these contracts from an economic point of view so as to highlight possible economic efficiencies that could be gained. This relationship between the contracts and network reservations, and the possible economic efficiencies resulting from the former will reinforce the view which argues that the Commission may consider associated long-term supply contracts as objective justifications while investigating preferential network reservations under EU competition law. Later on, the chapter will continue with the case law.

[51] Article 17 of Regulation 174/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15 and Article 36 of Directive 2009/73/EC concerning common rules for the internal market in natural gas [2009] OJ L 211/94

III. Long-term Supply Agreements among Member States and the Problem of Preferential Network Reservations

As mentioned before, the aim of energy regulation in the EU is to promote market integration, and thus, facilitate competition and security of supply.[52] This aim is based on the improvement of wholesale energy trade (within and) among Member States in the spot and forward markets by developing effective management of cross-border interconnectors and transmission pipelines. However, the completion of a truly integrated wholesale market at the level of the EU is still a work-in-progress that has been ongoing since the establishment of the first liberalisation Directive.[53] Long-term supply contracts signed among Member States have a hybrid role in this progress.

The first role of long-term supply contracts concluded between Member States might be slightly positive. Long-term contracts concluded between parties with opposing market positions within the same Member States will always tend to foreclose wholesale markets, since they reduce the amount of open long and short positions[54] that need to be closed by wholesale market trading (Chapter 2).[55] However, long-term electricity purchase/supply agreements signed among Member States, i.e. import and export contracts, can mitigate or worsen the effect of domestic long-term contracts depending on the short or long market positions of the Member States concerned, as the contracts will increase or decrease the amount of electricity that is available for trading within the Member States. For instance, Belgium and the Netherlands, which have short market positions, benefit from imports under long-term contracts, which increase wholesale market liquidity and thereby competition and market integration. However, the opposite is the case as France, as it has a net long market position. This means that the bulk of

[52] ACER/CCER, Annual Report on the Results of monitoring the Internal Electricity and Natural Gas in 2012, November 2013, para. 115

[53] Commission, Communication from the Commission, Progress towards Completing the Internal Energy Market, COM(2014) 634 final, p. 3

[54] A company with a short market position needs to procure energy from other resources in order to meet the demand to supply energy in a downstream market, whereas a company with a long market position needs to sell its excess energy to other market players.

[55] In the gas sector, long-term supply contracts signed between European incumbents and non-EU gas producers with flexibility provisions enable the buyer to vary the volume of gas purchased in the future. This flexibility avoids situations where there is an excess or shortage of gas, thereby reducing the incumbents' need to trade gas at national wholesale markets. Therefore long-term supply contracts decrease liquidity in wholesale markets. As a result, competition does not flourish, since new entrants are hesitant about entering the markets, as they do not have enough confidence about gas availability.

long-term contracts are export contracts, which further increase the impact of domestic contracts.[56]

The second role of long-term supply contracts might be indirectly detrimental. One of the main barriers to market integration, among others, is long-term cross-border network reservations stemming from pre-liberalisation long-term supply contracts signed between Member States.[57] Long-term cross-border network reservations hinder wholesale market integration, since they result in physical and/or contractual congestion, and thus cause inefficiencies in cross-border capacity allocation. Physical and contractual congestion on cross-border interconnectors is currently a problem in both the electricity and gas sectors due to the fact that they prevent cross-border flows from placing any significant competitive pressure on market players.[58]

For instance, in gas, an overall analysis of cross-border network capacity reservations indicates that these network capacities are, to a significant extent, fully pre-booked for a long period of time on the grounds of historical long-term energy supply contracts. Furthermore, the analysis shows that there is a substantial difference between the contractual capacity and the actual utilisation of this capacity, which indicates contractual congestion, i.e. contractual foreclosure. As a result, in the wholesale gas markets, long-term cross-border network capacity reservations on the basis of pre-

[56] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 468

[57] Other possible reasons can be summarised as: (i) lack of wholesale market transparency; (ii) lack of harmonisation of market design (e.g. differences between balancing regimes, access tariffs etc.); (iii) lack of efficient capacity allocation and congestion mechanisms; and (iv) lack of cross-border transmission network capacity, as well as (v) lack of investment in these infrastructures to support the development of cross-border trade between areas with excess supply and areas with excess demand, due to vertical integration between transmission operators with generation or supply.; ACER/CCER, Annual Report on the Results of monitoring the Internal Electricity and Natural Gas in 2012, November 2013, para. 469; DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 103-111

[58] Congestion occurs when there is insufficient transmission capacity available to implement all of the transactions simultaneously. A physical congestion occurs when there are not enough physical capacities to meet the demand for cross-border trade. This is thus a problem of investment in the transmission network. In an efficient market, where investment incentives are not influenced by supply interests, such physical congestion should signal to the transmission system operators a need for additional capacity. Contractual congestion occurs when the existing physical capacities are fully contracted, and sometimes then under-used, which does not maximise the use of the existing physical capacity. As a result of contractual congestion, interested shippers requesting capacity are refused on the basis that all capacity is already reserved. Contractual congestion thus actually stems from the problem of capacity allocation and management.

liberalisation long-term supply contracts remain significant barriers to the completion of a single European energy market.[59]

The effect of long-term supply contracts signed among Member States should thus be considered by taking into account an additional variable, as compared to the analysis of long-term supply contracts concluded within Member States, which is cross-border transmission network reservation.[60] With the consideration of physical and contractual congestion on most EU borders, granting long-term priority access rights to cross-border transmission networks could amount to the monopolisation of an essential facility and hence an abuse of dominant position, depending on the market position of the right holder.[61] The competition analysis of long-term supply contracts across Member States should therefore introduce the analysis of the effect of the associated long-term priority access rights on competition.[62] *Vice versa* the economic analyses mentioned above show that, during the antitrust assessment of long-term preferential network reservations, the effect of associated long-term supply contracts and the possible efficiencies that might stem from these contracts should be covered. Regarding these economic analyses and the relationship between contracts and network reservations, the final section of this chapter will discuss the probability of the consideration of this relationship as an objective justification under antitrust investigations by the Commission. Before that, there will be a critical discussion of certain decisions of the Court of Justice and the Commission within the next section. This discussion will show the evolution of the approach of the Commission to the legitimacy of preferential network reservations on the basis of long-term supply contracts.

IV. Case Law

As mentioned before, the monopolisation of scarce cross-border transmission network capacities by granting long-term priority access rights is very problematic in the

[59] The average contracted firm technical capacity of gas interconnection points in the European Union is 92%. Yet, the average utilisation rate is 59% and peak monthly utilisation is 77%. ACER/CCER, Annual Report on the Results of monitoring the Internal Electricity and Natural Gas in 2012, November 2013, para. 475

[60] A. De Hauteclocque, *Market Building through Antitrust: Long-term Contract Regulation in EU Electricity Markets* (Edward Elgar Publishing Limited 2013), p. 139

[61] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 202

[62] Hauteclocque, *supra* no 60

European energy markets in terms of competition and market integration. Since the provision of these rights is mostly based on pre-liberalisation long-term supply contracts, the validity of long-term priority access rights used to be recognised by the Commission. Nevertheless, one of the judgments of the Court of Justice, *VEMW*, had enormous effects in the electricity markets as it examined the legitimacy of these rights.[63] In the judgment, the Court emphasised the importance of granting access rights in a non-discriminatory and transparent way, and underlined the importance of the implementation of third party access for market liberalisation.

On the other hand, the Commission, in the *GDF Suez*[64] and *E.ON Gas* decisions,[65] examined long-term capacity reservations and strategic underinvestment in transmission networks under the scope of competition law. It found that granting preferential access rights, for historical reasons, without any transparent or non-discriminatory procedure, could constitute an abuse of dominant position within the meaning of the essential facilities doctrine. Besides, it was highlighted that if there is an economic efficiency gain such as an investment in transmission network capacities stemming from preferential network reservations, the firms under investigation can escape antitrust liability through objective justification. This approach by the Commission was reinforced by the *Viking Cable*[66] decision, in which the Commission deemed that a preferential network reservation was lawful as there was an investment in this interconnector. In addition to the above-mentioned cases, this section will also appraise the *Marathon*[67] decision of the Commission. This decision is crucial in terms of showing that the Commission may use an antitrust settlement as a tool to achieve its regulatory objectives such as the proper implementation of third party access.

These judgments and decisions are significant as, first, they show the role of the Court of Justice in the market regulation and, second, they demonstrate the extent to which the Commission takes into account the principles and objectives of market regulation

[63] Case C-17/03 *VEMW* [2005] ECR I-5016
[64] *Gaz de France* (Case COMP/39316) Commission Decision [2009]
[65] *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]
[66] *Viking Cable* (Case COMP/E-3/37921) Commission Decision [2001]
[67] *Marathon/Ruhrgas/GDF et alia* (Case COMP/36246) [2004]

while concluding antitrust investigations. In this sense, the case law indicates the fact that the Commission seems to assess investments in cross-border transmission networks solely as objective justifications for existing preferential network reservations in order to improve scarce cross-border transmission network capacity around the EU. Furthermore, apparently, the Commission uses the settlements in order to promote the third party access regime with the consideration of the creation of a single integrated energy market in the EU.

This part of the chapter will first examine the judgments of the Court of Justice. Then, the Commission's decisions will be evaluated. Finally, as regards the limited assessment of the Commission of objective justifications under these investigations, there will be a discussion regarding possible objective justifications under Article 102 TFEU other than network investments for preferential network reservations.

A. The Role of the European Court of Justice in the Assessment of Preferential Network Reservations: *VEMW* and *Republic of Slovakia*

1. The *VEMW* Judgment of the European Court of Justice

The *VEMW* judgment of the Court of Justice is significant in terms of showing how the European Courts would ascertain long-term preferential cross-border network reservations. The case was referred to the Court of Justice under Article 267 TFEU by the Dutch Administrative Court for Trade and Industry, which had to rule on the legality of the long-term priority access rights granted to the former electricity monopoly, Samenwerkende Elektriciteits Produktiebedrijven NV (hereafter SEP),[68] on Dutch interconnectors. Before the liberalisation of the electricity market, under the 1989 Law, the SEP was the only undertaking that was authorised to import electricity, and it was entrusted with providing a service in the general economic interest, including the reliable and efficient public distribution of electricity at the lowest possible cost. For the performance of its task the SEP concluded three long-term electricity purchase contracts in 1989 and 1990:

[68] From 1949 to 1998, the SEP was the manager of the national interconnecting grid, and was responsible for deploying power plants in the most economically efficient manner. <http://www.tennet.eu/nl/index.php?id=107> accessed 06 May 2014

- In 1989 with EDF for the purchase of 600 MW per annum until 2002 and of 750 MW per annum from 2002 to 2009,

- In 1989 with Preussen Elektra AG for the purchase of 300 MW per annum up to 2005,

- In 1990 with Vereinigte Elektrizitatswerke Westfales AG for the purchase of 600 MW per annum up to 2003.

The duration of these contracts extended beyond the time that the markets were opened up for competition.

Following the transposition of the first electricity directive, Directive 96/92/EC, into national law through the 1998 Law, the exclusive right of the SEP was abolished. The operation of the high-voltage network was transferred to the SEP's subsidiary, TenneT, which became a national network operator in 1998 and assumed ownership of the national network in 2001.[69]

According to the 1998 Law, transmission networks are operated by TenneT under the supervision of the Director of the Service for Implementation of Control of Energy Supply (hereafter the DTE). Article 36 of the 1998 Law made the DTE responsible *inter alia* for laying down the conditions for access to the systems. On 12 November 1999, the DTE adopted conditions governing the operation of the system for the cross-border transmission of electricity, the System Code.[70]

In order to enable the SEP to fulfil its duty arising from the contracts, in 2000, the System Code, enacted the SEP preferential status in relation to the allocation of importation capacity after market liberalisation started. 1500MW out of the 3200MW of available electricity import capacity on cross-border lines was reserved on a preferential basis for the SEP. Moreover, a preferential access right was granted to the SEP after 2000 by the Overgangswet (Transitional Law on the electricity generation sector). The Overgangswet provided that at the most 900 MW until 31 March 2005, and at the most

[69] The 1998 Law designated TenneT as the independent manager of the national transmission grid. TenneT is responsible for ensuring a reliable, high-quality supply of electricity in the Netherlands. <http://www.tennet.eu/nl/index.php?id=107> accessed 06 May 2014

[70] Case C-17/03 *VEMW* [2005] ECR I-4986

750 MW cross-border transmission capacities from 1 April 2005 to 31 March 2009 for the transmission of electricity, were allocated to the designated company, i.e. the SEP, where such transmission served to implement the energy purchase agreements concluded in 1989 and 1990.[71]

Other distribution companies operating in the market considered that the national provision distorted competition to their detriment and constituted an infringement of the principle of equal treatment contained in Article 7(5) of Directive 96/92/EC.[72] As a result, this preferential status offered to the SEP was challenged before the DTE by the distribution companies. The DTE recognised that the preferences granted to the SEP constituted obstacles to the proper functioning of the electricity market. It considered that, since competition in the generation market was limited in the Netherlands, a reservation for an outstanding period of cross-border transmission would be a serious restriction on import facilities, and thus, on trade as well as the competition level in the electricity market. Nevertheless, with regard to the legislation in force at the time that the contracts were concluded, and also pursuant to a service of general economic interest, the DTE refused the claim. Furthermore, it was found that interrupting the existing contracts would amount to unacceptable interference regarding the legal certainty of the parties, as well as constituting a significant financial loss.

Following the dismissal of the claim of the distribution companies by the DTE, they lodged an appeal against that decision with the Administrative Court for Trade and Industry. The claimants stated *inter alia* that the reservation of the import capacity for the electricity purchase contracts concluded by the SEP, which was no longer providing

[71] Case C-17/03 *VEMW* [2005] ECR I-4986, para.26; According to Article 13(1) of the Overgangswet (Transitional law on the electricity generating sector), the system operator shall allocate the designated company a maximum of 900 MW until 31 March 2005 and a maximum of 750 MW from 1 April 2005 to 31 March 2009 for the transport of electricity where such transport serves to implement the agreements concluded in 1989 and 1990 between the designated company and Electricite de France, Preussen Elektra AG and Vereinigte Elektrizitatswerke Westfales AG as far as these agreements are still in force.

[72] Article 7 of Directive 96/92/EC for electricity [1996] OJ L 27/20; According to Article 7(1), Member states shall designate or shall require undertakings which own transmission systems to designate a system operator to be responsible for operating, ensuring the maintenance of, and developing the transmission system in a given area in order to guarantee security of supply. Article 7(3) adds that the system operator shall be responsible for ensuring a secure, reliable and efficient electricity system. Article 7(5) reinforces non-discrimination between system operators and other undertakings by stating that 'The system operator shall not discriminate between system users or classes of system users, particularly in favour of its subsidiaries or shareholders.'

services of general economic interest after the opening-up of the market, was in breach of the prohibition of discrimination laid down in both European and national law. The decision of the DTE, they continued, also ignored the interest in promoting the development of trade in the market in electricity.

The Court of Justice examined the case as a result of a request by the Administrative Court for Trade and Industry for a preliminary ruling under Article 267 TFEU.[73] The questions asked by the Administrative Court regarding a preliminary ruling were, first, whether Article 106 TFEU[74] could justify granting a company, which was formerly entrusted with the operation of services of general economic interests and which entered into certain commitments in connection with such an operation, a preferential access right to enable it to fulfil those commitments after the particular economic task assigned to it had been completed. Secondly, the Administrative Court asked whether the granting of special rights in order to honour long-term electricity purchase contracts concluded in connection with a particular public task was compatible with the prohibition of discrimination contained in Article 7 of Directive 96/92/EC.[75]

[73] Article 267 TFEU: "The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:
(a) the interpretation of the Treaties;
(b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;
Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.
Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.
If such a question is raised in a case pending before a court or tribunal of a Member State with regard to a person in custody, the Court of Justice of the European Union shall act with the minimum of delay."

[74] Article 106 TFEU: "1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate Directives or decisions to Member States."

[75] Case C- 17/03 *VEMW* [2005] ECR I-4986, para. 24

According to the Advocate General, the problem in the case was not the scarcity of capacity but the method of distribution of this capacity. The network capacity concerned was distributed between market operators in favour of the SEP.[76] A preferential allocation of import capacity could not be justified per se, as the SEP argued, on the basis of the existing long-term supply contracts that were concluded on the grounds of services of general economic interest, which had expired before the right of preferential access to import capacity was granted. However, an objective justification for the preferential treatment afforded to the SEP could be construed due to a combination of three factors. First, regarding the requirement for equal treatment in Article 7(5) of Directive 96/92/EC, preferential treatment was conditionally offered to the SEP through national legislation with a view to honouring the long-term purchase contracts that were concluded to fulfil public interest commitments before the Directive came into force.[77] Second, community law did not preclude market operators from signing long-term electricity supply contracts after the initiation of the Directive.[78] Finally, the preferential treatment did not exceed the degree required in order to achieve its intended objective.[79]

As a result, the Advocate General argued that the prohibition of discrimination under Article 7 of Directive 96/92/EC did not preclude the preferential allocation of electricity transport capacity based on a national legislative provision in so far as that preferential treatment did not exceed the bounds necessary to fulfil the long-term purchase contracts and in so far as those contracts were not contrary to EU law, in particular EU competition law. It was also indicated that there was no need for a separate examination related to any possible discrimination within the meaning of Article 102 TFEU, since the preferential treatment offered to the SEP was justified on the objective

[76] Case C-17/03 *VEMW* [2005] ECR I-5016, para.52
[77] The Transitional Law of 2001 created a link between its proposed preferential allocation of importation capacity and the long-term purchase contracts between the SEP and foreign electricity producers. It made the preferential allocation conditional on the existence of such contracts and expressly provides for the grant of a preferential allocation in order to honour those contracts.
[78] Directive 96/92 did not contain express rules with regard to the existing long-term electricity supply contracts. Yet, apparently Regulation (EC) No 1228/2003 proceeded that such contracts are valid in principle as long as priority access rights is not assigned to those contracts which breach European competition law. Case C-17/03 *VEMW* [2005] ECR I-5016 para.63
[79] Case C-17/03 *VEMW* [2005] ECR I-5016, para.60-61

grounds.[80] It would have been inconsistent to conclude that there was objective justification for dissimilar treatment of the market participant while at the same time considering the same rule to be the cause of an abuse within the meaning of Article 102 TFEU.[81]

In contrast to the opinion of the Advocate General, the Court of Justice deemed the priority access right granted to the SEP to be discrimination within the meaning of Article 7(5) of Directive 96/92/EC. Accordingly, the task of providing services of general economic interests and the possible financial loss of the SEP that would result from the cancellation of the long-term energy supply contracts could not be accepted as objective justifications for the capacity on the network reserved for the SEP on a priority basis. Besides, the Court indicated that in order to eliminate some of the consequences of liberalisation, a transitional regime provided under Article 24 of Directive 96/92/EC[82] could have been implemented.[83] Under that provision Member States may seek derogations from Article 7 and 16,[84] in the case where commitments given before the entry into force of the Directive may not be honoured on account of its provision.

In accordance with Article 24 of Directive 96/92/EC, applications for derogation had to be submitted by Member States no later than one year after the Directive came into force.[85] However, the Netherlands did not apply for a temporary derogation from the application of Article 7 and 16 of Directive 96/92/EC. According to the Court of Justice, a

[80] Case C-17/03 *VEMW* [2005] ECR I-4986, para.111
[81] Case C-17/03 *VEMW* [2005] ECR I-4986, para.112
[82] Article 24 (1) of Directive 96/92:'Those Member States in which commitments or guarantees of operation given before the entry into force of this Directive may not be honoured on account of the provisions of this Directive may apply for a transitional regime which may be granted to them by the Commission, taking into account, amongst other things, the size of the system concerned, the level of interconnection of the system and the structure of its electricity industry. The Commission shall inform the Member States of those applications before it takes a decision, taking into account respect for confidentiality. This decision shall be published in the Official Journal of the European Communities.'
[83] Case C-17/03 *VEMW* [2005] ECR I-5016, para.57
[84] Article 16 of Directive 96/92/EC precludes any discriminatory conduct and asks Member States to choose one of the following options: negotiated third party access or a single buyer procedure. In other words, Article 16 organises transparent and non-discriminatory capacity allocation of cross-border transmission networks.
[85] This provision of the first regulatory package was changed through the adaptation of the second regulatory Directives. Derogation from third party access was provided only for the small isolated systems under Article 26 of Directive 2003/54/EC concerning common rules for the internal market in electricity [2003] OJ L 176/37. Such derogation under the second Directive is the same under Article 44 of the third Directive for electricity, Directive 2009/73/EC.

Member State could not unilaterally decide to disregard Article 7 or 16, because, otherwise, the procedure, criteria and limits set out in Article 24 would be meaningless.[86] The SEP, therefore, could not benefit from the derogation.[87]

On the other hand, the Advocate General argued that Directive 96/92/EC should be implemented in the light of the principles of legal certainty and the protection of legitimate expectations, which requires, in particular, that the 'substantive rules of Community law must be interpreted … as applying to situations existing before their entry into force only in so far as it clearly follows from their terms, objective, or general scheme that such an effect must be given to them'.[88] By virtue of Article 28 of the Directive, there was nothing in the Directive extending its validity, to justify the conclusion that it was intended to apply to situations existing prior to the enactment of it. In other words, there were no clear and certain provisions in Directive 96/92/EC in relation to the continued existence of long-term purchase contracts concluded in 1989 and 1990 before the Directive came into force.[89] Therefore, Directive 96/92/EC should not be interpreted as having a retroactive effect. From this point of view, the SEP claimed that it was entitled to fulfil the international contracts by reason of the principle of the protection of legitimate expectations and of legal certainty.

Nevertheless, the Court of Justice objected to the SEP pleading the principle of the protection of legitimate expectations, because the SEP, as a prudent and circumspect trader, could have foreseen that the adoption of a Community measure was likely to affect its interests.[90] According to the settled case law, any trader on the part of whom an institution has promoted reasonable expectations may rely on the principle of the

[86] Case C-17/03 *VEMW* [2005] ECR I-5016, para.61
[87] The Court of Justice argued that a different application, first, would risk endangering the transition from a monopolistic market in electricity to an effective internal market. The former monopolies could be protected from competition beyond the degree that the Community legislator considered appropriate in the Directive for the purpose of reconciling the completion of the internal electricity market. Secondly, it would compromise the objective of Article 24 with regard to equal treatment for the former monopolies that were in similar situations to that of the SEP. In order to safeguard the performance of the long-term contracts concluded prior to the liberalisation of the electricity markets Member States could confer an advantage on previously national incumbents if they were allowed to apply the Article outside of the procedure and conditions laid down. See Case C-17/03 *VEMW* [2005] ECR I-5016, para.62 and 63
[88] Case C-21/81 *Daniel Bout and BV I. Bout en Zonen* [1982] ECR 381, para.13
[89] Case C-17/03 *VEMW* [2005] ECR I-4986, para.64
[90] Case C-17/03 *VEMW* [2005] ECR I-5016, para.74

protection of legitimate expectations.[91] However, if a prudent and circumspect trader could have foreseen that the adoption of a Community measure was likely to affect his interests he cannot plead that principle if the measure is adopted. Furthermore, traders cannot have a legitimate expectation that an existing situation that is capable of being altered by Community institutions in the exercise of their discretion power will be maintained. This is particularly true in an area such as the common organisation of the market, the objectives of which require constant adjustment in order to meet changes in economic circumstances.[92]

The Court of Justice reinforced this objection by stating that the first stage of market liberalisation, which began in the late 1980s with fundamental steps towards completing the internal energy markets by abolishing regional and national monopolies, gave signals of possible further liberalisation.[93] Therefore, it could not be suggested that the Community institutions created well-founded expectations on the part of the SEP that a monopoly for the importation of electricity into the Netherlands would be maintained or that the SEP would be allowed to enjoy a preferential right to use the network for the cross-border transmission of electricity until the expiry of the international contracts which had been entered into.[94] According to the Court of Justice, thus, the SEP, as a prudent and circumspect trader, should have foreseen that possible measures that could be adapted in order to liberalise the energy markets one step further would most probably affect its interests.

With regard to the principle of legal certainty, the Court of Justice claimed that the principle requires in particular that new legal rules imposing changes on market

[91] Cases C-73/02 and C-38/02 *Di Lenardo Adriano Srl, Dilexport and Ministero del Commercio con I'Estero* [2004] (not published in the ECR), para. 70; Case C-104/97 P *Atlanta AG and Others v Commission* [1999] ECR-I 6983, para. 55

[92] Case C-265/85 *Van den Bergh en Jurgens and Van Dıjk Food Products v Commission* [1987] ECR 1155 para.44; Case C-22/94 *The Irish Farmers Association and Others v Minister for Agriculture, Food and Forestry, Ireland and the Attorney General* [1997] ECR-I 1809, para.25; in both decisions, the Court of Justice deemed that, in the view of foregoing considerations on the market, a prudent trader ought to have anticipated possible legal or financial changes. Therefore, the plaintiffs could not plead the principle of the protection of legitimate expectations.

[93] Directive 90/547/EEC of 29 October 1990 on the transit of electricity through transmission grids [1990] OJ L 313, and Commission Communication COM(89) 336 final of 29 September 1989 on increased intra-community electricity exchanges

[94] Case C-17/03 *VEMW* [2005] ECR I-5016, para.78

participants are clear and precise so that they may be able to ascertain unequivocally their rights and obligations and take steps accordingly.[95] Moreover, the legislature should take into account the particular situations of the participants and provide adaptations to the application of these rules. These requirements were satisfied by Directive 96/92/EC under Article 24, which allows special situations of participants such as the SEP within the context of the liberalisation of the market in electricity to be taken into account. The Directive offered Member States the possibility of derogation from Article 7 of the Directive with regard to operating commitments or guarantees granted before the Directive entered into force.[96] Therefore, the SEP could not claim the circumstances in the case as justification for the priority access rights granted to it on the grounds of the principles of legal certainty and the protection of legitimate expectations.

To sum up, the Court of Justice assessed the legitimacy of the preferential access right given to the SEP in 1999 and 2000 by considering the historical reasons behind that right. In contrast to the assessment of the Advocate General, the Court of Justice found that this background, namely the existing long-term purchase contracts concluded in order to fulfil the task of the SEP to import electricity for public distribution, could not be a legitimate justification for the preferential access right. According to the Court, a Member State should not be able to prevent the Community from undertaking or pursuing the liberalisation of the market in electricity with void general economic interests. The Court as a result built its decision on Article 24 of Directive 96/92/EC, which provided an opportunity to Member States to adjust their national circumstances pursuant to the legal and economic changes within the Community. On the other hand, since the Court of Justice did not accept making long-term purchase contracts concluded by the SEP subject to preferential treatment as the Advocate General had, it did not analyse the lawfulness of the long-term purchase contracts or the preferential access right from a competition law point of view. However, it stressed that there was no obligation in the Directive to revoke the contracts. Nevertheless, according to the

[95] Case C-143/93 *Gebroeders van Es Douane Agenten v Inspecteur der Invoerrechten en Eccijzen* [1996] ECR I-431, para.27
[96] Case C-17/03 *VEMW* [2005] ECR I-5016, para.82

Court, it was clear that the Directive did not allow the rules to be breached on the grounds that such a breach was necessary in order to honour those contracts.

The judgment implies that preferential network reservations should be assessed on a case-by-case basis by taking into consideration the discriminatory aspect of them. If there is an objective justification behind these reservations their lawfulness is likely to be approved. In the case, however, the Court verified that to grant a priority access right on the basis of a legal context that expired after the enactment of the Directive and that could have been derogated from third party access under Article 24 of the Directive was discriminatory.[97] As a result, there was no need for an individual assessment in order to see the discriminatory nature of the preferential right, as the discriminatory nature of the legal provision granting the right was clear. However, if long-term preferential reservations stem from other factors rather than a former legal context, the discriminatory nature of the reservations should be examined on a case-by-case basis. Likewise, if the reason behind giving a preferential access right do not fall into the scope of Article 24 of the Directive, it is necessary to individually verify whether the preferential right amounts to discrimination for other market operators, and whether there is an objective justification.[98] This approach should apply to any preferential network reservations granted before or after the Directive came into force.

In 2006, almost a year after the decision, the Commission published a staff working paper on the effects of the *VEMW* judgement.[99] In the paper, the Commission claimed that 'as a consequence, the grant to an undertaking of preferential transmission or distribution capacities must be considered as being discriminatory and is precluded by Directive 2003/54/EC and Regulation (EC) No 1228/2008'.[100] It continued by stating that, 'under the Directive and the Regulation, only the priority allocation of transmission or distribution capacities is incompatible with Community rules. Long-term supply contracts are not per se invalid under the Court judgment, although they cannot be

[97] Case C-17/03 *VEMW* [2005] ECR I-4986, para. 71
[98] K. Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Wolters Kluwer 2011), pp. 224-226
[99] Commission, 'Staff Working Document on the Decision C-17/03 of 7 June 2005 of the Court of Justice of the European Communities' SEC (2006) 547
[100] *Ibid*, para. 5

subject of preferential treatment'.[101] This comment may illustrate that the Commission interpreted the judgment to mean that granting preferential access should be categorically prohibited unless there has been derogation from third party access. It seems that this interpretation goes too far, since the Court of Justice did not actually categorically forbid long-term preferential network reservations.[102] On the contrary, the Court highlighted the importance of the individual assessment of preferential reservations. Accordingly, as mentioned before, priority access rights should be handled on a case-by-case basis in order to assess whether they are discriminatory as well as whether there is an objective justification for providing such rights.

In addition, according to the Commission, the principles of the protection of legitimate expectations and of legal certainty could not be justifications to derogate from the non-discriminatory rules contained in Directive 96/92/EC. Again, the Court of Justice did not mean that. What the judgment of the Court of Justice amounted to is that a market operator could not expect the legislation to remain unchanged. Yet, it could expect that special circumstances of those affected by the change would be considered, and that an adaptation period would be provided within the amended legislation.[103] Since the letter was provided under Article 24 of the Directive the Court of Justice did not accept any argument based on the principles of the protection of legitimate expectations and of legal certainty. As there will be situations which cannot be handled under the scope of Article 24, it cannot be stated that the protection of legitimate expectation and legal certainty should be kept out of the consideration in the cases of preferential network reservations.

Within the judgement of *Republic of Slovakia*, the Advocate General showed the extent to which the interpretation of the *VEMW* judgment by the Commission went far-beyond what the Court deemed appropriate.[104]

[101] *Ibid*, 7
[102] K. Talus, 'First Interpretation of Energy Market Directives by the European Court of Justice-Case C-17/03, Vereniging voor Energie' (2006) Vol.24 Journal of Energy and Natural Resources Law 39, pp. 46-48
[103] *Ibid*, 48
[104] Case C-264/09 *Slovak Republic v Commission* [2011] ECR I-8065

2. The *Republic of Slovakia* Judgment of the European Court of Justice

In an infringement proceeding initiated by the Commission before the Court of Justice against the Slovak Republic under Article 258 TFEU,[105] the Commission claimed that Slovakia had failed to fulfil its obligation under Article 9(e) and 20(1) of the second electricity Directive, Directive 2003/54/EC, which concerned non-discriminatory third party access to the transmission system on the basis of published tariffs.[106] The concern of the Commission stemmed from the conditions of a private law contract between a Swiss company, ATEL, and a state-owned network operator in Slovakia, SEPS. Pursuant to the contract, ATEL was supposed to pay over half of the construction costs of the still-to-be-constructed line from Poland to Slovakia, in return for priority access to the line for a defined and non-renewable period of 16 years. In bringing the case before the Court of Justice, the Commission built its opinion on the *VEMW* judgment, and alleged that the priority access given to ATEL was contrary to Slovakia's obligations under Article 9(e) and 20(1) of Directive 2003/54/EC. According to the Commission, granting preferential capacity for cross-border transmissions was precluded by Directive 96/92/EC unless this preferential treatment were authorised by the derogation set out in Article 24 of Directive 96/92/EC.

[105] The Commission, on the basis of Article 258 TFEU, may start an infringement proceeding against a Member States that does not fulfil its obligations arising from EU Law. Under the Treaty, the Commission is responsible for ensuring that EU law is correctly applied. Therefore, where a Member State fails to comply with EU law, the Commission can act on its own initiative or in response to complaints to bring this infringement to an end under Article 258 TFEU. Where it is necessary, the Commission may refer the case to the Court of Justice. With regard to the procedural steps under Article 258 TFEU, the Commission may negotiate with the Member State concerned in order to make it to properly transform EU law into the national law systems before bringing the case to the Court.
Proceedings under Article 258 TFEU seems similar to the process under commitment decisions as there is negotiation between the Commission and Member States or/and undertakings concerned under both proceedings. However, within the former, the Commission is limited with the exact provisions of EU law, whereas within the latter the discretion of the Commission is wider.

[106] Article 9 of the Directive lists the tasks of transmission system operators. According to Article 9(e), 'each transmission system operator shall be responsible for ensuring non-discrimination as between system users or classes of system users, particularly in favour of its related undertakings'. Article 20 of the Directive, on the other hand, organises the access to the system through third party access. Article 20(1) states that 'Member States shall ensure the implementation of a system of third party access to the transmission and distribution systems based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users. Member States shall ensure that these tariffs, or the methodologies underlying their calculation, are approved prior to their entry into force in accordance with Article 23 and that these tariffs, and the methodologies — where only methodologies are approved — are published prior to their entry into force.'

However, Advocate General Jaaskinen did not agree with the Commission, and criticised its argument from two different perspectives. First, according to the Advocate General, it would be injustice to categorically accept the noncompliance of preferential reservations with third party access as a breach of EU law unless there is derogation given by the Commission, because the requirement for derogation by Member States may not be technically realisable for every situation. Member States were able to request derogation from third party access under Directive 96/92/EC for one year after the Directive entered into force, i.e. until 20 February 1998. In the case of *Republic of Slovakia*, the contract concerned was concluded in 27 October 1997 between ATEL and SEPS. On 16 April 2003, Slovakia signed the Treaty of Accession, and in 1 May 2004 it joined the EU. Meanwhile, on 16 June 2003, Directive 2003/54/EC and Regulation 1228/2003 were published, and on 4 August 2003 these entered into force. Therefore, when the investment contracts were concluded Slovakia was not even a member of the EU. Thus, it was not expected that Slovakia would apply for derogation from third party access under Directive 96/92/EC or that it would amend the contract concerned pursuant to Directive 2003/54/EC. Second, considering previous decisions in which, given the necessity and importance of investments in the energy sectors, long-term priority access rights granted in order to secure investments were accepted as efficiency gains from a competition law point of view, the observation of the Commission that priority access is not allowed unless permitted by a corresponding derogation, does not correspond with the idea of balancing market liberalisation with the need to attract and protect investments.[107]

Besides, the Advocate General highlighted that ATEL's preferential access right amounted to discrimination within the meaning of Directive 2003/54/EC, and could not be justified on the basis of its financial participation. This priority right granted to ATEL was not covered by an exemption from the obligation of third party access in accordance with the official derogation procedures of Regulation 1228/2003 for

[107] Notice pursuant to Article 19(3) of Council Regulation No 17 concerning Case COMP/E-3/37921 - *Viking Cable* (2001) OJ C 247/04; See Commission, *XXXIIIrd Report on Competition Policy 2003*, SEC(2004)658 final, para. 86-100; Case C-264/09 *Slovak Republic v Commission* [2011] ECR I-8065, para.48-54

electricity.[108] Thus, the Advocate General considered that, in the absence of an official exemption, allowing investors to be treated differently would amount to permitting a small group of undertakings to buy priority access, which was against the very aims of Directive 2003/54/EC and of EU energy policy in general.[109]

After arguing that preferential treatment violated the Directive, the Advocate General next examined whether such discrimination was objectively justified. Consequently, it was found that, with regard to Article 351(1) TFEU,[110] the priority access rights had been granted before the accession of the Slovak Republic to the EU, so Slovakia could not be held to be in breach of its obligation under Articles 9 and 20 of Directive 2003/54/EC. Moreover, it was pointed out that this conclusion was also compatible with the derogation provisions set out in Article 24 of Directive 96/92/EC and Article 7 of Regulation 1228/2003.

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[108] According to Article 7(1) of Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchange in electricity [2003] OJ L 176/1, if there is an investment in a cross-border transmission network, this network can be exempted from third party access. In other words, the investor may have a preferential access right under certain conditions. In this regard, Article 7(1) of the Regulation states that 'New direct current interconnectors may, upon request, be exempted from the provisions of Article 6(6) of this Regulation and Articles 20 and 23(2), (3) and (4) of Directive 2003/54/EC under the following conditions:
(a) the investment must enhance competition in electricity supply;
(b) the level of risk attached to the investment is such that the investment would not take place unless an exemption is granted;
(c) the interconnector must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that interconnector will be built;
(d) charges are levied on users of that interconnector;
(e) since the partial market opening referred to in Article 19 of Directive 96/92/EC, no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnector;
(f) the exemption is not to the detriment of competition or the effective functioning of the internal electricity market, or the efficient functioning of the regulated system to which the interconnector is linked.'

[109] Case C-264/09 *Slovak Republic v Commission* [2011] ECR I-8065, para.57

[110] Article 351 TFEU: 'The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty.
To the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude.
In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under this Treaty by each Member State form an integral part of the establishment of the Community and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States.'

The Court of Justice concluded the investigation by deeming that preferential access was granted to ATEL regarding the investment contract, and, under Article 351(1) TFEU, it was not affected by the provision of Directive 2003/54/EC.[111] In other words, the Court of Justice justified the non-compliance with third party access through international protection of a foreign investor's priority access right to the network.

In contrast to the Advocate General, the Court of Justice did not verify whether ATEL's priority access right was against the third party access obligation. Nevertheless, the judgment is significant in terms of clarification of the law. First of all, the case reviewed the strict interpretation of the Commission. It illuminated that long-term priority access rights are not inherently and categorically illegal. Therefore, it was pointed out that these rights should be assessed individually. Secondly, it showed that while assessing the legitimacy of long-term priority access rights, possible objective justifications should be considered on a case-by-case basis. This approach will provide regulatory stability for investors to have a long-term pay-back period for capital intensive investments. Thirdly, it was indicated that even in situations where an investment is considered as an objective justification for a preferential access right, an exemption from third party access should be officially provided by the Commission in order to prevent large-scale undertakings from buying preferential rights by making investments without fulfilling the conditions listed in Regulation 1228/2003. Finally, the Advocate General highlighted a very particular fact here. It stated that since the preferential access right was granted before Slovakia joined the EU, Slovakia was not responsible for the non-implementation of the provisions of Directive 2003/54/EC.

Overall, the *VEMW* and *Republic of Slovakia* judgments show the appraisal of preferential cross-border network reservations under EU secondary law through infringement procedures. Both indicate that priority access rights that have granted should be examined on a case-by-case basis by taking into account how and why these rights are provided with the consideration of the tension between scarcity of cross-border transmission network capacity, i.e. the necessity of investments in these networks, and the objective of the creation of a single energy market in the EU. The

[111] Case C-264/09 *Slovak Republic v Commission* [2011] ECR I-8065, para.51

next section will add another dimension to this discussion by evaluating long-term preferential network reservations on the basis of EU competition law.

B. The Approach of the European Commission of Preferential Network Reservations under EU Competition Law

The decisions examined here will show that competition concerns related to preferential network reservations can also derive from abusive conduct by vertically integrated undertakings acting in favour of their affiliated supply firms. In this circumstance, the investigations are carried out by the Commission under the scope of the essential facilities doctrine. In addition, the cases will demonstrate that if a priority access right is granted for the sake of an investment in cross-border transmission infrastructure the Commission will finalise the investigation without a prohibition decision since the investment is recognised as an efficiency gain, i.e. an objective justification under Article 102 TFEU. After the assessment of the antitrust investigations of the Commission, the chapter will continue with a discussion on the possibility of the acceptance of long-term supply contracts as objective justification for preferential network reservations under Article 102 TFEU.

1. The Assessment of Preferential Network Reservations under Article 102 TFEU: *GDF Suez* and *E.ON Gas*

As mentioned before, the monopolisation of cross-border transmission networks through granting long-term priority access rights can be assessed under Article 102 TFEU, depending on the market power of the right holders. An abuse can arise where a system operator applies dissimilar conditions to equivalent transactions with customers, thereby placing other market participants at a competitive disadvantage. Therefore, (i) freeing some transmission capacity that is mainly blocked by preferential network reservations, (ii) alleviating capacity related foreclosure, and (iii) eliminating dissimilar conditions for other market players, have become the priority aims of the Commission under such antitrust investigations.[112]

[112] Originally coming from US jurisprudence, the essential facilities doctrine is used as a means to stimulate effective competition between firms. The European acceptance of the essential facilities doctrine is coherent with most of the case law on unilateral refusal to deal. *Commercial Solvent* (Joint

The *GDF Suez* and *E.ON Gas* decisions of the Commission can be given as two important examples of capacity release in order to create room for potential competitors.[113] They do not directly address the problems arising from the connection between pre-liberalisation long-term purchase contracts and long-term preferential network reservations. Yet, they do point out that the Commission pursues the approach of the Court of Justice adopted in *VEMW* in terms of the strict implementation of third party access. Additionally, the decisions clearly indicate 'the internalisation of the new trend of moving from the traditional long-term monopoly nature of energy sectors towards a competitive market model'.[114]

a) The *GDF Suez* and *E.ON Gas* Decisions

In the *GDF Suez* and *E.ON* decisions, the Commission claimed that the undertakings concerned may have abused their dominant positions within the meaning of Article 102 TFEU in the form of refusal to supply.[115] In *GDF Suez*, the Commission initiated a formal antitrust proceeding after finding that certain behaviour by GDF Suez might have prevented or reduced competition in downstream supply markets through long-term reservations of transport capacity and underinvestment in import infrastructure.[116] The competition investigation was addressed to GDF Suez and its subsidiaries that own and operate the gas transport network in most of France.

Cases C-6 & C-7/73 *Istituto Chemioterapico Italiano Spa and Commercial Solvent Corp. v Commission* [1974] ECR 223) showed that in some circumstances, refusal to supply a competitor with an essential input could be considered a violation of Article 102 TFEU. Three main conditions for application of the essential facilities doctrine are defined in *Bronner* (Case C-7/97 *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG. v Commission* [1998] ECR I-7791): (i) access must be essential for carrying out the applicant's business, (ii) access must be denied without objective justification, (iii) the refusal must prevent any competition in the related market. The scope of the essential facilities doctrine is extended by the European antitrust authorities in infrastructure industries, see the *GVG* decision (Case COMP/37.685 Commission Decision [2003] OJ L 11/17).

[113] *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]

[114] A. De Hauteclocque and K. Talus, 'Third Party Access: A Comparative Study on Access Regimes in EU Electricity Grids and Natural Gas Pipelines' (2011) Vol.9(3) Oil, Gas and Energy Intelligence <http://www.ogel.org/article.asp?key=3128> accessed 21 January 2013, p. 20

[115] In energy, the finding of dominance and its abuse does not differ markedly from the application of these concepts in any other sector. A transmission system operator is generally considered dominant in the relevant market as it controls a facility with strong natural monopoly characteristics, access to which is required to compete in the relevant markets.

[116] Commission, 'Antitrust: Commission opens formal proceedings against Gas de France concerning suspected gas supply restrictions' MEMO/08/328

In the preliminary assessment, the Commission demonstrated that GDF Suez held a dominant position in the gas import and supply markets. The Commission's analysis showed that there were several barriers to entry to the French market because of difficulties relating to the international purchase of gas, bottlenecks in import capacity and limited access to storage. GDF Suez's strong position in the gas supply markets, achieved by vertical integration throughout the economic chain, was guaranteed for the foreseeable future regarding its reservation of long-term capacity. In addition, GDF Suez's gas infrastructure and import capacity, including interconnection capacity, constituted an essential input, as access to this infrastructure and import capacity was an objective requirement in order to be able to supply gas in the balancing zones of GDF Suez's network. Also, it was impossible to reproduce a new infrastructure that could constitute an effective competitive constraint on GDF Suez's infrastructure, because of technical, legal and economic barriers.

The Commission considered that GDF Suez might have abused its dominant position by foreclosing for a long period access to gas import capacity in the balancing zones, thereby restricting competition in the markets for the supply of gas.[117] This capacity had been reserved for historical reasons and assigned to GDF Suez without any transparent or non-discriminatory procedure. There was, therefore, considerable unsatisfied demand from third party shippers. As a result, market entry for potential competitors in the gas wholesale market was blocked. Moreover, a strategic limitation of the investment by GDF Suez in existing import capacity was identified by the Commission as a refusal to supply, as this was making it even more difficult for third parties to import gas into France.[118]

To address these concerns, GDF Suez proposed to release approximately 10% of the total long-term reservations of gas import capacity into France, including both LNG re-

[117] Cross-border balancing means both the exchange and trade of flexible gas between neighbouring balancing zones in order to facilitate market integration and the arrangements between network users to trade out their imbalances across two adjacent balancing zones. A balancing zone is defined as an entry-exit point into a balancing system. As a consequence, if an import capacity into a balancing zone is foreclosed, potential competitors cannot enter the balancing market where they can sell their gas in order to fill short market positions of other market operators. See ERGEG, Framework Guideline on Gas Balancing in Transmission Systems, 2011 Ref: E10-GNM-13-03, p. 9

[118] *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]

gasification terminals and pipelines, in favour of third-parties, and to continue to reduce the share of the reservations to below 50% by 2014.[119] Within the limits of Regulation 715/2009, GDF Suez was permitted to book interruptible and short-term capacity.[120]

Similar to GDF Suez, E.ON held a dominant position in the gas transport market as well as in the wholesale and retail supply markets.[121] In the preliminary assessment, the Commission claimed that E.ON may have abused its dominant position by way of long-term bookings on its gas transmission system.[122] It was also demonstrated that E.ON had booked, on a long-term basis, until 2019, most of the firm and freely available capacities at the entry points giving access to its grid. As a result, there was no gas transmission capacity available to competitors of E.ON wanting to transport gas into E.ON's network. Consequently, they were faced with a permanent capacity bottleneck, which severely limited the volume of gas transported to their actual or potential customers.

The Commission concluded that E.ON's long-term reservations amounted to a refusal to supply an essential input and constituted an abuse of its dominant position. Moreover, the Commission deemed that the use of network capacity by the essential facility holder for its own supply business was not sufficient to objectively justify an abuse under Article 102 TFEU. Following the investigations, E.ON proposed to commit to a significant, structural reduction of its long-term gas capacity reservations. The capacity release corresponded to around 15% of entry capacities into its gas transmission grid. In addition, there will be further reduction in the high-caloric gas

[119] Commission, 'Antitrust: Commission accepts commitments by GDF Suez to boost competition in French gas market-frequently asked questions' MEMO/09/536

[120] Regulation No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation No 1775/2005 [2009] OJ L 211/36

[121] E.ON was the holder of a natural monopoly transmission grid through its subsidiary EGT. In addition, in the wholesale market, E.ON was the leading supplier in its grid area with very high market shares. E.ON was also dominant in the market for retail supplies to industrial customers within its grid area.

[122] The Commission, in its competition investigation, addressed E.ON and its subsidies E.ON Ruhrgas and EGT. E.ON is a German undertaking active in the production, transportation, distribution and supply of energy. E.ON Ruhrgas, a wholly-owned subsidiary of E.ON, serves regional and local distributors, industrial customers and electricity generation plants. EGT, a wholly-owned subsidiary of E.ON Ruhrgas, owns and operates E.ON's gas transmission system in Germany.

market area (up to 50%) as well as in its grid for low-caloric gas (up to 64%) by 2015.[123] Similar to *GDF Suez*, the decision did not prevent E.ON from booking short-term and interruptible capacity. Moreover, E.ON can book long-term capacities under the condition that its overall booking shares decrease over time until reaching the thresholds of 50% and 64% by 2015.[124]

In both decisions, the commitments were accepted by the Commission in order to achieve an immediate and long-term release of capacity, which would also result in a permanent structural change in the market given the duration of the commitments (*quasi* structural effect). As a result of the long-term capacity releases, the capacities would be handed back on a lasting basis, which would guarantee that the effect of the commitments would not be dependent on the companies' future behaviour.[125] In this sense, it was expected that the commitments would help to promote the allocation of the capacity of cross-border pipelines in Germany and France on the basis of non-discriminatory and transparent capacity allocation and congestion management methods in compliance with *ex-ante* regulatory rules. Therefore, it can be stated that the Commission seems to have achieved a regulatory objective through commitment-based enforcement.

Similarly, it seems that the Commission attempts to strengthen the third party access regime by imposing behavioural remedies that can improve transparent and non-discriminatory capacity allocation and congestion management in the energy markets. For instance, in the *Marathon* settlement,[126] the concern was the joint refusal to grant access to continental European gas pipelines by a group of European gas companies. The case was triggered by a company, Marathon, a Norwegian subsidiary of a US oil and gas producer. Although the complaint was withdrawn after Marathon and the

[123] Commission, 'Antitrust: E.ON's commitments open up German gas market to competitors' IP/10/494
[124] *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]
[125] Commission, 'Antitrust: Commission accepts commitments by GDF Suez to boost competition in France gas market-frequently asked questions' MEMO/09/536
[126] Commission, 'Commission's competition services settle Marathon case with Thyssengas' IP/01/1641; Commission, 'Commission's competition services settle Marathon case with Gasunie' IP/03/547; Commission, 'Commission's competition services settle Marathon case with German gas company BEB' IP/03/1129; Commission, 'Commission settles Marathon case with Gaz de France and Ruhrgas' IP/04/573

European companies reached a commercial settlement the Commission continued the investigation under EU competition law considering the interests of the Community.[127] In order to conclude the proceedings, the undertakings concerned proposed, first, with respect to congestion management, to introduce a use-it-or-lose-it principle and to develop a secondary market in which capacity holders could trade capacity rights acquired from the pipeline owners. Second, so as to improve transparency of their access regimes, they agreed to publish on their websites the contracted and available capacity at all entry and exit points, both for internal and external connections. Third, they committed to improving their handling of access requests in order to limit the reasons justifying refusals. The Commission welcomed the commitments as they could contribute to better functioning of the gas transmission market. However, these commitments went beyond the existing regulatory provisions at this stage of the liberalisation.[128] The decision was superior to current legislation, and also, showed that the mandatory introduction of a regulated third party access regime was a necessity for the completion of market liberalisation in the energy markets. The decision itself could be recognised as a reflection of the intention of the Commission as stated by Mario Monti, the previous Competition Commissioner, that: "… competition policy can contribute effectively to ensure a fair and non-discriminatory access to national gas pipelines", and "… the Commission is fully committed to foster the liberalisation process by chasing anticompetitive behaviour".[129]

All of these cases show that the application of the essential facilities doctrine in the energy sectors is not limited to refusal to supply cases, but is extended to discrimination, transparency requirements, and inadequate investment and so on. The extension of the doctrine also appears to be a consequence of the deficiencies of market regulation. The problems in the energy markets remain the same: (i) transparent and non-discriminatory methods to allocate the capacity are not implemented efficiently and effectively; and, (ii) ownership requirements are not fulfilled. Hence, vertically integrated undertakings can still take advantage of their transmission systems to protect

[127] Commission, 'Commission's competition services settle Marathon case with Thyssengas IP/01/1641
[128] This was before access Regulation 1775/2005 for gas transmission networks entered into force.
[129] Commission, 'Commission's competition services settle Marathon case with German gas company BEB' IP/03/1129

or strengthen the market positions of their affiliated arms in relevant markets.[130] Therefore, it seems that the Commission tends to use antitrust investigations in order to eliminate the market deficiencies deriving from insufficient and inefficient implementation of sector-specific regulatory provisions. As seen in the above-mentioned decisions, the Commission attempts to facilitate the proper implementation of third party access and vertical unbundling, or widen the limits of these regulatory rules, in order to improve the market regulation one step further. However, this strategic behaviour by the Commission might be detrimental rather than beneficial to the future of the energy markets given that it could increase legal uncertainty. Legal uncertainty, in particular in the recently liberalised energy markets, could ultimately decrease the incentive of market operators to invest and reduce the number of new entrants. Hence, it may hinder market integration and competition, as will be discussed within the next chapter.

Other than the *GDF Suez* and *E.ON* decisions, several antitrust investigations show that the Commission has a different approach to preferential network reservations if certain efficiencies are gained from these reservations. Apparently, in some circumstances, the preferential allocation of cross-border transmission capacity can be objectively justified. For instance, a possible objective justification for such unequal treatment might be an investment in transmission capacity. The essential element here is that the competitive disadvantage to competitors of long-term preferential access is counterbalanced by the investment in transmission infrastructure. As will be seen below, it is clear that long-term preferential reservations seem to be objectively justified when tied to a new investment in cross-border capacities. After that, there will be a discussion on other possible objective justifications, such as long-term supply contracts with efficiency gains.

2. Investment in Capacity of Cross-border Interconnectors vs. Priority Access Rights: *Viking Cable* and *UK-France Submarine Cable*

The case law indicates that, under certain circumstances, to grant a priority access right to a company with market power may not be an infringement of EU competition law, if

[130] Commission, *Report on Competition Policy 2012*, COM(2013) 257 final, p. 6

there is an investment that can be recognised as an efficiency gain that objectively justifies this preferential right.[131]

In *Viking Cable*, in 2000, the Commission received a notification pursuant to former Regulation 17/62 of three agreements concluded between E.ON (a vertically integrated electricity company in Germany), Statkraft (a Norwegian state-owned company active in the production, supply and trade of electricity), and Statnett (a Norwegian state-owned company responsible for the operation of the national grid). The agreements concerned the creation and operation of a joint venture, Viking Cable, for the construction and operation of a new sub-sea cable between Norway and Germany for the transmission of high-voltage electricity.[132]

According to the agreements, Viking Cable would be owned by Statnett and E.ON and would have a transmission capacity of 600 MW. [133] The agreements provided for an exchange of electricity between Norway and Germany. The power delivery would take place from Statkraft to E.ON for a maximum output of 600 MW and 1200 GWh per year for 25 years. The electricity would be delivered through a short-term exchange between the companies, with a duration of one day or less, via the spot exchange in Norway. The agreements granted Statkraft and E.ON the exclusive right to use Viking Cable for a period of 25 years.

The contracting parties claimed that in order to secure the viability of the investment in transmission capacity it was necessary to have a priority access right for 25 years. In addition, they stated that the fulfilment of the power exchange agreements was

[131]Case T-201/04 *Microsoft v Commission* [2007] ECR II-3601; Case C-209/10 *Post Denmark S/S v Konkurrenceradet* [2011] published in the electronic Reports of Cases (Court Reports - general); In *British Airways* the Court of Justice stated that 'It has to be determined whether the exclusive effect arising from such as system, which is disadvantages for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of that system bears no relation to advantages for the market and consumers or if goes beyond what is necessary in order to attain those advantages, the system must be regarded as an abuse'. (Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331, para.60)

[132]Notice pursuant to Article 19(3) of Council Regulation No 17 concerning (Case COMP/E-3/37921 – *Viking Cable*) (2001) OJ C 247/04

[133] One of the three agreements was the General Agreement concluded between E.ON and Statkraft concerning a firm power delivery from Statkraft to E.ON and mutual electricity exchange between the contracting parties via Viking Cable. Remaining two agreements were the Shareholders Agreement concerning the terms and functioning of Viking Cable, and the Master Agreement by which Statkraft assigns all of its rights and obligations under the Shareholder Agreement to Statnett.

dependent on that full transmission capacity on Viking Cable being available to Statkraft and E.ON on demand. With the consideration that Viking Cable would result in new capacity being added to the transmission connections between Germany and Norway, the Commission took a favourable view towards the long-term power exchange agreement as well as the long-term preferential network reservation.

First, this decision is aligned with the general idea of EU competition policy, since the Commission may let a dominant undertaking engage in anticompetitive conduct that is indispensable and proportionate to the goal allegedly pursued by the company, as long as this conduct produces an economic efficiency gain which outweighs the negative effects of this anti-competitive behaviour.[134] Second, it is parallel with the approach that can be seen in the provision of exemptions from third party access under Article 17 of electricity Regulation 714/2009 and Article 36 of gas Directive 2009/73/EC.[135] As the

[134] In the *Post Denmark* judgment, the Court of Justice identified conditions for a successful efficiency defence under Article 102 investigations or litigations. These conditions are: (i) the efficiency gain counteracts any likely negative effects on competition and consumer welfare, (ii) this efficiency gain results from a conduct subject to the investigation, (iii) this conduct is necessary for the achievement of the efficiency gain, and (iv)the conduct does not eliminate effective competition; Case C-209/10 *Post Denmark S/S v. Konkurrenceradet* (published in the electronic Reports of cases (Courts Reports – general), para.40-42; Commission, Communication from the Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings 2009/C 45/02, para.28-31 and 89

[135] Energy regulation in Europe attempts to stimulate transmission investment by allowing third parties to invest in the transmission networks given the concern about underinvestment. With access regulation, however, investors may refrain from making investments in high-cost projects such as investment in cross-border transmission infrastructures, as they will bear all of the project costs as well as the risk of investment, and face a truncated return due to access regulations. Even if national regulatory authorities allow investors a rate of return, access regulations may mute investment incentive, unless this return fully compensates investors for the *ex-ante* risk associated with the project. In order to encourage investment by third parties, the current legislation may grant a regulatory holiday, i.e. an exemption from third party access. The objective of a regulatory holiday is thus to increase investment incentives by allowing investors a period in which to complete their investment and gain profits unhindered by regulatory intervention, for instance, the *EstLink*, *BritNED*, *BBL*, *Nabucco*, *Gazelle* decisions. All these decisions can be found on the DG TREN website. As the new regulatory package was established in 2009, exemption decisions given before then would have been based on electricity Regulation 1128/2003 and gas Directive 2003/55/EC. For further discussion see C. Kessel, L. Meeus and C. Schwedler 'Experience with Interconnection Merchant Projects under Regulation (EC) 1228/2003: Prospects for Regulation (EC) 714/2009' (2011) Vol.18 Utilities Law Review 787; K. Kuijlaars and G. Zwart 'Regulatory Issues Surrounding Merchant Interconnection' (2003) Office for Energy Regulation, the Netherlands http://www.marketdesign.se/images/uploads/2003/cp_061603_2_zwart_kuijlaars.pdf; G. Brunekreeft, 'Regulatory Issues in Merchant Transmission Investment' (2005) Vol.13 Utility Policy 395; P. Joskow and J. Tirole 'Merchant Transmission Investment' (2005) Vol. LIII The Journal of Industrial Economics 237; A. De Hauteclocque and V. Rious, 'Reconsidering the European Regulation of Merchant Transmission Investment in Light of the Third Energy Package: The Role of Dominant Generators' (2011) Vol.39 Energy Policy 56; J. Gans and S. King 'Access Holidays for Network Infrastructure Investment'(2003)

construction and operation of interconnectors is very capital intensive and risky the investor can require the reservation of transfer capacity in order to ensure repayment of the loan.

On the other hand, for already existing and amortised interconnectors owned by dominant firms, the Commission has been particularly harsh and intervened on several occasions to ensure that long-term reservations do not block market access for competing suppliers.[136] It seems that the Commission has indeed systematically deemed long-term capacity reservations to be an abuse of dominant position under competition law and required that most of these capacities be freed up. The decision concerning the submarine interconnector between the United Kingdom and France is an example of the enforcement of competition law in order to free up some interconnector capacity.[137] The Commission found that a system where the total capacity of the interconnector was reserved for EDF, for the export of electricity to the UK, could be violating competition law, in particular Article 102 TFEU. The submarine interconnector was jointly owned by the transmission system operators of the UK and France, which held dominant positions in the market for the transmission of electricity between the UK and France. Granting a priority access right in favour of EDF placed its competitors in a dissimilar and disadvantaged position by letting EDF circumvent the rules for capacity allocations applicable to others.[138] Considering the Commission's concerns, the operator of the submarine infrastructure agreed to open up access to the infrastructure. The relative but general antitrust tolerance towards risky infrastructure investment seems not to be applied to existing and amortised infrastructure.[139]

Overall, it is fair to say that to defend existing long-term network reservations on the grounds of objective justifications seems rather difficult and limited to new

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Vol.10 Agenda 48; R.J Gilbert and D.M. Newbery 'The Dynamics Efficiency of Regulatory Constitutions' (1994) Vol.25 The RAND Journal of Economics 157

[136] Hauteclocque, *supra* no 60, 107

[137] Commission , 'UK-France electricity interconnectors opens up, increasing scope for competition' IP/01/341

[138] *Ibid*

[139] A. De Hauteclocque and K. Talus, 'Capacity to Compete: Recent Trends in Access Regimes in Electricity and Natural Gas Networks' in B. Delvaux, M. Hunt and K. Talus (eds.), *EU Energy Law and Policy Issues* (Vol.3 Intersentia 2011) p. 233

investments.[140] Accordingly, unless there is an exemption from third party access through *ex-ante* regulation, or there is an investment in transmission network capacity, which can be considered as an efficiency gain, long-term preferential network reservations are considered anticompetitive. The extent to which it is possible to claim an objective justification defence on the basis of an associated long-term supply contract under Article 102 TFEU will be discussed below.

V. Can Existing Long-term Supply Contracts Objectively Justify Preferential Network Reservations under Article 102 TFEU?

So far this chapter has shown how *ex-ante* regulation facilitates the effective and fair allocation of cross-border interconnectors and pipelines through regulatory rules, and how EU competition law should in theory have a complementary role in the solution of the problem of discriminatory capacity allocation. Yet, it has also shown how, in practice, the Commission has developed a more interventionist approach through antitrust settlements. Given this strategic approach by the Commission, the case law implies several important outcomes. It clearly shows that the aim of the Commission is to eliminate market deficiencies as well as the infringement of EU competition law through antitrust enforcement. It also shows that the Commission attempts not only to increase scarce capacity of cross-border transmission networks by identifying investments as objective justifications under Article 102 TFEU, but also to promote efficient use of them by imposing capacity release commitments on the undertakings concerned. Moreover, it is indicated that the Commission has not been tempted to take into consideration existing cross-border long-term supply contracts as a justification within investigations into related priority access rights. Therefore, a question that arises is, to what extent is it possible to claim an existing cross-border long-term supply contract as an objective justification during the investigations of a related long-term preferential network reservation under Article 102 TFEU?[141]

[140] Hauteclocque and Talus, *supra* n 114, 30-31

[141] A dominant undertaking that engages in abusive anticompetitive conduct could avoid being subject to EU antitrust enforcement, if this conduct results in procompetitive effects by way of efficiency gains that outweigh the anticompetitive effects of the conduct, or if the conduct can be justified on the basis of objective necessity. The objective necessity of the conduct can be decided on the basis of factors external to the dominant undertakings. See The Guidance of the Commission's enforcement priorities in

Supposing a hypothetical context, similar to that within the *VEMW* decision, in which a cross-border transmission network operator preferentially reserves its network capacity in order to honour a long-term electricity import contract concluded with a nuclear electricity generator that has just entered an electricity generation market within a neighbouring Member State. Within this context, a likely competition concern of the Commission would be refusal to supply under the essential facilities doctrine as occurred in the *GDF Suez* and *E.ON Gas* decisions. An efficiency gain that could be claimed by the network company as an objective justification defence[142] under this hypothetical question would be a cost efficiency resulting from the long-term contract[143] as the final price of electricity would be cheaper than the final price of domestic electricity (assuming that domestic electricity is produced through gas-power plants and thus, since the generation cost is higher than for a nuclear-based power plant, the consumer price is greater than the consumer price of imported electricity).[144] Moreover, the company could boost its defence by claiming that if there was not a long-term contract concluded due to the preferential network reservation, there would not be a new entrant investing in nuclear technology for electricity generation and thereby no cost efficiency would occur. *Vice versa* it could be argued that if the network company was not be able to preferentially book its network capacity there would not be a long-term contract promoting this new investment. In the light of these arguments, it should

applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings 2009/C 45/02 para.30; On the other hand, it is argued that objective justification defence under Article 102 consists of two types of defences including efficiency defenced and social welfare defences. See R. Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (Oxford University Press 2011), pp. 304-317

[142] The burden of proof for objective justification under Article 102 is open to debate. See P. J. Loewenthal, 'The Defence of "Objective Justification" in the Application of Article 82 EC' (2005) Vol.28 World Competition 455, pp. 467-469; R. Nazzini, 'The Wood Began to Move: An Essay on Consumer Welfare, Evidence and Burden of Proof in Article 82 Cases' (2006) Vol.31 European Law Review 518, pp. 521-524; P. Akman, 'The European Commission's Guidance on Article 102 TFEU: From *Inferno* to *Paradiso*?' (2010) Vol.73 The Modern Law Review 605, p. 622

[143] The objective justification defence under Article 102 TFEU reflects Article 101(3) TFEU, although the accuracy of this approach by the Commission is open to debate regarding differences between the articles. Within this sense, the dominant undertaking concerned could ground its defence on cost efficiencies and qualitative efficiencies pursuant to Guidance on the application of Article 101(3) TFEU. See Notice Guidelines on the application of Article 81(3) of the Treaty (2004) OJ C 101/08.

[144] Certainly, in order to identify a cross-border long-term supply contract as an efficiency gain within the investigation of the associated preferential network reservation, it is necessary to develop comprehensive economic analyses of the effect of the supply contract on liquidity, competition levels in the relevant market and other market conditions such as the portfolio of technologies used for electricity generation so on.

be underlined that, while assessing the legitimacy of preferential network reservations, the interconnection between long-term supply contracts concluded among Member States and preferential network reservations as well as possible efficiencies stemming from the contracts (if there are any) should be taken into consideration.

On the other hand, should there be a risk of elimination of effective competition in the relevant downstream market through preferential network reservations, it does not seem that any sort of economic efficiency linked to associated long-term supply contracts would be accepted as an objective justification, considering the Guidance on the enforcement priorities in applying Article 102. Accordingly, an undertaking under investigation should demonstrate that the efficiency is sufficient to guarantee that no net harm to consumers is likely to arise. The undertaking concerned is expected to show, with a sufficient degree of probability, and on the basis of verifiable evidence, that the following cumulative conditions are fulfilled: (i) the efficiency is likely to be generated as a result of the conduct subject to the investigation; (ii) the conduct is indispensable to the realisation of the efficiency; (iii) the likely efficiency brought about by the conduct outweighs any likely negative effects on competition and consumer welfare in the affected markets; and, (iv) effective competition in the market will not be eliminated.[145] Regarding the last condition, the Guidance explicitly states that a conduct can only be assessed under the scope of the objective justification defence if 'the conduct does not eliminate effective competition removing all or most existing sources of actual or potential competition. … Where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains. In the Commission's view, exclusionary conduct which maintains,

[145] This provision has been criticised by scholars. While the Commission only needs to prove likely detrimental effects of refusal to supply so as to deem infringement of Article 102 TFEU the undertaking concerned must demonstrate the satisfaction of the conditions with a sufficient degree of proportionality and on the basis of verifiable evidence. Moreover, it must be guaranteed that no net harm to consumers is likely arise, while likely consumer harm is enough to determine the existence of the infringement. These conditions are found requiring 'highly standard of proof' from the undertaking. Akman, *supra* n 142, 620-624; A. Jones and B. Sufrin, *EU Competition Law: Text, Cases, and Materials* (5th edn, Oxford University Press 2014) p. 391

creates or strengthens a market position approaching that of a monopoly can normally not be justified on the grounds that it also creates efficiency gains.'[146]

As regards this provision, even though cost efficiency occurs, it seems that the tendency of the Commission is to make a decision favouring competition in the energy markets, in particular, with the consideration of the fact that one of the main objectives of the market liberalisation policy in energy is to create a well-functioning competitive market. The market foreclosure of competitors may counter the liberalisation objective and decrease consumer welfare in the longer term.[147] As a result, it seems that the only possible justification to have an individual exemption for a preferential cross-border network reservation under EU competition law is an investment in network capacity regarding the scarcity of networks and the privileged objectives of the EU in the European energy markets.[148]

VI. Conclusion

This chapter attempted to address the problem of long-term preferential network reservations of cross-border interconnectors and transmission pipelines, as granted preferential access rights are considered to be an obstacle to market integration and the development of competition in the energy markets in Europe.

The chapter first assessed the problem by taking into account two different angles: EU secondary law and EU competition law, since the Commission attempts to solve the

[146] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009) OJ C 45/02, para. 30

[147] P. Lowe, 'The European Commission Formulates its Enforcement Priorities as Regards Exclusionary Conduct by Dominant Undertakings' (2009) GCO The Online Magazine for Global Competition Policy Release: FEB-09 (1) <https://www.competitionpolicyinternational.com/file/view/5826_accessed_01_July 2014> accessed 17 October 2014, pp. 7-8

[148] With the consideration of the finding of this section of the chapter, there may be further discussion on the objective of Article 102 TFEU and whether the Commission should change its attitude under objective justification defence in a way that favours consumer welfare. Regarding the scope of the thesis there will not be discussion over this conflict. For further readings see E. Roussena, 'The Concept of 'Objective Justification' of an Abuse of a Dominant Position: Can it help to modernise the analysis under Article 82 EC?' (2006) Vol.2(2) The Competition Law Review 27; L. L. Gormsen, 'The Conflict between Economic Freedom and Consumer Welfare in the Modernisation of Article 82 EC' (2007) Vol.3(2) European Competition Journal 329, and for further decisions see Case C-85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, para. 123, Case T-219/99 *British Airways v Commission* [2007] ECR II-5917, para. 293, Case T-203/01 *Manufacture Francaise des Pneumatiques Michelin v Commission* (Michelin II) [2003] ECR II-4071, para. 239-40

problem through these two legal tools. The chapter found that EU secondary law promotes transparent and fair network allocation through regulatory provisions such as third party access and vertical unbundling, whereas EU competition law aims at preventing market operators with market power from abusing their positions by engaging in unilateral anticompetitive conduct in the form of refusal to supply, discrimination, strategic under-investment and so on. Thus, the chapter indicated that, in theory, there is a complementary relationship between EU secondary law and EU competition law. However, in practice, regarding the competition decisions of the Commission, it was pointed out that the Commission tends to adopt a rather interventionist approach. Before analysing the decisions of the Commission and the Court of Justice, the chapter looked at the relationship between long-term supply contracts and preferential network reservations as network reservations can be made on the basis of existing long-term supply contracts. This section of the chapter concluded that these associated contracts might be taken into account while assessing preferential network reservations, in particular in certain situations where the long-term supply contracts generate economic efficiencies.

Under the case law section, the chapter first evaluated the *VEMW* judgment of the Court of Justice, since this judgment had an enormous impact on the approach that the Commission adopted to assessing the legitimacy of preferential access rights. In this case, an existing priority access right could not be justified by an association with long-term supply contracts signed before the first regulatory Directive entered into force. It was deemed discriminatory unless the Member State concerned had consulted for derogation from third party access under Article 24 of Directive 96/92/EC. This new trend was also adopted by the Commission through a staff working paper on the effects of the *VEMW* judgement, and pursued within investigations into long-term network reservations under EU competition law.

The *GDF Suez* and *E.ON* decisions of the Commission showed that preferential network reservations by a network company in favour of its affiliated supply company would be assessed under Article 102 TFEU and considered as an abuse of dominance in the form of namely, refusal to supply and discrimination. Also, the *Marathon* decision

along with *GDF Suez* and *E.ON,* demonstrated that commitments with a *quasi*-structural effect, proposed through antitrust settlements, are more than welcomed by the Commission, as they are sufficient to eliminate the anticompetitive behaviour of the incumbents as well as market deficiencies. On the other hand, *Viking Cable* showed that the Commission seems to have a favourable opinion regarding the provision of a long-term priority access right to a dominant undertaking, if this granted priority access right results in an efficiency gain such as an investment in cross-border transmission capacity, which outweighs the anticompetitive effect of the right. Overall, the analysis of the case law showed that, according to the Commission, preferential cross-border transmission network reservations can only be objectively justified on the basis of an investment in network capacity or granted exemption from third party access through *ex-ante* regulatory provisions. This outcome indicated that the Commission pursues the objective of market regulation and aims at balancing equal and fair access to interconnectors by market players with the development of interconnector capacities through new investments, which are promoted by assessing them as objective justifications.

Finally, the chapter examined a hypothetical case in order to indicate that under some circumstances preferential network reservations might be objectively justified on the basis of long-term supply contracts concluded among Member States if these contracts produce efficiencies. Nevertheless, while carrying out this analysis, the chapter took into account the approach that the Commission has adopted in the newly liberalised markets. Accordingly, the Commission tends to take a view in favour of an improvement in competition, and states that effective competition in downstream markets cannot be sacrificed on the grounds of any kinds of efficiencies.

CHAPTER 4

COMMITMENT PROCEEDINGS UNDER ARTICLE 9 OF REGULATION 1/2003 IN THE EUROPEAN ENERGY MARKETS

I. Introduction

The new competition regime in the EU came into force with the modernisation of European competition law in May 2004. Council Regulation 1/2003 on the implementation of the rules of competition laid down in Articles 81 and 82 of the Treaty[1] (Article 101 and 102 TFEU) replaced Regulation 17/62 and fundamentally changed the system of enforcement of EU competition law by extending the powers of the European Commission.[2] The introduction of the new method of solving cases - commitment decisions[3] - and the imposition of new and improved remedies, via Article 7 and Article 9, are two examples of the most important changes.

Regulation 1/2003, for the first time, entails a public settlement procedure where the Commission can conclude its investigations by rendering commitments binding upon the undertakings that propose these commitments, instead of issuing a prohibition decision, as long as the commitments address the Commission's concerns over competition. When the Article 9 procedure was passed into law, commitment decisions were expected to remain an exceptional, alternative mechanism in the Commission's

[1] 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 [2003] OJ L 1/1

[2] E. Wind, 'Remedies and Sanctions in Article 82 of the EC Treaty' (2005) Vol.26(12) European Competition Law Review 659, p. 661

[3] Before the modernisation, the Commission used behavioural remedies offered as commitments by the undertakings concerned to settle competition proceedings on an informal basis. A number of cases were resolved through informal commitments, which were considered by the Commission as acceptable but it was not until the enactment of Regulation 1/2003 that this practice was given an express legal basis. See L.O. Blanco, *EC Competition Procedure* (2nd edn., Oxford University Press 2006), p. 54

toolbox.[4] However, in fact, over the past years, they have become a cornerstone of antitrust investigations at the EU level.[5]

On the one hand, certain advantages of antitrust settlements such as the efficient and swift resolution of competition problems are undeniable. On the other hand, the commitment-based antitrust enforcement poses a number of issues such as the imposition of far-reaching or insufficient commitments,[6] a lack of clarification regarding the law and legal uncertainty. A broad discretionary power granted to the Commission under Article 9, the implementation of a softened test for the proportionality of commitments, and finally limited judicial scrutiny of commitment decisions can be stated as being the main reasons behind these problems.

Given the number of antitrust investigations in the energy sectors (i.e. electricity and natural gas) concluded through Article 9, public settlement procedures seem to play a more significant role in these markets than in others. 10 out of the 34 commitment decisions given since May 2004 are related to energy while the other decisions are related to various markets.[7] Moreover, since May 2004, only two antitrust investigations in energy have been concluded through the prohibition procedures under Article 7 of

[4] J. T. Lang, 'Commitment Decisions and Settlements with Antitrust Authorities and Private Parties under European Antitrust Law' in B. E. Hawk (ed.), *Fordham Corporate Law Institute: International Antitrust Law & Policy* (Juris Publishing, Inc. 2006), pp. 265-324

[5] P. Lugard and M. Mollmann, 'The European Commission's Practice under Article 9 Regulation 1/2003: A Commitment a Day Keeps the Court away?' Vol.3 Competition Policy International, p. 3; A. Johnson and B. Sufrin, *EU Competition Law* (5th edn, Oxford University Press 2014), pp. 1081-1091; Commission, Competition Policy Brief, 'To Commit or not to Commit: Deciding between Prohibition and Commitments' (2014) Issue 3, pp. 1-2; M. Cunningham, 'Commitments as a Regulatory Device in Network Industries' (Commitments in EU Competition Policy Conference, Liege Competition and Innovation Institute/Brussels School of Competition, June 2014)

Between May 2004 and February 2014, the Commission adopted 35 commitment decisions under Article 9 and 21 non-cartel prohibition decisions under Article 7. This figure indicates that Article 9 has *de facto* disposed of the vast majority of proceedings in competition law.

[6] This effect of commitment-based enforcement might be defined as Type one and Type two errors.

[7] See Table 4 below.

In addition to the cases listed within the Table 4, there are cases which are still under investigation: *French Electricity Wholesale Market* (Case COMP/39442) [2009], *Upstream Gas Suppliers in Central and Eastern Europe* (Case COMP/39816) Commission Decision [2012], *BEH Electricity* (Case COMP/39767) [2014]

The data given under footnotes 6 and 7 was gathered from a case search engine provided within the website of the European Commission. <http://ec.europa.eu/competition/elojade/isef/index.cfm?clear=1&policy_area_id=1> Also, note that the names of the decisions have been copied as they appear on the website of the European Commission.

Regulation 1/2003.[8] In this regard, the generalised implementation of commitment decisions in the recently liberalised energy markets may worsen the effects of commitment-based enforcement in terms of less clarification with regard to the law, legal uncertainty and the risk of not eliminating the Commission's concerns. In addition, the excessive use of public settlement procedures might harm the functioning of the energy markets due to the fact that a decrease in legal certainty may discourage undertakings from investing or new entrants from entering the markets. Thus, while the aim of the Commission is to create more liberalised and competitive energy markets through commitments, excessive use of public settlement may have the opposite effect.

Table 4: Antitrust cases in energy closed through commitment decisions between May 2004 and November 2014[9]

No	Case	Case Number	Year	Legal Basis
1	Distrigaz	COMP/37966	2007	102
2	E.ON-German Electricity Wholesale Market	COMP/39388	2008	102
3	E.ON - German Electricity Balancing Market	COMP/39389	2008	102
4	RWE Gas Foreclosure	COMP/39402	2009	102
5	GDF Foreclosure	COMP/39316	2009	102
6	EDF - Long-term Electricity Contracts in France	COMP/39386	2010	102

[8] GDF/ENEL & GDF/ENI (Case COMP/38662) Commission Decision [2004] and *Romanian Power Exchange/OPCOM* (Case.AT 39984) Commission Decision C (2014) 1342 final [2014]

[9] The data given under footnotes 6 and 7 was gathered from a case search engine provided within the website of the European Commission.

7	SvK – Swedish Interconnector	COMP/39351	2010	102
8	E.ON Gas Foreclosure	COMP/39317	2010	102
9	ENI	COMP/39315	2010	102
10	CEZ	COMP/39727	2013	102

As a result, the aim of this chapter is, first, to point out the possible detrimental effects of the excessive use of public settlement in the energy markets, and then to examine certain energy cases finalised on the basis of commitment proceedings under Regulation 1/2003 in order to discuss the appropriateness of commitment decisions in the energy markets. Also, the chapter aims at providing a hypothetical legal framework that could help addressing the shortcomings of commitment procedures mentioned above.

The chapter is thus organised in the following manner. First, the chapter will clarify the application of Article 9 of Regulation of 1/2003 from the substantive and procedural aspects. Additionally, the motivations of the Commission and undertakings to pursue commitment proceedings rather than prohibition decisions will be analysed. Second, the chapter will discuss the possible detrimental effects of the generalised use of antitrust settlements particularly in the recently liberalised energy markets. Third, the decisions of the Commission concluded through structural or behavioural remedies will be examined in order to assess the proportionality of commitments, as well as to see whether the Commission uses Article 102 TFEU and Article 9 of Regulation 1/2003 as regulatory tools to eliminate the deficiencies of the energy markets. Finally, the chapter will conclude with a number of observations on the need to introduce a more comprehensive legal framework for the use of commitment decisions in the energy markets, which may also be considered for the use of commitment proceedings in general.

II. Implementation of Competition Rules by the European Commission under Regulation 1/2003

Before the modernisation of EU competition law, a settlement procedure existed in the form of informal decisions made by the Commission so as to close investigations when the Commission and undertakings concerned reached an agreement on certain behavioural changes.[10] However, this procedure did not allow the Commission to legally bind the undertakings under investigation to behavioural or structural remedies through a formal decision. Nor did it provide the Commission with a mechanism to force the undertakings to fulfil the commitments through imposing a periodic penalty payment or fine.[11] With the modernisation of antitrust enforcement, these shortcomings have been eliminated through the enactment of Article 9.

This part of the chapter will evaluate first, prohibition decisions under Article 7, and then, commitment decisions under Article 9 of Regulation 1/2003 in order to understand the factors that contribute to these different types of decisions. This will then help to explain why the Commission and the undertakings under investigation prefer to engage in commitment proceedings as well as the detrimental effects that are likely to be derived from commitment decisions. However, before that, given the importance of the principle of proportionality within the context of the chapter, the next section will provide brief information about this principle for further clarification.

A. The Principle of Proportionality in EU Law

Although the principle of proportionality[12] was occasionally mentioned in early cases in the Court of Justice, recognition of the principle as a "general principle of law" can be traced back to 1970s.[13] The general principle of EU law essentially requires that

[10] F. Cengiz 'Judicial Review and the Rule of the Law in the EU Competition Law Regime after *Alrosa'* (2011) Vol.7 European Competition Journal 127, p. 127

[11] H. Schweitzer, 'Commitment Decision under Article 9 of Regulation 1/2003: The Developing EC Practice and Case Law' (2008) EUI Working Papers Law 2008/22 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1306245> accessed 02 June 2011, p. 2

[12] The principle of proportionality, which is a general principle of public law, has been developed particularly in French administrative and German criminal law. See P. Graig, *EU Administrative Law* (Oxford University Press 2006)

[13] Case C-11/70 *Internationale Handelsgesekkschatf v Einfuhr-und Vorratsstelle Getreide* [1970] ECR 1125; F. G. Jacobs, 'Recent Developments in the Principle of Proportionality in European Community Law' in E. Ellis (ed.), *The Principle of Proportionality in the Laws of Europe* (Hart Publishing 1999), p. 270

measures adopted by EU institutions must be proportionate to the objectives they pursue.[14] The principle is a criterion for the lawfulness of any act by the institutions of the EU, including decisions taken by the Commission.[15] According to the case law of the Court of Justice, the application of the principle can be tested through a three-part test: (i) a test of suitability - this assesses whether the measure is suitable to achieve a legitimate aim; (ii) the least restrictive alternative test - this assesses whether the measure is necessary to achieve this aim; and (iii) proportionality *stricto sensu* - this establishes whether the measure will have any excessive effect on the applicant's interests.[16]

Despite the very abstract nature of the principle, an objective analysis in the judicial review for the principle is conducted by the EU courts.[17] They assess the appropriateness and necessity of a measure in relation to the specific aim pursued by the institution that has adopted the measure in a question. Within the context of commitment decisions, as will be seen below, the principle of proportionality is directly related to the exercise of the Commission's discretionary power granted through Article 9 of Regulation 1/2003 in terms of deciding which antitrust enforcement procedure should be pursued and the enforcement of the proposed commitments on the undertakings concerned. In addition, the principle of proportionality, in theory, may provide relevant grounds for the judicial review of commitment decisions so as to ascertain the suitability and necessity of the commitments implemented by the EU Courts.

However, as will be seen below, the application of the principle of proportionality and the limits of judicial scrutiny under commitment decisions are softened and restricted. This approach can actually be seen as one of the main reasons for certain problems resulting from commitment-based antitrust enforcement such as over-enforcement without eliminating the main competition concerns of the Commission. This problem is becoming more visible particularly in the European energy markets, because several

[14] Case C-66/82 *Fromancais SA v FORMA* [1983] ECR 395; Case C-181/*84 Man (Sugar) Ltd v Internvention Board for Agricultural Produce (IBAP)* [1985] ECR 2889
[15] Case C-441/07 P *Alrosa Company Ltd v Commission* [2010] ECR I-5949
[16] Jacobs, *supra* n 13, 270
[17] Cengiz *supra* n 10, 145

investigations concluded through informal/formal settlement proceedings. Besides, the proper application of the principle is rather important in the energy markets, as the lack of proportionality increases the legal uncertainty, which may deter energy companies from making new investments and dissuades potential entrants from entering the markets.

Given the significant role of legal certainty in terms of the development of a well-functioning energy market, finding a solution for this problem is becoming more important. Hence, this chapter will attempt to propose a hypothetical guideline, which will provide several measures that could increase the appropriateness of commitments and extend the limits of judicial review. Before that, there will be an analysis of prohibition and commitment procedures as well as a discussion of their impacts on the energy markets.

B. Prohibition Proceedings under Article 7 of Regulation 1/2003

Article 7 provides that where the Commission finds an infringement of Article 101 or 102 TFEU, it may require the undertakings concerned to bring the infringement to an end.[18] In order to do that the Commission can impose on the undertakings concerned behavioural or structural remedies (with/out a fine) within the limits of the principle of proportionality; in other words, where the remedies are appropriate to the infringement and necessary to effectively bring it to an end.[19] Structural remedies can only be imposed either where there is no equal behavioural remedy or where any equal

[18] Article 7(1) of 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 [2003] OJ L 1/1: 'Where the Commission, acting on a complaint or on its own initiative, finds that there is an infringement of Article 81 or of Article 82 of the Treaty, it may by decision require the undertakings and associations of undertakings concerned to bring such infringement to an end. For this purpose, it may impose on them any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. If the Commission has a legitimate interest in doing so, it may also find that an infringement has been committed in the past'.

[19] R. Whish and D. Bailey, *Competition Law* (7nd edn, Oxford University Press 2012), p. 254; With regard to the wording of the article, in order to prohibit an activity, the Commission should, first, find an infringement of Article 101 or 102 TFEU. If the infringement is still going on the Commission can impose remedies so as to bring the infringement effectively to an end. Such remedies imposed on the undertakings concerned might be behavioural or structural. A behavioural remedy can be negative, i.e. stopping a certain kind of conduct (a cease-and-desist order), for example refraining from a certain conduct or similar conducts that pose the same anticompetitive results in the future, or positive, i.e. ordering an undertaking to do something.

effective behavioural remedy would be more burdensome for the undertakings than the structural remedy. Recital 12 of the Regulation highlights the importance of the principle of proportionality by adding that changes to the structure of an undertaking would only be proportionate where there is a substantial risk of a lasting or repeated infringement that derives from the very structure of the undertaking. A possible example of this could occur where a vertically integrated undertaking consistently refuses to allow its competitors to have access to an essential facility or discriminates against downstream competitors in relation to a vital input; another example could arise where an undertaking repeatedly engages in a margin squeeze.[20] Finally the Commission can complete the proceedings for a prohibition decision by imposing a fine under Article 23 of Regulation 1/2003, as a separate punitive feature of the prohibition decision.[21]

Under antitrust enforcement, the remedies imposed on undertakings might have different impacts pursuant to the subject matter of the infringement investigated by the Commission. Under an investigation into a breach of Article 101 TFEU, a potential remedy imposed by the Commission cannot do more than bringing the conduct to an end, because of the characteristic of Article 101 TFEU, which prohibits all agreements, decisions and concerted practices between undertakings which prevent, restrict or distort competition in the relevant markets. On the other hand, the impact of remedies imposed under Article 102 TFEU can be regulatory in nature, since Article 102 TFEU incorporates certain procedures or substantive characteristics more typically associated

[20] *Ibid*, 254

[21] P. Lowe and F. Mier-Rigaud, 'Quo Vadis Antitrust Remedies' in B. E. Hawk (ed.), *Fordham Corporate Law Institute: International Antitrust Law & Policy* (Juris Publishing, Inc. 2008), pp. 597-611; The imposition of remedies and fines should not be confused. Remedies are not a way of punishing undertakings that engage in anticompetitive conduct, nor are they used to compensate the parties harmed by the infringements. They are obligations or conditions imposed on the undertakings concerned in order to bring infringements to an end as well as to create a competitive market, at least as much as it was before the infringements occurred. This approach aligns with an effect-based approach to unilateral behaviour, where an emphasis is placed on analysing the effects of certain behaviour.
On the other hand, the punitive feature of Article 7 is rendered by the imposition of a fine. While fines are able to deter the undertakings concerned or other undertakings from engaging in similar infringements in the future, they may not be able to eliminate the effects of infringements or, restore market functioning. If the effects of an infringement can still be perceived at the time of the adjudication of a prohibition decision, the Commission may impose structural or behavioural remedies in order to create competitive market conditions - as they were before the infringement. This is a result that cannot be achieved through the imposition of a fine.
See P. Hellstrom, F. Maier-Rigaud and F. W. Bulst, 'Remedies in European Antitrust Law' (2009) Vol.76 Antitrust Law Journal 43 p. 50 ; Wind, *supra* n 2, 662-665

with regulation such as providing access to an essential facility (refusal to supply), or a price policy for this essential facility (margin squeeze), which are at the same time under the scope of sector-specific regulation.[22]

However, this difference seems to be diminished within the informal settlements between the Commission and the parties concerned during energy investigations. As seen within the second chapter, in *OMV/Gazprom,*[23] OMV offered a set of behavioural remedies with regulatory effects such as the improvement of third party access, although, the subject matter was a long-term supply contract including a territorial restriction clause under the scope of Article 101 TFEU, which could have been ended through a cease-and-desist order.[24] Furthermore, in *DUC/DONG*,[25] the undertakings, in addition to a cease-and-desist order, agreed on contract-unrelated commitments such as establishing new supply relationships with new entrants, and introducing an improved access regime for DONG's off-shore pipelines in order to enhance competition in the market.[26] As will be seen, this approach has gradually changed with the modernisation of EU competition law. The Commission seems to be more careful about the adequacy and appropriateness of the commitments imposed on undertakings in the energy markets, in particular since the *Alrosa* judgment[27] of the Court of Justice.[28] In this regard, it can be stated that the introduction of commitment-based antitrust enforcement, which replaced informal settlement procedures under former Regulation 17/62, has improved the proportionality of commitments compared to informal settlements on the basis of energy cases. Nevertheless, the application of the principle

[22] N. Dunne, 'Commitment Decisions in EU Competition Law' (2014) Vol.6(3) Journal of Competition Law and Economics 399, p. 414
[23] OMV/Gazprom (Case COMP/38085) [2005]
[24] Commission, 'Competition: Commission secures improvement to gas supply contracts between OMV and Gazprom' IP/05/185
[25] *DONG/DUC* (Case COMP 38187) [2003]
[26] Commission, 'Commission and Danish competition authorities jointly open up Danish gas market' IP/03/566
[27] Case C-441/07 P *Alrosa Company Ltd v Commission* [2010] ECR I-5949
[28] It has been argued that, after the *Alrosa* Judgment of the Court of Justice, the proper implementation of principle of proportionality reduced since the Court limited the impact of the principle under commitment decisions. Yet, on the basis of energy cases, it is more realistic to see that after *Alrosa* Judgment the Commission started to include a separate section for the principle within its decisions, which did not occur under informal settlement proceedings. Therefore for the energy cases, it can be stated that after the enactment of Article 9 and the *Alrosa* Judgment the importance of the principle of proportionality increased.

of proportionality is still weak under Article 9 of Regulation 1/2003 and there are still some problems stemming from this lack of proportionality as will be discussed below. The next section will evaluate commitment proceedings on the basis of procedural and substantive law.

C. Commitment Proceedings under Article 9 of Regulation 1/2003

Under Article 9 of the Regulation, the Commission is granted the power to render suggested commitments by undertakings binding upon them, instead of giving a prohibition decision, when the commitments eliminate the concerns of the Commission over competition.[29] The wording of the article and Recital 13 of Regulation 1/2003 elucidates the three aspects of giving a commitment decision.[30] The first aspect is the intention of the Commission to adopt a decision requiring that an infringement be brought to an end. The second is a proposal comprising a set of structural or behavioural commitments by the investigated undertaking, which address the Commission's concerns regarding competition. The final aspect is to bind the undertakings to these commitments by a commitment decision without a further

[29] Article 9 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty [2003] OJ L 1/1:
'1. 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 concerns expressed to them by the Commission in its preliminary assessment, the Commission may by decision make those commitments binding on the undertakings. Such a decision may be adopted for a specified period and shall conclude that there are no longer grounds for action by the Commission.
2. The Commission may, upon request or on its own initiative, reopen the proceedings:
(a) where there has been a material change in any of the facts on which the decision was based;
(b) where the undertakings concerned act contrary to their commitments; or
(c) where the decision was based on incomplete, incorrect or misleading information provided by the parties.'

[30] Recital 13 of 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 [2003] OJ L 1/1: 'Where, in the course of proceedings which might lead to an agreement or practice being prohibited, undertakings offer the Commission commitments such as to meet its concerns, the Commission should be able to adopt decisions which make those commitments binding on the undertakings concerned. Commitment decisions should find that there are no longer grounds for action by the Commission without concluding whether or not there has been or still is an infringement. Commitment decisions are without prejudice to the powers of competition authorities and courts of the Member States to make such a finding and decide upon the case. Commitment decisions are not appropriate in cases where the Commission intends to impose a fine.'

extended investigation showing the existence of an infringement. After the decision, there should be no remaining grounds for action by the Commission.[31]

Commitment decisions do not state whether or not there is or has been an infringement of Articles 101 or 102 TFEU. The only legal effect of commitment decisions is to close the investigation on the basis that the commitments offered by the undertakings fully address the Commission's concerns over competition.[32] This feature of commitment decisions may cause several outcomes. From a legal point of view, commitment decisions produce legal and functional uncertainty, because (i) they reduce established infringement, which decreases clarification of law, and reduces clear and consistence precedents, and (ii) they diminish the assessment of the detrimental effects of an infringement on competition in the relevant markets.[33]

From an investigated undertaking's point of view, non-establishment of an infringement may have two significant results. First, logically, the Commission cannot impose a fine on the undertakings concerned under Article 9 without a decision stating the existence of an infringement. Once the Commission decides to follow the Article 9 procedure, it should terminate the investigation without enforcing any fine, as long as the undertakings do not break the remedy agreement.[34] Besides, according to Recital 13 of Regulation 1/2003, commitment decisions are not appropriate where the Commission intends to impose a fine. Thus, the commitment procedures for the undertakings

[31] This leads to two different views among scholars: (i) some support that an alleged anticompetitive conduct concerned becomes no longer one that, as a matter of administrative priority, the Commission wishes to pursue as a result of the elimination of the Commission's concerns through commitments; (ii) whereas others argue that commitments must completely remove all the concerns of the Commission. For the first view see Commission Notice on the Handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty [2004] OJ C101/65;Whish and Bailey, *supra* n 19, 255-261; W. Wils 'Settlement of EU Antitrust Investigations: Commitment Decisions under Article 9 of Regulation No. 1/2003' (2006) Vol.49(3) World Competition 345, p. 360
For the opposing argument see D. Waelbroeck, 'The Development of a New "Settlement Culture" in Competition Cases. What is left to the Courts?' in C. Gheur and N. Petit (eds.) *Alternative Enforcement Techniques in EC Competition Law* (Bruylant 2009), p. 221

[32] Cengiz *supra* n 10, 130

[33] A. Gautier and N. Petit, 'A Policy in Search of a Framework: Scope, Duration, Remedies, etc.' (Commitments in EU Competition Policy Conference, Liege Competition and Innovation Institute/Brussels School of Competition, June 2014)

[34] Article 23(2) Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty [2003] OJ L 1/1. For instance, the *Microsoft* decision (Case COMP/39530), the Commission imposed a € 561 million fine on Microsoft for not complying with the commitments accepted under commitment proceedings in 2009.

concerned can be a strategic concession that helps them to avoid a significant fine by offering more onerous commitments.[35] Second, not finding an infringement may secure the undertakings from being a part of follow-on litigation in the national courts.[36] It may also limit the reputational damages typically associated with prohibition decisions.[37] These two outcomes can motivate the undertakings under investigation to propose a set of far-reaching commitments in order to convince the Commission of their readiness to start commitment proceedings.

Given the possibility of the imposition of far-reaching commitments on the basis of Article 9, it might be crucial to highlight the differences between the types of remedies and commitments that could be imposed under Article 7 or 9 as well as the application of the principle of proportionality. As mentioned before, while the remedies imposed under Article 7 are based on the finding of an infringement, under Article 9 a set of commitments is proposed on the grounds of the Commission's concerns. Thus, under prohibition decisions the adequacy of the remedies imposed is approved through economic facts that are found during investigations. Besides, the proportionality of the remedies is guaranteed by the wording of the rule. For the implementation of structural remedies, there should be no equally effective and less burdensome behavioural remedies, and also, the infringement should stem from the very structure of the undertaking.[38] Therefore, the enforcement of a structural remedy might be justified through the repetition of a similar infringement that could not be prevented by the behavioural remedies enforced in the former investigation of the same undertaking. Clearly, under Article 7, structural remedies can be utilised as a last resort so as to end or deter infringements of Articles 101 and 102 TFEU.[39]

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[35] For instance, in the *OPCOM* decision (Case COMP/39984), the Commission recently deemed to impose a fine of just over € 1 million on OPCOM, Romanian Power Exchange, for abusing its dominant position in the Romanian market.

[36] Lowe and Mier-Rigaud, *supra* n 21, 607-608; Lang, *supra* n 4, 265-324; W. Wils, 'The Use of Settlements in Public Antitrust Enforcement: Objectives and Principles' (2008) Vol.31 World Competition 335, pp. 340-341

[37] C. J. Cook, 'Commitment Decisions: The Law and Practice Under Article 9' (2006) Vol.29(2) World Competition 209, p.212; Lang, *supra* n 4, 265-324

[38] Recital 12 of 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 [2003] OJ L 1/1

[39] W. Wang, 'Structural Remedies in EU Antitrust and Merger Control' (2011) Vol. 34 World Competition 571, pp. 576-581

However, no criteria are provided for the imposition of commitments within the Article 9 procedures. For this reason, there was a discussion over the application of the principle of proportionality under Article 9 in the *Alrosa* judgment of the Court of Justice.[40] In the judgment, the General Court claimed that the examination of the proportionality of the commitments should be the same regardless of which antitrust enforcement procedure was being followed. According to the General Court, the voluntary nature of commitment proceedings does not relieve the Commission of complying with the principle of proportionality. The fact is that the voluntary submission of commitments does not make them necessary and appropriate. Therefore, the Commission is obliged to ascertain the proportionality of the commitments proposed on the basis of Article 9 as if they had been imposed under Article 7.[41] The Commission did not agree with the General Court and argued that the approach of the Court disregarded the fundamental differences between those two provisions, and also negated the practical effect of Article 9. In addition, the Commission argued that it should be considered that under Article 9 undertakings offering a set of commitments make a choice about the way in which they intend to address competition concerns and should be ready to have them made binding upon themselves.

The Court of Justice observed that the application of the principle of proportionality may vary depending on whether it is considered in a prohibition or commitment decision. The administrative efficiency rationale and the participatory nature of the commitment regime require application of a different, lighter proportionality test for commitment decisions compared to the test applied in prohibition decisions. Accordingly, under Article 9, the Commission is confined to verifying that the commitments proposed by the undertakings address the competition concerns in an antitrust investigation, and that the

[40] Case T-170/06 *Alrosa v Commission* [2007] ECR II-260, para. 105

[41] De Beers and Alrosa are two commercial companies operating in the diamond market. Following an antitrust investigation over an abuse of dominance of the Commission, in 2006, De Beers submitted commitments that would ensure the complete cessation of the supply of rough diamonds between De Beers and Alrosa. The Commission made these commitments binding under Article 9 of Regulation 1/2003 (Case COMP/B-2/38381). Alrosa applied to the General Court for the annulment of the Commission's commitment decision. Alrosa argued that the Commission had breached the principle of proportionality and conducted a manifest error of assessment by accepting individual commitments that would result in the entire cessation of the trade relationship between the parties, whereas less onerous measures would address the concerns over competition.

undertakings have not offered less onerous commitments that also adequately address these concerns. In other words, the commitments accepted by the Commission must be the least restrictive of all of the commitments offered by the undertaking concerned. Also, these accepted commitments must not go manifestly beyond what is necessary to address the Commission's concerns.[42] Consequently, while concluding investigations on the basis of Article 9, the Commission is not obliged to seek out less onerous solutions than the commitments offered by the undertakings. Nor does it have to compare these commitments with the measures that might be imposed in a prohibition decision or consider as disproportionate any commitments that go beyond these potential measures. According to the Court of Justice, undertakings therefore consciously accept that the concessions they make may go beyond what the Commission itself could impose on them under Article 7.[43]

The observation of the Court of Justice indicates that it does not seem to take the reality of situations into account.[44] Regarding the procedural law of commitment decisions, the undertakings concerned may not be aware that the set of commitments they offer may go beyond what would be imposed under an Article 7 decision. According to the procedure pursued under Article 9, an investigated undertaking can contact the Commission at any point in time to explore its readiness to enter into a commitment decision. Following the proposal of the undertaking, a State of Play meeting is offered to the undertaking at which the Commission presents its preliminary competition concerns arising from the investigation and indicates a timeframe within which the discussion on potential commitments should be concluded.[45] After the State of Play meeting and once the Commission is convinced that the undertaking is seriously interested in submitting adequate formal commitments addressing its concerns over competition, a preliminary assessment should be drafted. This preliminary assessment summarises the main facts

[42] Sadowska, *supra* n 12, 185
[43] Case C-441/07 P *Alrosa Company Ltd v Commission* [2010] ECR I-5949, para. 48
[44] Y. Botteman and A. Patsa, 'Towards a more Sustainable Use of Commitment Decisions in Article 102 TFEU' (2013) Vol.13 Journal of Antitrust Enforcement Advance Access 1, p. 9
[45] This meeting provides undertakings, shortly after the opening of proceedings, with an opportunity to give their initial reactions to the issues identified by the Commission. At a sufficiently advanced stage in the investigation, the meeting gives the undertakings an opportunity to understand the Commission's preliminary view on the status of the case following its investigation and on the competition concerns identified.

of the case and identifies the competition concerns.[46] The undertaking concerned proposes a set of commitments on the basis of the preliminary assessment by the Commission, i.e. without having fully-analysed the economic-based evidence.[47] Therefore, it is hard to believe that undertakings can draft a set of sufficient and necessary commitments. Within this procedural context, it seems that, in practice, even before the delivery of a preliminary assessment to an investigated undertaking, the undertakings and the Commission may reach an agreement over the potential commitments that will be offered.[48] This makes it even more difficult for the firm to realise and consciously accept that the commitments may go beyond what the Commission would impose under a prohibition decision.[49]

Besides, apparently undertakings under investigation do not have the monopoly on initiatives on commitments. Before a market test, the Commission can ask them to modify the text.[50] Although the commitments are voluntarily submitted, 'the Commission

[46] These procedural steps can only be taken if the undertaking concerned informs the Commission of its willingness to engage in commitment proceedings shortly after the initiation of an investigation. Otherwise, a statement of objections could already have been submitted by the Commission and, in that instance the provision of a preliminary assessment would be unnecessary.

[47] In the *Coca-Cola* decision (Case COMP/A.39116/B2), it appears that a draft set of commitments was largely decided upon even before the Commission issued a preliminary assessment. G. S. Georgiev, 'Contagious Efficiency: The Growing Reliance on U.S.-Style Antitrust Settlements in EU Law' (2007) No.4 Utah Law Review 971, p. 975. Similarly, in the *CEZ* decision (Case AT.39727), it seems that the negotiations over commitments took place before the submission of a preliminary assessment.

[48] For example, in the *Coca-Cola* decision (Case COMP/A.39116/B2) the preliminary assessment was delivered to the undertakings on 15 October 2004. Four days later the undertakings submitted commitments as a response to the preliminary assessment. It was reported that the negotiations over the draft commitments were ongoing for several months between the Commission and the company concerned.

[49] Botteman and Patsa, *supra* n 44, 10; F. W. Papp, 'Critical Consideration on the Commission's Commitments to the Commitment Procedure' (2013) Vol.3 Competition Policy International <https://www.competitionpolicyinternational.com/file/view/6903> accessed 4 July 2014, pp. 1-6; T. Graf, 'Commitments in Fast Moving Industries: A False-good Idea?' (Commitments in EU Competition Policy Conference, Liege Competition and Innovation Institute/Brussels School of Competition, June 2014)

[50] The aim of a 'market test' is to ensure the effectiveness of suggested commitments to address the concerns of the Commission by communicating with interested third parties who have relevant market knowledge and experience. The Market Test may contribute to the proportionality of commitments proposed, as the aim of the test is to observe the exploration of third parties' over the appropriateness of the commitments. Although the Commission is not legally bound by the comments of third parties, the market test provides the Commission with useful indications on whether the commitments are appropriate, excessive or insufficient, as well as how the commitments could be improved. After the test, significant or less significant modifications, depending on the case, may become necessary to the proposed commitment text. The Commission therefore may give another opportunity to undertakings concerned to improve the commitments in order to make them appropriate to address the concerns, or decide to conclude the investigation pursuant Article 7, or deem the non-necessity of the commitments.

could make proposals during discussions on how to modify certain elements of the text, and may even provide certain drafting proposals on a specific issue'.[51] Even though the undertakings do not have to adjust the commitments according to the suggestions of the Commission, this illustrates that, particularly regarding the unequal bargaining strength between the Commission and the companies, the commitments may have been set by the Commission in some cases.[52]

The Commission's contribution to a set of commitments can be assessed from two different aspects: first, the undertakings concerned can gain important insights into the Commission's perspective and intentions during a discussion regarding modification of the text of the commitments.[53] Second, the Commission may use settlement proceedings as an alternative mechanism for market regulation since regulatory objectives could be achieved more swiftly through commitment decisions.[54] Besides, commitment decisions grant the Commission the ability to achieve market objectives that *ex-ante* sector regulation has failed to deliver, through *ex-post* antitrust intervention.[55] However, such wide competence seems to damage legal certainty, as will be discussed below.

Overall, the substantive aspect of commitment decisions seems largely uncertain. This might be because of the fact that the Commission has not expanded upon what types of

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Commission, 'Antitrust Manual of Procedures: Internal DG Competition working documents on procedures for the application of Article 101 and 102 TFEU' (Commitment Decision) (2012) 2014 (Section 16, p. 7)
S. Rab, D. Monnoyeur and A. Sukhtankar, 'Commitments in EU Competition Cases Article 9 of Regulation 1/2003, Its Application and the Challenges Ahead' (2010) Vol.5 Journal of European Competition Law & Practice 26, pp. 29-30

[50] Commission, 'Commitment Decisions: Article 9 of Council Regulation 1/2003 Providing for a Modernised Framework for Antitrust Scrutiny of Company Behaviour' MEMO/04/217; Commission, Competition Policy Brief, 'To Commit or not to Commit: Deciding between Prohibition and Commitments' (2014) Issue 3, pp. 1-2

[51] Commission, 'Antitrust Manual of Procedures: Internal DG Competition working documents on procedures for the application of Article 101 and 102 TFEU' (Commitment Decision) (2012) (Section 16, p. 7)

[52] Lugard and Mollmann, *supra* n 5, 6-8

[53] Cook, *supra* n 37, 210

[54] Botteman and Patsa, *supra* n 44, 7-9

[55] Petit, *supra* n 15, 358; D. Geradin and J.G. Sidak, 'European and American Approach to Antitrust Remedies and the Institutional Design of Regulation in Telecommunications' in S. K. Majumdar, I. Vogelsang, and M. E. Cave (eds.) Handbook of Telecommunications Economics, Vol. 2 (Elsevire B.V. 2005), pp. 517-553; Geradin and O'Donoghue, *supra* n 15, 416-419; Cengiz *supra* n 10, 136

commitments would address its concerns under different scenarios of possible infringement of EU competition law.[56] Even though Regulation 1/2003 provides a body of soft law clarifying the characteristics of Article 9, the Commission has not published any guidance for potential commitments, except for a short memo and a Competition Policy Brief, which were announced on the Commission's webpage.[57] Thus, it might be unmanageable for undertakings to either draft a clear set of commitments or develop a strategy that will be pursued during a settlement process.

D. Potential Reasons for the Use of Commitment-based Enforcement Policy from the Aspect of the European Commission and Undertakings

1. Reasons for Undertakings to Propose a Set of Commitments

Decisions given under Article 9 are often considered attractive for undertakings as there is no established infringement that might render them being subject to a fine as well as private litigation.[58] Moreover, commitment decisions tend to reduce the negative publicity for undertakings.[59]

Risk-averse undertakings may propose far-reaching commitments in order to avoid prohibition decisions. If the Commission and the parties cannot reach an arrangement following the settlement negotiations, or if the undertakings concerned do not propose commitments, the Commission can initiate a prohibition procedure. The probability of having a prohibition procedure renders risk-averse undertakings offering far-reaching commitments so as to secure a commitment decision rather than going through an antitrust investigation and appeal process, in particular in view of the litigation and other related legal costs, and the relatively uncertain nature of the EU antitrust policy.[60]

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[56] Cengiz *supra* n 10, 136

[57] Commission, 'Commitment Decisions: Article 9 of Council Regulation 1/2003 Providing for a Modernised Framework for Antitrust Scrutiny of Company Behaviour' MEMO/04/217; Commission, Competition Policy Brief, 'To Commit or not to Commit: Deciding between Prohibition and Commitments' (2014) Issue 3

[58] Lowe and Mier-Rigaud, *supra* n 21, 597-611; Lang, *supra* n 4, 265-324; Wils, *supra* n 36, 340

[59] Cook, *supra* n 37, 212; Lang, *supra* n 4, 265-324

[60] Cook, *supra* n 37, 215; Papp, *supra* n 49, 6; Lang, *supra* n 4, 265-324; Cengiz *supra* n 10,; I. Lionas, 'Competition Law and Remedies in Europe Which Limits for Remedial Discretion?' (2013) CLES Research Series 2/2013 <https://www.ucl.ac.uk/cles/research-paper-series/index/edit/research-papers/cles-2-2013> accessed 6 June 2014, pp. 66-76

Although under some circumstances commitment proceedings can be lengthy and complex, undertakings can still avoid a time-consuming, expensive and complicated procedure involving controversy over facts, economic assessment and legal rules by suggesting commitments in order to close investigations.[61]

2. Reasons for the Commission to Conclude Cases through Commitment Decisions

Commitment decisions, under some circumstances, can be attractive to the Commission as well. If the Commission does not intend to impose a fine and the anticompetitive practice concerned can be ended with the same result that would have been achieved by a prohibition decision the Commission may prefer to make commitments binding upon the undertakings concerned in order to close the investigation in an easier, and perhaps quicker and less controversial way.[62] In such situations, commitment decisions can help the Commission to reduce an institutional cost that would arise under a prohibition decision, thereby enabling it to tackle more cases.

Similar to the undertakings concerned, the Commission may prefer to follow commitment proceedings if an investigation requires complex and complicated economic analyses. Following the establishment of the guidance on the application of Article 102 TFEU, the Commission has been confronted with a heavier evidentiary and methodological burden in investigations over abuse of dominance.[63] The Commission is required to develop plausible and well-articulated theories of harm that are supported by economic evidence in order to establish dominance and the abuse of it. The rise of an economic-based approach in antitrust enforcement policy may encourage the Commission to circumvent the economic complexity through commitment proceedings especially where economic theory does not provide a solid foundation for prohibiting a certain conduct but where the empirical evidence points out a tangible risk of harmful

[61] W. Wils, 'The Use of Settlements in Public Antitrust Enforcement: Objectives and Principles' (2008) Vol.31 World Competition 335, p. 340
[62] Lang, *supra* n 4, 265-324
[63] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009) OJ C45/7

exclusion.[64] In such situations, through Article 9 procedures, the Commission could reach commitments that eliminate all of its concerns without dealing with the complexity of Article 102 TFEU.[65]

Another advantage of commitment decisions from the Commission's point of view could be a weak form of judicial review against commitment decisions.[66] This may increase the incentive of the Commission to finalise investigations through commitment decisions in cases for which there might be a greater need to establish a legal precedent through a prohibition decision, since the more novel the theory of harm, the greater the risk of annulment by the European Court.[67] In *Alrosa*, the Court of Justice held that judicial review for Article 9 decisions is limited to whether the Commission's assessment is manifestly incorrect.[68] When this weak form of judicial scrutiny is combined with a softened form of the proportionality test, this implies that wide remedial discretion is granted to the Commission under the Article 9 procedures. As clarified by the Court of Justice, 'the General Court could have held that the Commission had committed a *manifest error* of assessment only if it had found that the Commission's conclusion was *obviously unfounded*, having regard to the facts established by it'.[69] In other words, as long as the Commission imposes the least onerous commitments necessary to address its concerns from among those offered by the parties the decision is deemed to pass judicial scrutiny.[70] Besides, although the undertakings concerned can challenge the refusal of the Commission to accept the commitments suggested by the undertakings, it seems unlikely that such an appeal would succeed.[71] As the General Court claimed, the

[64] Botteman and Patsa, *supra* n 44, 8; Papp, *supra* n 49, 5
[65] Lang, *supra* n 4, 265-324
[66] It has been argued that this softened judicial scrutiny may result from the voluntary nature of commitment proceedings. Even if this is the case, the intensity of the judicial review of commitment decisions should be equivalent to that of merger control decisions, as will be discussed below. Lionas, *supra* n 60, 38-48
[67] M. Mariniello, 'Commitments or Prohibition? The EU Antitrust Dilemma' (2014) Vol.2014/01Bruegel Policy Brief, p. 5
[68] Case C-441/07 P *Alrosa Company Ltd v Commission* [2010] ECR I-5949, para.42
[69] *Ibid*, para.63
[70] Cengiz *supra* n 10, 150
[71] In the judgment Alrosa and De Beers offered joint commitments for the investigation under Article 101 TFEU. However, because of the negative outcomes of the market testing, the Commission did not impose them. Instead, a set of commitments proposed by De Beers under a commitment proceeding under Article 102 TFEU was imposed. One of the objections that Alrosa raised during the appeal was the non-imposition of the joint commitments since they were less onerous.

Commission is never obliged to accept commitments instead of giving a prohibition decision so as to bring proceedings to an end.[72] Consequently, commitment proceedings under Article 9 provide discretionary leeway to the Commission without any serious degree of judicial supervision.[73] In the light of such discretion, it can be argued that the Commission is able to implement its own sectorial policies through commitment-based enforcement as seems to happen in the energy markets.[74]

Therefore, other motivations of the Commission to conclude investigations through commitment proceedings might be to obtain *quasi*-regulatory commitments that would not be imposed under prohibition decisions given the strict application of the principle of proportionality.[75] The capability of the Commission under Article 9 to impose commitments that could help to achieve regulatory policy objectives within regulated markets may lead to misuse of this process.[76] It seems that, regarding the Commission's tendency to employ EU competition law aggressively to dispel regulatory market failures, the abuse of Article 9 procedures by the Commission may continue in this way.

Last but not least, the disposition of the Commission with regard to relying on commitment decisions may derive from the policy orientation of the Commissioner responsible for competition policy. To greater or lesser extent enforcement priorities in EU competition policy may change pursuant to the socio-economic agenda of the Commissioner.[77] For instance, during Joaquin Almunia's[78] term as Vice President of

[72] Case T-170/06 *Alrosa v Commission* [2007] ECR II-260 para.130; Whish and Bailey, *supra* n 19, 255-261

[73] Lionas, *supra* n 60, 38-48; H. Schweitzer, 'Judicial Review in EU Competition Law' in I. Lianos and D. Geradin (eds.), *Handbook on European Competition Law: Enforcement and Procedure* (Edward Elgar 2013), p. 491

[74] Schweitzer, *ibid*; See Commission, 'Speech: Statement on the Google Investigation' of J. Almunia (the Vice President of the European Commission responsible for the competition policy) SPEECH/14/93. He claims that 'the concessions we extracted from Google in this case are far-reaching and have the clear potential to restore a level playing-field in the important markets of online search and advertising'.

[75] Schweitzer, *supra* n 11, 11; Georgiev, *supra* n 47, 975; Whish and Bailey, *supra* n 19, 255-261; K. Talus, *Vertical Natural Gas Transmission Capacity, Upstream Commodity Contracts and EU Competition Law* (Wolters Kluwer 2011)

[76] Petit, *supra* n 15, 350; Geradin and Sidak, *supra* n 55, 517-553; Geradin and O'Donoghue, *supra* n 15, 416-419; Cengiz *supra* n 10, 135-139

[77] Botteman and Patsa, *supra* n 44, 13-17

[78] Mr. Almunia was on duty from 2010 until 2014, under the second Barroso Commission. Margrethe Vestager will take his place from 1 November 2014.

the European Commission responsible for competition policy the Commission has adopted fourteen commitment decisions and four prohibition decisions.[79] According to Almunia, Article 9 procedure is 'an excellent tool to keep good competitive conditions in the Single Market'.[80] This may be indicative of a preference on the part of the Vice President for negotiated outcomes. However, this approach raises the question of whether this is a new trend in EU antitrust enforcement policy, which will be pursued regardless of changes at the top of the Directorate General for Competition.

The next section will assess the application of commitment proceedings in the EU, and discuss possible detrimental effects of the generalised use of commitment-based enforcement particularly in energy. Before that, the findings in this section regarding the advantages and disadvantages of commitment decisions for the Commission and the undertakings concerned will be summarised in Table 5.

[79] For the purpose of such review, the search function on the website of the Directorate-General for Competition of the European Commission has been used, see <http://ec.europa.eu/competition/elojade/isef/index.cfm> accessed 14/03/2014; Regarding the context of this chapter, prohibition decisions mean that any infringement decisions related to the infringement of Article 101 and 102 TFEU, but cartel decisions.

[80] Commission, 'Speech: Remedies, commitments and settlements in antitrust' of J. Almunia SPEECH/13/210, p. 5

Table 5: Advantages and disadvantages of commitment proceedings for the European Commission and energy companies (*Source: Own illustration)

Commitment Proceedings	Advantages	Disadvantages
For the companies under investigations	No fine Less negative publicity No follow-up private litigation	More concession through far-reaching commitments
	No dealing with the complexity of Article 102 TFEU	Legal uncertainty and insufficient body of case law and guidance
	A relatively short procedure	Less likely to result in a successful appeal
	Possibly obtaining an important insight into the European Commission's perspective and intentions	Less contribution to antitrust enforcement in terms of clarification of the rules, and a clear precedent
	Less costly	
	Undertakings might find it more comfortable to propose commitments and to deal with a single interlocutor (the Commission rather than a national regulatory authority) considering the ongoing liberalisation process	
For the Commission	The application of a softened test for the proportionality of commitments	Risk of the implementation of insufficient commitments
	The implementation of far-reaching, more flexible, consensual commitments	Unclear identifications of antitrust violations may significantly limit the accountability of the Commission
	No need to deal with the uncertainty state of Article 102 TFEU to draft any complex remedies	
	Weak form of judicial review-less likely to be subject to an appeal	
	Less costly	

E. A General Analysis of and the Likely Detrimental Effects of Commitment-based Enforcement Policy

This section of the chapter will shed some light on commitment decisions in terms of current situation of commitment proceedings and possible problems that may be created through excessive implementation. It is clear that commitment-based enforcement can bring some advantages in terms of procedural economy in a situation where the subjects of the investigation are based on a robust body of case law and adequately tested theories of harm. However, in an instance where concerns over competition are likely to raise novel questions under EU competition law or rely upon controversial theories of harm, such as excessive pricing or refusal to supply, the Article 9 procedures do not seem to be able to eliminate the risk of ambiguity of law. In addition, under such circumstances, due to the lack of analyses during Article 9 procedures, the commitments imposed on the undertakings concerned may fail to address the concerns of the Commission.

Insufficient clarification regarding the circumstances in which commitment proceedings can be used raises the question of whether the alleged market distortions should be addressed through a commitment or, rather, a prohibition decision, i.e. a question regarding the appropriateness of commitment decisions. The recently published Competition Policy Brief to a certain extent clarifies this issue.[81] According to the Policy Brief, the Commission cannot base its decision on Article 9 when it intends to impose a fine, for instance in the case of a secret cartel for which an alternative cartel-settlement procedure exists.[82] Moreover, it adds that the Commission should not conclude an investigation through commitment proceedings if a legal precedent needs to be set. Also, it is stated that commitment decisions are more convenient where the primary aim of the Commission is not punishment for past behaviour, but adjusting it in the future.

[81] Commission, Competition Policy Brief, 'To Commit or not to Commit: Deciding between Prohibition and Commitments' (2014) Issue 3, pp. 1-2

[82] Commission, 'Antitrust Manual of Procedures: Internal DG Competition working documents on procedures for the application of Article 101 and 102 TFEU' (Commitment Decision) (2012) (Section 16); Commission Regulation (EC) No.622/2008 of 30 June 2008 amending Regulation (EC) No 773/2004, as regards the conduct of settlement procedures in cartel cases [2008] OJ L 171/3; Commission, Commission Notice on the Conduct of Settlement Procedures in View of Adoption of Decisions Pursuant to Article 7 and 23 of Council Regulation (EC) No. 1/2003 in Cartel Cases, [2008] OJ L167/1

However, cases handled by the Commission through commitment proceedings are puzzling in this sense. First of all, there is no clarification regarding why the Commission intends (or does not intend) to impose a fine. Given decisions such as *Telefonica*[83] and *Deutsche Telekom*,[84] the Commission appears to be apt to impose a fine where an undertaking abuses its dominant position through margin squeeze. However, in the *RWE* decision, as will be discussed below, the Commission preferred to conclude the investigation into a margin squeeze through commitment proceedings, even though it could have imposed a fine as well as structural remedies under a prohibition decision.[85] Second, it is stated that commitment proceedings might be more appropriate when the concerns over competition are grounded on a robust body of case law and adequately tested theories of harm. Nevertheless, the case law indicates that investigations that are likely to raise novel questions under EU competition law or that involve very harmful conduct can be concluded through commitment decisions.[86] For instance, in the *Google* case,[87] the concerns of the Commission raised a novel question under EU competition law in terms of Google's anticompetitive behaviour in relation to online research and online advertising. Yet, apparently, the case will be finalised through commitment-based enforcement given that adversarial proceedings would not bring immediate effects or necessarily deliver a better outcome for consumers according to Almunia.[88] In addition, in the *E-Books* decision, the concern of the Commission was a concerted practice among four publishers and Apple, which was possibly developed in order to raise the retail prices of e-books.[89] Despite the fact that the concern of the Commission was not far from cartel conduct the investigation was concluded through a commitment decision.

[83] *Wanadoo España vs. Telefónica* (Case COMP/38.784) Commission Decision [2007]
[84] *Deutsche Telekom AG* (Case COMP/C-1/37.451, 37.578, 37.579) Commission Decision C (2003) 1536 [2003] OJ L 263/9
[85] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]
[86] Lugard and Mollmann, *supra* n 5, 10-11; Botteman and Patsa, *supra* n 44, 20-27; F. W. Papp, 'Best and even Better Practices in Commitment Procedure after *Alrosa*: The Dangers of Abandoning the "Struggle for Competition Law"' (2012) Vol.29 Common Market Law Review 929, pp. 961-966
[87] *Google* (Case Comp/C-3/39740) [2014]
[88]Commission, 'Speech: Statement on the Google Investigation' of J. Almunia SPEECH/14/93; However, the approach of the Commission within this case may change regarding the attitude of the new commissioner for competition, Margrethe Vestager.
[89] *E-Books* (Case COMP/39847) Commission Decision C(2013) 4750 [2013]

This ambiguity over commitment proceedings seems to result from the wide remedial discretion of the Commission, which is strengthened through the softened application of the principle of proportionality as well as limited judicial review.[90] Generalised use of commitment-based enforcement mainly stemming from this widened discretion of the Commission is likely to create certain detrimental effects particularly in the energy markets. These effects can be categorised into two groups: (i) the creation of legal uncertainty, and (ii) the intervention of the Commission particularly in the regulated markets.

1. The Creation of Legal Uncertainty

Commitment proceedings may undermine legal certainty in the markets, since they provide less guidance on permitted and prohibited practices under the European competition rules. The positive outcomes prohibition decisions result in, such as the clarification of novel legal issues and the identification of theories of harm supported by economic-based evidence, are likely to be lost if disputes are negotiated rather than adjudicated.[91] This danger recently became clearer in the energy markets given the drastic decline in prohibition decisions, which provide legal certainty for future investigations by the Commission by clarifying the legal boundaries and legal principles applied in previous cases.[92]

By disclosing very few facts and including only cursory legal and economic analyses, commitment decisions have very little precedential value. Thus, the business

[90] Wils, *supra* n 31, 362; H. Schweitzer, 'Commitment Decisions in the EU and in the Member States: Functions and Risks of a New Instrument of Competition Law Enforcement within a Federal Enforcement Regime' (2012) No. 48150 e-Competition Bulletin, Special Issue on Commitment Decisions, pp. 18-19; In this sense, an action brought before the General Court by Hynix (Case T-148/10 and T-149/10 *Hynix Semiconductor v Commission*) regarding the *Rambus* decision of the Commission (Case COMP/38636) was expected to be a good opportunity for the Court to clarify the discretion of the Commission under commitment proceedings; yet Hynix withdrew its action against the Commission following of a patent license agreement, which involved the settlement of all outstanding claims between the firm and the Commission. Yet, the arguments of the complainant are still significant in terms of showing that there can be similar complaints about the application of Article 9, in particular, given the rise of a commitment-based enforcement policy in EU competition law. Hynix claimed that the commitments made binding by the Commission were manifestly inappropriate given the facts of the infringement, and therefore that the Commission had violated Article 9 of Regulation 1/2003. In addition, it argued that the Commission had failed to give reasons as to the appropriateness and adequacy of the commitments and thus had committed a serious error of assessment.

[91] Cook, *supra* n 37, 224-226

[92] Papp, *supra* n 86, 955; Botteman and Patsa, *supra* n 44, 17

community does not have enough examples to carry out self-assessment of its business practice. Therefore, businesses may test the legitimacy of certain practices by engaging in them and, under anticompetitive investigation, find a quick way out by proposing far-reaching commitments.[93] In such situations, the question will not be whether the conduct complies with EU competition law but rather 'how much a dominant firm is willing to give to buy the right to engage in anticompetitive conduct'.[94]

Furthermore, it seems that the lack of legal certainty or more generally less clarification of the rules harms the objective of the creation of a single market, because asymmetric information and increase in cost, due to the legal uncertainty, is likely to discourage market participants from making an investment and potential competitors from entering the markets.[95] Thus, an excessive use of commitment-based enforcement in the recently liberalised energy markets may be detrimental for the development of competition. As a result, apparently, prohibition decisions and commitments cannot be considered as perfect substitutes in the energy markets. Indeed, for commitment proceedings to work, prohibition proceedings should be a viable option.[96]

2. The Intervention of the Commission in the Regulated Markets

As mentioned before, commitment-based enforcement in EU competition law seems to be convenient tool for the Commission to facilitate market regulation, since commitment proceedings permit the Commission to prospectively influence the behaviour and/or structure of individual firms.[97] Given that the Commission has broad discretion to approve commitments that would not have been imposed under prohibition decisions, commitment decisions may be adopted in sectors where the Commission is pursuing a specific aim such as creating a well-functioning competitive market.[98] The increase in the number of investigations concluded through commitment decisions in the energy markets as well as in the number of behavioural and/or structural commitments imposed

[93] Papp, *supra* n 86, 955
[94] *Ibid*
[95] A. De Hauteclocque and L. Hancher, 'Manufacturing the EU Energy Markets: The Current Dynamics of Regulatory Practice' (2010) EUI Working Papers RSCAS 2010/01 <http://ideas.repec.org/a/sen/journl/v11y2010i3p307-335.html> (accessed 16 February 2013), p. 12
[96] Georgiev, *supra* n 47, 1024
[97] Dunne, *supra* n 22, 427
[98] Schweitzer, *supra* n 90, 13

on investigated undertakings implies that the Commission is attempting to create a single and competitive well-functioning energy market through these commitments, which may resemble regulation rather than real antitrust enforcement.[99]

The Article 9 procedure provides the Commission with *quasi*-regulatory powers by allowing it to build up a desirable market structure, which it otherwise could not. The limitation of contract duration/volume is a typical example of such influence (Chapter 2).[100] Furthermore, under commitment proceedings the Commission is able to tailor the remedies to both the specific market conditions and its competition concerns. In most of the energy cases to date, the issues have been the difficulty for the competitors of incumbents to enter the market or explore their market powers. The commitment procedure has allowed the Commission to reach agreements on very detailed plans to introduce flexibility in market access, *inter alia* through divestiture of the ownership of specific generation or network businesses, as will be seen below, and through behavioural remedies such as freeing up some network capacities (Chapter 3).

This intervention of the Commission may at some points be beneficial for market operators as it removes regulatory shortcomings from the market. On the other hand, thanks to the wide remedial discretion of the Commission, less-strict application of the principle of proportionality and the limited judicial review of Article 9 decisions, the use of *ex-post* antitrust enforcement for *ex-ante* market regulation under commitment proceedings may increase the legal uncertainty for market operators, regulators and national courts, as mentioned above.[101]

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[99] S. Grassanil, 'The Increase Abuse of Commitments in European Antitrust Law: Stockholm Syndrome?' (2013) Vol.3 Competition Policy International Chronicle, p. 5

[100] *Gas Natural* (Case COMP/37542) [2000]; *Distrigaz* (Case COMP/B-1/37966) Commission Decision [2007]; *Gaz de France* (Case COMP/39316) Commission Decision [2009]; *E.ON Gas* (Case COMP/39317) Commission Decision C (2010) 2863 final [2010]; *Long-term Contracts France* (Case COMP/39386) Commission Decision [2010]

[101] For further reading about discussion over the intervention of the Commission in regulated markets see N. Economides, 'Competition Policy in Network Industries: An Introduction' (2004) NET Institute Working Paper 04-23 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=386626> accessed 7 February 2013; Geradin and O'Donoghue, *supra* n 15; G. Monti, 'Managing the Intersection of Utilities Regulation and EC Competition Law' (2008) Vol.4(2) The Competition Law Review 123; M. Hellwig, 'Competition Policy and Sector-specific Regulation for Network Industries' (2008) Max Planck for Research on Collective Goods Bonn 2008/29 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275285> accessed 5 February 2013; I. Colomo, 'On the Application of Competition Law as Regulation: Elements for a Theory' (2010)

In the next section, the focus will be on certain investigations in the energy markets that were concluded through commitment proceedings, particularly with regard to the appropriateness of the structural or *quasi*-structural commitments imposed on the undertakings concerned, in order to analyse whether the Commission has certain regulatory objectives in its antitrust investigations in the energy sectors. After that, the chapter will attempt to provide a hypothetical framework (a guideline) for better use of commitment proceedings.

III. Case Law

As mentioned before, a number of commitment decisions in the energy markets show the eagerness of the Commission to solve competition problems in these markets on the basis of Article 9. The ambition of the Commission may stem from the potential of commitment decisions to (i) introduce competition into the markets more quickly than prohibition decisions, and (ii) achieve regulatory goals that would be difficult to achieve through sector regulation. This is because the market regulation in the energy sectors has not been fully completed, since to a large extent it incorporates political compromises. While prohibition decisions constrain the scope of the Commission's remedial action due to the principle of proportionality, commitment decisions allow it to impose structural or behavioural remedies that go beyond what would be imposed under Article 7 of Regulation 1/2003. Therefore, it is significant to examine the decisions of the Commission, namely *E.ON,*[102] *CEZ,*[103] *RWE*,[104] *ENI,*[105]*and SvK*.[106] The aim of analysing these cases is to assess the appropriateness of the commitments imposed in terms of addressing the concerns of the Commission. After that, the chapter will propose a hypothetical legal framework guideline, which could eliminate these deficiencies and increase the efficiency of commitment proceedings.

Vol.29 Yearbook of European Law 261, p. 265; J. Tapia and D. Mantzari, 'The Regulation/Competition Interaction' in D. Geradin and I. Lianos (eds.) *Research Handbook on European Competition Law: Substantive Aspects* (Edward-Elgar 2013), p. 588

[102] There are two cases involving E.ON. The first case relates to the German electricity wholesale market (case COMP/39388), whereas the second case relates to the German electricity balancing market (Case COMP/39389). Since the Commission concluded the cases in a single decision this thesis examines the cases as if they were a single case.

[103] *CEZ* (Case AT/39727) Commission Decision C(2013) 1997 final [2013]

[104] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]

[105] *ENI* (Case COMP/39315)Commission Decision [2010]

[106] *Swedish Interconnectors* (Case COMP/39351) Commission Decision [2010]

A. The Analysis of The European Commission's Decisions

In the cases examined below the concerns of the Commission were related to network foreclosures stemming from the probability of the undertakings abusing their dominant/collective dominant positions in different ways. In the *E.ON* decision, the Commission stated in the preliminary assessment that E.ON, a vertically integrated energy company, had a collectively dominant position with RWE and Vattenfall in the German electricity wholesale market,[107] and may have abused its dominant position by withdrawing available capacity.[108] Additionally, according to the preliminary assessment, E.ON was dominant in the market for secondary balancing energy in the E.ON network area, in which E.ON TSO (the transmission system operator owned by E.ON) acted as a monopolist. The Commission's concerns were that E.ON may have abused its dominant position in the network through increasing its own cost in order to favour its production affiliate and pass on the cost to the final consumers, and through preventing power generators from other Member States from selling balancing energy into the E.ON balancing market.[109] Similarly, in the *CEZ* decision,[110] the concern of the Commission was that CEZ, the incumbent electricity producer in the Czech Republic, may have abused its dominant position in the Czech electricity market, in particular by hindering the entry of competitors, in breach of EU competition rules. The Commission claimed that CEZ's behaviour, in particular its hoarding of capacity in the transmission network, may have resulted in preventing competitors from entering the Czech wholesale electricity market.[111]

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[107] According to the established case law, undertakings occupying a joint dominant position may engage in joint or individual abusive conduct. Case T-228/97 *Irish Sugar* [1999] ECR II-2969, para.66; Joined Cases T-191/98 and T-212/98 to T-214/98 *Atlantic Container Line v Commission* [2003] ECR II-3275

[108] The withdrawal of generation capacity by a dominant undertaking is considered an abuse of dominant position and thereby against Article 102 TFEU. Such action causes serious harm to all kinds of consumer groups by directly increasing the prevailing price in the spot market as well as by indirectly raising the prevailing price in long-term markets. As the consumers in electricity markets have limited capacity to show a reaction to the price signals, and furthermore, as building new generation capacity requires long lead times, capacity withdrawals are severely detrimental to consumers.

[109] Commission, Notice published pursuant to Article 27(4) of Council Regulation (EC) No 1/2003 in Cases COMP/B-1/39.388 — *German Electricity Wholesale Market* and COMP/B-1/39.389 — *German Electricity Balancing Market* OJ C 146

[110] *CEZ* (Case AT/39727) Commission Decision C(2013) 1997 final [2013]

[111] Commission, 'Antitrust: Commission opens formal proceedings against Czech electricity incumbent CEZ' IP/11/891

In the *RWE* decision, RWE, a vertically integrated company, may have abused its dominant position in the gas transmission market as well as in the downstream gas supply markets within its grid by refusing its actual and potential competitors' demand to access its network facilities, and also, by squeezing its rivals' margins in the downstream gas supply markets. Likewise, in the *ENI* decision, according to the Commission's Statement of Objections, ENI was a vertically integrated company holding a dominant position in the market for the transport of gas to and into Italy by means of its ability to effectively control and influence the use of all viable international pipelines for shipping gas into Italy. ENI also controlled all of the viable network infrastructures and owned the transmission system operator, which held significant capacity/use rights regarding those import pipelines. Additionally, ENI had a significant portfolio of long-term gas import contracts and it remained a gas producer in its own right both in Italy and abroad. Therefore, ENI had a dominant position in the wholesale supply market in Italy as a whole and in particular in the market for supplies to gas fired power plants and the market for supplies to large industrial customers. The Commission's concerns over competition were that ENI may have been deliberately hoarding and degrading its network capacity as well as strategically limiting investment in its network.

In the *SvK* decision, the Commission suspected that Svenska Kraftnät (SvK), the Swedish monopoly transmission system operator, may have abused its dominant position by limiting export transmission capacity on Swedish electricity interconnectors to neighbouring countries and thereby hindering competition as well as the proper functioning of the single market in electricity.[112] However, SvK claimed that export capacity limitation was necessary to lighten internal congestion in its electricity transmission network. However, this argument was not accepted as an objective justification, as the Commission focused on the objectives of the internal market rather than the objective of market efficiency, in other words economic welfare.

[112] Commission, 'Antitrust: Commission opens proceedings against Swedish electricity Transmission System Operator concerning limiting interconnector capacity for electricity exports' MEMO/09/191

Under the antitrust settlements, pursuant to the concerns of the Commission, the investigated companies proposed structural or behavioural remedies such as the divestiture of generation or network business, or the introduction of new bidding zones[113] in the Swedish electricity market. Having briefly discussed the decisions, the chapter will continue with individual in-depth examinations of each decision.

1. The *E.ON* Decision

As mentioned above, in the E.ON decision, the first concern of the Commission was with regard to the German wholesale electricity market. According to the preliminary assessment, E.ON might have had the incentive and ability to withdraw generation capacity given its broad generation portfolio including its base-load (nuclear, hydro and coal) and high-cost (hard coal, gas, oil) generation capacities. The Sector Inquiry demonstrated that in competitive short-term markets, prices are set by the short-run marginal cost (hereafter SRMC)[114] of the plant producing the last unit of electricity that is required to meet demand.[115] The last or marginal unit needed to meet demand is also the one with the highest SRMC of all units, i.e. the most expensive one for consumers, running at a given point in time. In this sense, it is significant to underline that the SRMC of the price setting unit determines the revenues not only of the owner of the marginal plant, but also of all of the other units called on to produce in any given hour, i.e. the sale price of all other units. As a result, the Commission deemed that the broad generation portfolio of E.ON might have provided a greater incentive and ability to withdraw generation capacity in order to increase the revenue of its generation plants to the detriment of the final consumers,[116] in particular given the inflexibility of demand and the non-storability of electricity.[117]

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[113] The introduction of new bidding zones in the electricity market in Sweden means that the electricity market will be divided into zones and electricity will be traded separately in each of these zones. Thus, there will be a different price for electricity in each zone depending on the bids of the participants as well as the balance between the supply and demand in each zone.

[114] SRMC mainly consists of the fuel costs and other different production costs of a plant.

[115] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para.368-372

[116] According to economic literature, to conclude long-term supply contracts in the wholesale electricity market may mitigate the potential pricing abuse. If a big share of E.ON's capacity is bound through long-term contracts its incentive and ability to reduce output in order to manipulate the price would be reduced, since less volume is traded in the spot market and the higher price is set only for the un-contracted capacities. (See P. Joskow and E. Kahn, 'A Quantitative Analysis of Pricing behaviour in California's Wholesale Electricity Market during summer 2000: The Final Word' (2002) Vol.23(4) The Energy Journal

The Commission also considered that price increases in spot markets through the withdrawal of generation capacity could affect forward markets as they are driven by the corresponding trend in short-term prices.[118] As a result, according to the Commission's investigation, E.ON may have withdrawn or refrained from bidding a certain amount of capacity into the Germany power exchange even though that capacity was available and would have been profitable to run.[119]

In the preliminary assessment the Commission also raised concerns that, in order to limit the volume of electricity traded in the wholesale market, E.ON may have deterred actual or potential competitors from entering the generation market by offering new competitors participation in an E.ON power plant and by signing long-term supply contracts. It appeared to the Commission that E.ON may have wanted to combine the withdrawal of generation capacity with this strategic behaviour so as to maintain wholesale price levels, which were higher than under competitive circumstances.[120]

The second concern of the Commission was over the German balancing market.[121] E.ON TSO (the transmission system operator belonging to E.ON) may have purchased

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1, pp. 1-36). In the decision, however, the Commission did not mention whether or not the volume of E.ON's generation sold under fixed-price long-term contracts. Due to the lack of information, it can be argued that the Commission assumed that the most of electricity generated by E.ON was traded in the spot market, because in this situation the incentive and ability of E.ON to withdraw generation capacity would be in the highest level. As a result of the fact that under an Article 9 procedure the Commission does not have to support its concerns with economic-based evidence it did not underline the theory of a profitable capacity withdrawal. See M. Sadowska, 'Energy Liberalisation in Antitrust Straitjacket: A Plant too Far? (2011) Vol.34(3) World Competition: Law and Economics Review, p. 16

[117] P. Chauve and others, 'The E.ON Electricity Cases: An Antitrust Decision with Structural Remedies' (2009) No.1 Competition Policy Newsletter, pp. 1-4

[118] According to the Sector Inquiry, prices in the forward markets can be influenced by the volatility of spot prices in the future. Thus, undertakings with market power in the generation market may influence price changes in forward markets by withholding part of their generation capacity; this results in price volatility in the spot markets. Consequently, withholding generation capacity not only increases spot market prices but also raises forward market prices as a result of the increase in demand even though the forward market prices were much higher than the prices in the spot market before the withdrawal of the capacity. DG Competition Report on Energy Sector Inquiry, SEC(2006) 1724, para. 376

[119] Commission, Notice published pursuant to Article 27(4) of Council Regulation (EC) No 1/2003 in Cases COMP/B-1/39.388 — *German Electricity Wholesale Market* and COMP/B-1/39.389 — *German Electricity Balancing Market*' OJ C 146

[120] Commission Decision of 26 XI 2008 related to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.388 *German Electricity Wholesale Market* and COMP/39.389 — *German Electricity Balancing Market*), para. 50-55

[121] Balancing power services: As electricity cannot be stored, balancing mechanisms are indispensable to balance the difference between forecast and actual electricity demand and production. Therefore, there must be properly operating balancing services for the accurately functioning electricity markets. The

secondary balancing power instead of tertiary balancing power[122] in favour of its own generation affiliate which was the main operator in the secondary balancing market. By doing so E.ON TSO had increased its own cost. Yet, it did not become worse off as it passed on the additional balancing costs to the final consumers. Moreover, the Commission stated in the preliminary assessment that E.ON may have prevented the import of balancing energy by power producers from other Member States into the E.ON balancing area so as to reserve the German balancing area for German power producers. As a result, E.ON had discriminated against power producers from other Member States on the grounds of nationality.[123]

a) The Commitments and Proportionality

Pursuant to Article 9 of Regulation 1/2003, E.ON proposed to divest power plants and its transmission network in order to address the concerns of the Commission established in the preliminary assessment as well as to bring to a rapid close the potentially protracted competition cases.[124]

balancing mechanism is under the control of transmission system operators. They should constantly monitor networks and take balancing measures when necessary.

[122] Secondary and tertiary balancing powers are part of separate product markets because of their technical specifications such as the different lead times with which they are called upon (within a few minutes for secondary reserves and within a quarter of an hour for tertiary reserves) as well as the technical requirements for their provision on the part of the power plants themselves. Yet, both types of reserves are called on by the transmission system operator for the purpose of balancing systems and the transmission system operator has some flexibility to order either of the two reserves in order to resolve some unbalances.

[123] Commission Decision of 26 XI 2008 related to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.388 *German Electricity Wholesale Market* and COMP/39.389 — *German Electricity Balancing Market*), para. 50-55

[124] Chauve and others, *supra* n 117, 1-4

E.ON divested:

	Source of Generation	Total Amount of Generation Capacity	Amount of Divested	Total Amount of Divested Capacity
Base-load Generation	hydro (run-over-river and pump-storage)	985.7 MW	678,38 MW	2783,88 MW
	nuclear	5263 MW	1501 MW	
	lignite	1289 MW	604,5 MW	
High-cost Generation	hard coal	3114 MW	1744,6 MW	2235,6 MW
	gas fired	491 MW	491 MW	
	oil fired	unknown	0 MW	Total: 5019.48MW

On the one hand, the Commission stated that the commitments suggested by E.ON were necessary and proportionate to remove E.ON's incentive and ability to withdraw generation capacity, which stemmed from the structure of E.ON's power plan portfolio.[125] First, there were no behavioural remedies that would have been as effective as the divestment of generation capacity in that controlling E.ON's bidding behaviour on an hourly basis for a large number of plants might have been demanding as well as more burdensome for E.ON than the structural solution.[126] Second, as the concerns

[125] Commission Decision of 26 XI 2008 related to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.388 *German Electricity Wholesale Market* and COMP/39.389 — *German Electricity Balancing Market*)

[126] Possible behavioural remedies might have been to force E.ON to utilise long-term supply contracts in order to reduce E.ON's incentive to withdraw generation capacity, as after making long-term supply contracts the profitability of withdrawing would be less, since there would not be enough electricity to

arose due to the very structure of E.ON's generation capacity, i.e. E.ON's large portfolio of power plants, there was a substantial risk of a lasting or repeated infringement.

On the other hand, there are several studies that discuss whether the structural commitments imposed on E.ON were the most efficient and proportionate remedies to address the abuse of strategic capacity withdrawal.[127] According to Sadowska, the commitments did not directly address the alleged strategy of unilateral capacity withdrawal, the risk of which the Commission wanted to eliminate in the first place.[128] Her work shows that the divestiture remedies did not significantly change the structure of the generation capacity in terms of the proportion of each technology and the sources used to generate electricity within the total generation portfolio of E.ON, although the Commission, while reasoning the case, attached the greatest importance to the size and structure of E.ON's generation portfolio. It simply scaled the generation portfolio down in terms of figures.[129] Nevertheless, even though the structure of the generation capacity was not actually changed, it was lessened, and the market was opened to other operators. As a result, the divestiture reduced E.ON's incentive and ability to withdraw generation capacity, which was one of the objectives of the commitment proceedings, since the total withholding decreases as the number of generators increases.[130]

The E.ON decision, given the economic literature, may also be criticised in terms of the divestiture of both base-load generation capacities, namely hydro, nuclear and lignite, and high-cost generation capacities, such as hard-coal, gas-fired and oil-fired. According to economic evaluations, the divestiture of solely high-cost generation

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trade in spot markets. Yet, as stated in the preliminary assessment, long-term supply contracts were used so as to deter actual or potential competitors from entering the wholesale market.

[127] Tapia, and Martzari, *supra* n 101, 460-471

[128] Pre- and post-divestiture the percentage of hydro energy in electricity generation is 12%; the percentage of nuclear energy in electricity generation is 33%; the percentage of lignite coal energy in electricity generation is 5% (it was 3%); the percentage of hard coal energy in electricity generation is 28% (it was 27%); the percentage of gas energy in electricity generation is 16% (it was 18%); the percentage of oil energy in electricity generation is 4% (it was 5%); and the percentage of other energy sources in electricity generation is 2%, for the total generation capacity of E.ON; Sadowska, *supra* n 116, 460-471

[129] *Ibid*

[130] P.Hellstrom, F. Maire-Riguad, and F. W. Bulst, 'Remedies in European Antitrust Law' (2009) Vol.76 Antitrust Law Journal 43, pp. 54-58

capacities could be more effective in decreasing the incentive of undertakings with a dominant position to abuse their power,[131] and in reducing wholesale electricity prices.[132] According to Federico and Lopez, the divestment of marginal plants, i.e. high-cost generation plants, can reduce prices by seven times more than the divestment of base-load plants.[133] Furthermore, targeted divestiture can reduce prices more significantly than a cross-the-board divestiture.[134] The divestiture of high-cost generation capacities may reduce the generator's incentive to use its assets strategically.[135] The E.ON decision therefore does not entirely correspond with this economic assessment as the decision entails not only the divestiture of high-cost generation capacities but also the divestiture of base-load generation capacities. However, this does not mean that the structural remedies imposed in the E.ON decision were completely inappropriate to remove the concerns of the Commission. The commitments proposed by E.ON reduced the market power of E.ON, and thus the market concentration. In addition, the Commission claimed that the selection of verified power plants in terms of fuel and technology was necessary and proportionate to meet the concerns clarified in the preliminary assessment. It was also sufficient and appropriate to balance the power plant portfolio of other market operators, which should consist of plants along the entire merit curve, i.e. base-load plants and flexible plants.[136]

[131] According to the Sector Inquiry, withdrawing energy generation might be more profitable for a dominant undertaking if it has a wide portfolio of electricity generation. When the undertaking constrains electricity generation by limiting the capacity of base-load plants, it will fully cover its loss with the increase in price due to the high-cost generation capacities; DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 368-372; M. Arellano and P. Serra, 'A Model of Market Power in Electricity Industries Subject to Peak Load Pricing' (2007) Vol.35 Energy Policy 5130, p. 5134

[132] This is because the technology used for electricity generation has a significant impact on price formation. Since high-cost generation plants require relatively more expensive raw material for energy generation, the price of the electricity generated by these plants will be relatively higher compared to base-load power plants; G. S. Crawford, J. Crespo, and H. Tauchen 'Bidding Asymmetries in multi-unit auctions: Implications of Bid Function Equilibrium in the British Spot Market for Electricity' (2007) Vol.25 International Journal of Industrial Organisation 1233, p. 1258

[133] G. Federico and A. L. Lopez, 'Selecting Effective Divestment in Electricity Generation Markets' (2011) Vol.21 European Transections on Electrical Power 1914, p. 1921

[134] Crawford, Crespo, and Tauchen, *supra* n 132, 1258; Sadowska, *supra* n 116, 460-471

[135] Sadowska, *ibid*; Federico and Lopez, *supra* n 133, 1921

[136] Commission Decision of 26 XI 2008 related to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.388 *German Electricity Wholesale Market* and COMP/39.389 — *German Electricity Balancing Market*), para. 84

Besides, the decision indicates another aspect of commitment proceedings. It seems that, while making the decision, the Commission took into account the findings of the Sector Inquiry and imposed the disposal of base-load generation. The Sector Inquiry clarifies that, in the electricity generation markets, most of the newly-built generation capacities are based on gas-fired plants as well as wind and other renewable generation facilities.[137] This analysis was supported in the E.ON decision by the Commission, which noted that only gas-fired capacity was added to the German electricity generation market by new entrants because the investment in base-load generation requires higher fixed cost and new entrants find it more attractive to invest in peak generation such as gas-fired plants (Chapter 2).[138] Therefore, the E.ON's competitors did actually have access to peak-load generation. As a result, in order to cover the divestiture of base-load generations in the decision, the Commission seemed to reason that the divested plants would help actual and potential competitors to access new plants and plants with technologies that they did not possess. This would allow them to have a more balanced portfolio and more capacity to exert competitive pressure on E.ON in the wholesale electricity market.[139]

To sum up, the implementation of structural remedies by the Commission might not be completely irrelevant, since there was a substantial risk of a lasting and repeated infringement of competition law. Yet, the attitude of the Commission, such as its handling of the investigation as a tool to eliminate market deficiencies by imposing structural remedies, can be discussed on the grounds of whether a divestment of power plants representing a cross section of E.ON's generation portfolio was the most suitable remedy for a strategic capacity withdrawal. Indeed, it seems that the set of

[137] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724, para. 407
[138] Sadowska, *supra* n 116, 470
[139] Regarding the concerns over the balancing market, E.ON divested its Transmission System Business. The divestiture of the transmission network along with the system operation activity of E.ON was found sufficient and proportionate by the Commission, since its concerns stemmed from an inherent conflict of interest within E.ON as a vertically integrated electricity company controlling both transmission and production/supply of electricity. Besides, a behavioural remedy managing E.ON's purchasing behaviour would have been more burdensome, and furthermore, this remedy would not have prevented E.ON from engaging in discriminatory conduct against operators from other Member States who wanted to enter the German balancing market (Chapter 3). Commission Decision of 26 XI 2008 related to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39.388 *German Electricity Wholesale Market* and COMP/39.389 — *German Electricity Balancing Market*), para. 86-88

commitments proposed by E.ON was drafted as a result of negotiations between the Commission, which was pursuing the goal of energy liberalisation, and E.ON, which was considering its own strategic interests. Furthermore, the Commission's choice between prohibition and commitment proceedings is questionable, due to the fact that its concerns over the anticompetitive conduct of E.ON were likely to raise novel questions under EU competition law, in particular regarding the complexity of electricity markets. By concluding the investigation through adversarial proceedings, the Commission could have carefully identified electricity markets, precisely clarified its concerns and supported them with economic-based evidences. This would have increased legal certainty as well as providing a precedent for other energy companies and also for national courts and/or competition authorities, specifically considering the similarities between the general structures of the national electricity markets within the EU. In addition, under a prohibition decision, the Commission could still have extracted the same structural remedies imposed on E.ON in the case had these remedies been found to be proportionate. With regard to this point, the main reasoning behind the application of a commitment procedure might be that the commitments proposed by E.ON may not have been imposed by the Commission under Article 7 of Regulation 1/2003 considering the strict application of the principle of proportionality within this procedure.

2. The *CEZ* Decision

In the *CEZ* decision, the Commission considered that the conduct of CEZ, a state-owned incumbent operator in the Czech electricity market, may have led to a substantial distortion in competition and resulted in the enhancement of CEZ's dominant position. The suspected illegal conduct excluded potential competitors and raised prices in the Czech wholesale electricity market.[140]

According to a preliminary assessment, during the relevant period, CEZ was most likely a dominant company in the market for the generation and wholesale supply of electricity with regard to three indicators, namely, the structure of the Czech wholesale electricity market, CEZ's control over certain types of electricity generation, and finally, high

[140] Commission, 'Antitrust: Commission confirms inspections in Czech electricity sector' MEMO/09/518

barriers to entry.[141] CEZ, in addition to electricity generation, was operating in several areas of the electricity and lignite sectors and enjoying access to the cheapest sources of generation such as nuclear and lignite. Given that all significant generation projects had been developed by CEZ, it remained difficult for new entrants to enter the electricity generation and wholesale supply markets. Furthermore, CEZ controlled the largest distribution system operator.

The Commission, in the preliminary assessment, took the view that CEZ may have pursued a strategy to prevent new entry to the market for the generation and wholesale supply of electricity. As part of that strategy, CEZ may have made a potentially pre-emptive reservation in an electricity transmission system by referring two alternative projects: lignite-fired or gas-fired power generation capacity. However, the reservation did not correspond to genuine generation projects.[142] As a result, the Commission deemed that, due to the pre-emptive reservation of CEZ, its competitors could have been prevented from having access to the transmission network, which constituted an indispensable input, i.e. an essential facility for every large scale electricity generator.[143] In particular, CEZ may have prevented the entry of a competitor, which (i) was pursuing a competing project in lignite-fired capacity to be connected to the transmission network through a network substation[144] at which CEZ had made its potentially pre-emptive

[141] In 2010, the market shares of the largest competitors of CEZ were [0-15] %; Commission Decisions of 10/04/2013 addressed to CEZ,a.s. relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreements (AT/39727 – *CEZ*) C(2013) 1997 final, para. 14-17

[142] Regarding the lignite-fired generation capacity, according to the preliminary assessment of the Commission, CEZ would not have been in a position to procure fuel in the volumes necessary to carry out the project. Concerning the gas alternative, the reservation was not backed by the project concerned, since, first, it did not fit with the company's overall portfolio development strategy, second, it was made at a moment which was at odds with the company's standard practice of project development, and third, it was made long before the site for the gas-fired project was eventually selected; Commission Decisions of 10/04/2013 addressed to CEZ,a.s. relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreements (AT/39727 – *CEZ*) C(2013) 1997 final, para. 32

[143] Eventually, the transmission system operator refused to connect a new competing lignite-fired generation project to a specific network substation linked to the transmission network, because there was not sufficient capacity at that substation in view of the previous reservation made by CEZ; Commission Decisions of 10/04/2013 addressed to CEZ,a.s. relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreements (AT/39727 – *CEZ*) C(2013) 1997 final, para. 33

[144] For the transmission of electricity generated by large-scale power plants, the electricity must be injected into the transmission system, and this injection must be done through a specific connection point,

reservation, and (ii) presumably could have, in the long run, developed a wider portfolio of generation units.

Consequently, the Commission took the preliminary view that CEZ had prevented, or at the very least considerably delayed, the entry of a new competitor into the market by making a potentially pre-emptive reservation in the electricity transmission network with the aim of depriving other undertakings of the means of competing and, ultimately, of preventing them from entering the market.

a) The Commitments and Proportionality

CEZ undertook to divest one of the following generation assets in the Czech Republic to a suitable buyer, subject to approval by the Commission:

- Pocerady lignite-fired power plant (1 000 MW); or
- Chvaletice lignite-fired power plant (800 MW); or
- Detmarovice coal-fired power plant (800 MW), or
- Melnik III lignite-fired power plant (500 MW) and Tisova lignite-fired power plants (Tisova I — 184 MW and Tisova II — 112 MW); both power plants (Melnik III and Tisova) can be sold separately.

CEZ agreed not to acquire direct or indirect influence over the divested generation asset for a period of 10 years.[145]

The observations received in response to the market test notice of the Commission, pursuant to an Article 9 procedure, raised some doubts as to the suitability of the Detmarovice power plant to meet the identified competition concerns. As regards the results of the market test, CEZ removed the Detmarovice power plant from the list of proposed commitments. Other than that, the market test confirmed that the structural

a so-called network substation. In other words, the connection point of the power plant and the transmission network is this network substation.

[145] CEZ will carry out the sale under the supervision of a monitoring trustee, who will verify in particular that the transaction does not raise new competition concerns. The buyer will have to be approved by the Commission; Commission Decisions of 10/04/2013 addressed to CEZ,a.s. relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreements (AT/39727 – *CEZ*) C(2013) 1997 final, para. 82

commitments voluntarily offered by CEZ were sufficient to address the concerns of the Commission without imposing disproportionate conditions on either CEZ or third parties.

The commitments in their final form satisfied the Commission. The transfer of some of CEZ's generation capacity to a competitor represented a proportionate and clear-cut solution. The divestiture of some generation capacity was necessary in this case, as no other type of remedy could have effectively addressed the effects of CEZ's conduct. Acquiring any of these assets could allow the buyer to establish itself in the Czech market for the generation and wholesale supply of electricity. The new entrant could then gradually develop a wider portfolio of generation assets and compete effectively with CEZ.

The former Commission Vice-President responsible for competition policy, Joaquin Almunia, claimed that 'More competition leads to lower prices. The divestiture of significant generation capacity will allow a new player to enter the Czech electricity market and to compete with the incumbent CEZ. This will benefit for all electricity customers'.[146]

In order to assess the necessity and sufficiency of the commitments implemented by the Commission it is crucial to look deeply at the structure of the Czech electricity market. The market is composed of electricity producers, a transmission system operator, distribution system operators, a market operator, electricity traders and customers.[147] From an energy regulation point of view, the amendment to the Energy Act, through which the Czech Republic have implemented Directive 2009/72/EC, contains important provisions on full ownership unbundling.[148] In theory, CEPS, a transmission system operator for the sole electricity transmission grid in the Czech Republic, has been fully unbundled from electrical energy producers and distributers since September 2009, as confirmed by the national regulatory authority of Czech Republic, the Energy Regulation Office. However, in reality, the application of full ownership unbundling has not been

[146] Commission, 'Antitrust: Commission accepts commitments from CEZ concerning the Czech electricity market and makes them legally binding' IP/13/320
[147] V. Rovensky and J. Beres (2013) 'Czech Republic' in E. H. O'Donell (ed.), *Electricity Regulation in 27 Jurisdictions Worldwide 2013* (Law Business Research Ltd. 2013), p. 43
[148] The 2011 amendment of Energy Act No.458/2000 (CR)

completed properly since both CEPS and CEZ are controlled by the State but by different ministries.[149] Even though the companies are managed by different ministries it is hard to guarantee no connection between them while giving decisions over their commercial activities. Therefore, the divestiture of certain generation assets of CEZ may promote ownership unbundling.

Nevertheless, it is difficult to state that the imposition of structural commitments would be sufficient to entirely eliminate the concern of the Commission, which was inefficient allocation of transmission capacity in the Czech Republic in the first place, as CEPS still has the incentive and ability to make preferential network reservations in favour of CEZ (Chapter 3).[150] The main problem seems to result from the remaining market deficiencies. In this sense, there are two other possible ways in which this problem could have been handled: a prohibition procedure under EU competition law; or the Commission could have started an infringement proceeding against the Czech Republic under Article 258 TFEU (Chapter 3). With regard to the former, the Commission could have addressed the problem more effectively by properly defining anticompetitive conduct and imposing a different set of commitments, such as use-it-or-lose-it, along with the divestiture of generation assets in order to improve a secondary market where network capacity that was unused by CEZ could be allocated to another market player. However, apparently, the Commission found it more appropriate to bind CEZ to solely structural commitments more appropriate, due to the possible procedural burden of a prohibition decision. On the other hand, the Commission would have preferred to follow an infringement proceeding under Article 258 TFEU rather than an antitrust proceeding in order to completely eliminate the market failure. Under this alternative option, the Czech Republic could have been forced by the Court of Justice to properly implement

[149] 70% of CEZ's stake belongs to the State whereas 100% of CEPS is owned by the Minister of Industry and Trade. This information is available at http://www.cez.cz/en/cez-group/cez-group.html and http://www.ceps.cz/ENG/O-spolecnosti/Pages/Akcionari.aspx accessed 12/04/2014

[150] According to domestic regulatory rules, CEPS has many duties including to provide transmission services to anybody who is connected to the transmission grid and fulfils the relevant conditions, unless there is a demonstrable insufficiency of the transmission capacity. For further information see National Report of the Energy Regulatory Office on the Electricity and Gas Industries in the Czech Republic for 2012
http://www.ceer.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20Reporting%202013/NR_En/C13_NR_CzechRep-EN_2.pdf accessed 12/04/2014

vertical unbundling, which might have prevented CEPS from engaging in anticompetitive network reservation.

To sum up, the CEZ decision of the Commission can be seen as another attempt to remove regulatory failure by enforcing EU competition law. Besides, regarding the aims of the Commission in the energy markets, such as to adjust the future behaviour of dominant undertakings commitment decisions might be found by the Commission to be more appropriate then prohibition proceedings, as in these markets the speed of the enforcement might be significant for the effectiveness of the commitment.

3. The *RWE* Decision

As mentioned before, RWE is a vertically integrated gas company, with activities in the production and import of gas; it holds a dominant position in the German gas transmission markets within its network area. In the preliminary assessment, the Commission suspected that RWE, in the gas transmission, storage and downstream gas distribution businesses, may have abused its dominant position by means of refusal to supply and margin squeeze.[151]

According to the preliminary assessment of the Commission, RWE TSO (the transmission system operator owned by RWE) may have refused access to its network by various means related to RWE TSO's capacity management. The Commission deemed that RWE may have understated the capacity technically available to third parties. In fact, it was found that on many bottleneck points RWE actually used significantly more capacity than indicated by RWE TSO as being the maximum technical capacity. This understatement clearly led to unjustified refusals and deterring

[151] Regarding the gas transmission market, due to the economic impossibility of building new connections to other pipelines, the customers connected to RWE's grid had only one option to transport their gas, namely RWE. High entry barriers for potentially competing TSOs such as high construction costs and high barriers to supply via other markets areas guaranteed that RWE TSO's position in the transmission business within its network area would not be challenged within the foreseeable future. Regarding the downstream gas supply markets, the chance for third party suppliers to compete with RWE in the supply market was limited by the small volumes of transport capacity available to them. The low share of gas transported for third suppliers on RWE's TSO pipelines translated into equally low market shares in the supply markets served by these pipelines, notably the wholesale supply markets. Due to the absence of a functional third party access system and the fact that almost the entire available capacity was booked on a long-term basis for RWE Energy, the risk for RWE Energy of losing customers due to a price increase was negligible. Commission Decision of 18 III 2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39402 - *RWE gas foreclosure*), para. 17-19

transport customers from requesting transport capacities. The significant difference between the capacity indicated and that actually used also pointed to a strategy aimed at keeping the transport capacities in favour of its own affiliate for a long period of time as well as foreclosing potential third transport customers. Furthermore, the Commission's investigations showed that the transmission requests of RWE's competitors were regularly and systematically rejected and that the reason given was scarce transmission capacity.[152]

These facts may demonstrate that there was neither a functional third party access system nor an effective congestion management system, which could actually have avoided many of the refused and delayed capacity requests, which harmed third party transport customers and ultimately consumers. The Commission therefore claimed that RWE TSO's intention may have been to protect RWE from new competitors in the retail market rather than to attract new transport customers. Third party shippers were, as a result of this intention, only granted a fraction of the transport capacity on RWE's transmission grid in order to prevent them from competing in an effective manner in the downstream supply markets.[153]

Regarding the second concern of the Commission, margin squeeze, the preliminary assessment stated that RWE may have intentionally set its transmission tariffs at an artificially high level in order to squeeze its competitors' margins in the downstream gas supply markets.[154] According to the Commission, there was evidence that the network tariffs were creating asymmetric cost effects to the detriment of downstream competitors of RWE. The preliminary assessment illustrated that certain types of clauses covered by network tariffs, which were elevating the costs of the tariffs, were only applied to third party users. Moreover, RWE TSO's rebates increased the existing cost disadvantages for RWE's competitors in the downstream supply markets, as these rebates were only granted to RWE due to the long-term transmission contracts, although they were

[152] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]
[153] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]
[154] O. Koch and others, 'The RWE Gas Foreclosure Case: Another Energy Network Divestiture to Address Foreclosure Concerns' (2009) No.2 Competition Policy Newsletter, pp. 1-3

technically available for all market operators.[155] The preliminary assessment also raised concerns over the balancing system, which posed a negative impact on new entrants through high penalty fees and through high balancing costs, which were not paid by RWE due to an agreement signed between RWE TSO and RWE. These kinds of cost asymmetries prevented market operators from effectively competing with RWE in the downstream market.[156]

a) The Commitments and Proportionality

RWE agreed to divest its transmission system business including the entire current German high-pressure gas transmission network with a total length of approximately 4000 km. According to the Commission's decision, the commitments suggested by RWE were suitable to remove the Commission's concerns over competition. The disposal of RWE's transmission business would guarantee that RWE's control over the transmission network would be removed thereby preventing the company from engaging in similar anticompetitive practices relating to the access to its network in the future. These structural remedies were also necessary, since there was no behavioural remedy that would be as effective as the divestiture, which could be easily monitored and administered without generating more costs for RWE.[157]

Furthermore, the Commission deemed that, without a structural remedy, the incentives to further engage in such behaviour would not have been removed effectively, because the anticompetitive unilateral behaviour of RWE, on a lasting and repeating basis, stemmed from an inherent conflict of interest within RWE as a vertically integrated gas company, i.e. from the very structure of the undertaking (Chapter 3).[158] Pursuant to the findings in Chapter 3, it can be stated that the structural remedies imposed on RWE seem to align with the Sector Inquiry as well as with the economic literature on vertical unbundling in the energy markets. Accordingly, full ownership unbundling is accepted as the best regulatory option to prevent a network firm from engaging in certain anticompetitive behaviours in favour of its affiliated supply company, as ownership

[155] Commission Decision of 18 III 2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (Case COMP/39402 - *RWE gas foreclosure*), para. 29-36
[156] *Ibid*
[157] *Ibid*, para. 46-53
[158] *RWE Gas Foreclosure* (Case COMP/39402) Commission Decision [2009]

unbundling splits the interests of the network operator and the companies that are active in competitive parts of the industry.[159] Generally speaking, although full ownership unbundling may pose some disadvantages such as the generation of double marginalisation and transaction costs it facilitates the creation of a level playing field by reducing cross-subsidisation and other distorting behaviours of network companies.

Besides, it is clear that the negotiations between the Commission and RWE resulted in a set of commitments that can dispel the shortcomings of the gas markets pointed out within an OECD Report.[160] The Report describes the conditions of the German energy markets within the time period in which the investigation was carried out by the Commission. According to the report, Germany implemented the EU unbundling requirements by choosing the weakest form of separation between network business and competitive services. While the EU required at least a legal unbundling under the second regulatory package, in Germany there was no operational and informational unbundling, as legal and accounting unbundling was progressing slowly. Whereas only a small number of transmission system operators had their own staff, strategic functions and a large part of operative services remained with the holding company. Apparently, such unbundling was not sufficient to eliminate the incentive and ability of the holding company to influence the network operator and obtain information that was close to other market players. In addition, only a few network operators were geographically separated from other affiliate companies or aimed at developing their own trademark. Also, the electronic information system containing integrated information on both the network and distribution was shared by two thirds of the legally unbundled companies.[161] As a result, the report shows that the network operator that was owned and operated by the vertically integrated company could favour its affiliates. It could also discriminate against independent network users by asking overly high prices and imposing penalty charges.

[159] DG Competition Report on Energy Sector Inquiry 10 January 2007 SEC(2006) 1724 para. 53-173
[160] N. Brandit, *Reaping the Benefits of Stronger Competition in Network Industries in Germany* (2008) OECD ECO/WKO(2008)30, pp. 10-11
[161] *Ibid*

Overall, it seems that, through commitment-based enforcement, the Commission not only brought E.ON's alleged anticompetitive behaviour to an end but also prevented it from engaging in similar conduct in the future. It also eliminated the shortcomings of the domestic regulatory provisions through structural commitments.

4. The *ENI* Decision

As previously mentioned, ENI was an integrated state-owned gas company, with activities in the production and import of gas, the gas transmission and storage businesses, and the downstream gas distribution business. By the time the Commission issued its Statement of Objections, ENI solely or jointly controlled and held significant transmission rights for all of the existing gas importation infrastructure.[162] With regard to the corporate structure of the pipelines at stake and the shareholding agreements, the Commission considered that ENI had the necessary information and the power to decide on the allocation of capacity on a short- and long-term basis as well as to carry out capacity enhancements. Moreover, ENI held a strong market position in the gas supply markets due to a significant portfolio of long-term gas import contracts. ENI's market position was further strengthened by existing bottlenecks in the capacity combined with the difficulty of access to storage for its competitors. As a consequence, the Commission concluded that ENI held a dominant position both in the gas transmission market towards Italy and in the wholesale supply market as a whole.[163]

The Commission had concerns over three different behaviours conducted by ENI related to its dominant position, and its power to control the use and enhancement of infrastructures. These behaviours were capacity hoarding, capacity degradation and strategically limited investment. In terms of capacity hoarding, the Commission found that ENI may have systematically reduced access to the gas transport infrastructure to third party traders by understating the capacity that was actually technically available. In addition, the Statement of Objections showed that ENI had carefully maintained direct

[162] These infrastructures were the Trans-Mediterranean and Trans Tunisian pipelines, used to import Algerian gas to Italy; the Greenstream pipeline, used to import Libyan gas to Italy; the TENP/Transitgas pipelines, used to import North European gas to Italy; the TAG pipeline, which allows some marginal import/export of Russian gas via that country; and the Panigaglia LNG Terminal.

[163] Commission Decision of relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COMP/39315 - *ENI*) [2010], para. 29-35

control over import capacity into Italy over time, and had secured primary capacity rights as a result of long-term capacity bookings on its infrastructure. With regard to capacity degradation, the capacity allocation had been designed in a way that reduced the value of capacity for ENI's competitors by fragmenting the capacity, which had resulted in separate and uncoordinated capacity sales on complementary pipelines. The lack of coordination may have discouraged or prevented shippers from obtaining capacity.[164]

The Commission also indicated that ENI may have strategically underinvested in its transport capacity in order to keep gas supply tight, although this was not profitable for ENI, as an operator of transport pipelines, due to the significant and credible long-term capacity demand from third party shippers on the pipelines. The limitation of investments was therefore meant to protect ENI's own downstream profits to the detriment of profit on the transportation level in order to maximise its overall profits. In the decision, the Commission concluded that, in order to prevent competition and lower prices in the downstream markets through limiting third party access to transport capacity, ENI may have embarked upon a strategy of deliberately avoiding capacity expansion.[165]

a) The Commitments and Proportionality

Following the settlement proceedings under Article 9 of Regulation 1/2003, the Commission concluded the investigation by rendering several commitments suggested by ENI binding upon the incumbent. ENI committed to divesting its stakes in the transmission system operators of the pipelines TENP (the gas transmission system business in Germany), Transitgas (the gas transmission system business in Switzerland), and TAG (the gas transmission system business in Austria). With respect to TAG, ENI suggested that the stakes in TAG could be purchased by a public entity that was either directly or indirectly controlled by the Italian Government - which was likely to be Cassa Depositi Prestiti Spa (hereafter CDP).[166]

[164] *Ibid*, para. 45-54
[165] *Ibid*, para. 55-60
[166] CDP is a joint-stock company under public control of Italian Government, through the Minister of Economy and Finance. CDP's main purpose is to deploy financial resources for public investments, infrastructure projects for the delivery of public services, large-scale public works of national interest and

The Commission claimed in its decision that these commitments were necessary and sufficient to address the concerns directly related to the management of capacity on the import infrastructures. ENI would no longer be subject to the inherent conflict that it faced operating both as a transmission system operator and as a vertically integrated company, which gave ENI an incentive to engage in a profitable strategy to foreclose rivals in order to protect its margin in the downstream markets. Thus, in the future, ENI would not need to continue its anticompetitive conduct, for example refusing to grant access to these infrastructures, granting access in a less attractive manner, or limiting investment in new capacity to transport gas into Italy. Because of the structural basis of the anticompetitive conduct, the Commission argued that, in the absence of structural remedies, the incentive for ENI to further adopt the alleged anticompetitive behaviour would not have been removed. Decisions, with respect to both the day-to-day management of the gas transmission system and to investing in transport capacity should be taken not only independently by the transmission system operator, but also having regard for the commercial interests of the transmission system operator alone and not of any particular gas suppliers. Only by this means it is possible to remove the link between the decision on the transmission system operator level and the interests of downstream profitability.[167]

In addition, according to the Commission, no behavioural remedies would have been as effective as the divestiture, as ENI's repeated and long-lasting anticompetitive conduct derived from the structure of the undertaking. Moreover, the Commission supported the inadequacy of behavioural remedies by stating that, although monitoring the TSO's behaviour had already formed an internal part of the regulatory framework, ENI could not be prevented from engaging in anticompetitive conduct. Thus, the divestiture was a clear-cut solution to the identified competition concerns.[168]

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other public-interest projects. Inter alia CDP owns participations in activities that are of general economic interest as well as activities that are potentially conducted in competition with other market players. Specifically, CDP currently holds majority or minority stakes in ENI, TERNA and so on. This information is available in <http://www.cdp.it/en/company-profile/mission-and-role/mission-and-role.html> accessed 7 November 2013

[167] Commission Decision of relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COMP/39315 - *ENI*) [2010], para. 87-95

[168] *Ibid*, para. 92

The *ENI* decision demonstrates two important points related to commitment-based enforcement. First, the status of ENI as a state-owned undertaking raises the question of what role the Italian Government played in the commitment proceeding between the Commission and ENI. On the one hand, the decision indicates that the Commission could have used its public power through antitrust settlement vis-à-vis undertakings, and perhaps Member States, in order to achieve the creation of a fully unbundled market structure in the European energy markets. On the other hand, the settlement procedure illustrates that a political power of a Member State can be used against the Commission, with the consideration of the divestiture of the ownership of the TAG pipeline to another state-owned company. Although it was quite clear that this structural commitment could not precisely address the concern of the Commission, it was satisfied with the idea of selling the stake to a state-owned entity, namely CDP, because the latter was independent of and unconnected to ENI. Also, the CDP had its own financial resources, competencies and incentives to develop the divested business as a viable and reliable entity.[169] Therefore, the Commission seemed to be obstructed by the political intervention of the Italian Government while trying to eliminate regulatory deficiencies in Italy through antitrust enforcement.

Second, similarly to the *RWE* decision, the set of structural commitments proposed by ENI seems to comply with the economic analyses and the findings of the Sector Inquiry on vertical de-integration (Chapter 3). However, despite the compliance of the proposed commitments with the economic assessment, the idea of using commitment-based enforcement to overcome certain regulatory failures in the Italian and German energy market could be rather harmful for the creation of a single and competitive energy market in Europe, since an environment with legal uncertainty or with the expectation of possible intervention by the Commission is not ideal for firms that are willing to enter the market or make an investment.[170]

[169] *Ibid*, para. 96-112

[170] Apparently the Commission aims to create full ownership unbundled companies in the energy market through commitment decisions. The policy justification for this approach is clear. As Member States continue to dither over energy liberalisation, the Commission uses alternative methods to create competitive markets and to regulate energy markets one step further without dealing with political opposition; Monti, *supra* n 101, 136-138

5. The *SvK* Decision

The *SvK* decision is a very interesting decision in terms of showing that full ownership unbundling might not be the most appropriate solution for efficient and effective utilisation of the capacity of cross-border interconnectors as well as market integration in the EU, an argument which contrasts with the discussion covered within the Chapter 3. In 2009, the Commission decided to open formal proceedings against SvK regarding its possible anticompetitive behaviour in the Swedish electricity transmission market. (SvK is a state-owned administrative authority whose duty is to maintain, operate and develop the national transmission grid for electricity including all of the state-owned interconnectors with neighbouring countries.) According to the preliminary assessment, SvK has a monopoly in the Swedish electricity transmission market, as it has been granted an exclusive concession to operate the Swedish electricity transmission network.[171]

The Commission initiated an antitrust investigation against SvK pursuant to a complaint by Dansk Energy (DaE), a commercial and professional organisation of Danish energy companies operating in Denmark, regarding the behaviour of SvK. According to the claim by DaE, SvK was limiting the transmission capacity of the Öresun interconnector between southern Sweden and eastern Denmark.[172] By doing so, SvK had caused economic losses to Danish consumers, because, due to the export limitation from Sweden to Denmark, Denmark had to use more expensive thermal power plants to meet the electricity demand in Denmark. DaE also claimed that SvK's behaviour was detrimental to competition and trade within the single market, and thereby violated EU

[171] Having brief information on the electricity system in Sweden may help to increase the understanding of the case. The Swedish electricity transmission system is integrated into the Nordic Market, which includes Denmark, Finland and Norway. The network in Sweden is heavily interconnected with its neighbouring countries. The demand in Sweden is mainly located in the south where the major cities are situated, while relatively cheap hydro electricity generation is located in the north of Sweden. In addition to the domestic demand for electricity in south Sweden, there is often demand from Norway, Denmark, Germany and Poland. The capacity of the network is such that electricity flows from northern to southern Sweden. However, at times of the day when demand is high, the transmission capacity may be insufficient to satisfy all of the demand in the south of Sweden. P. Chauve et al., 'Swedish Interconnector Case/Improving Electricity Cross-border Trade' (2010) No.2 Competition Policy Newsletter 3

[172] DaE's complaint was submitted to the Commission in 2006. However, the Commission started formal proceedings pursuant to the complaint in 2009. Speculatively it can be reasoned through that the Commission might have given priority to other antitrust cases, or it might have waited on purpose, given the close relationship between the case and sector-specific regulation.

competition law. Although the complaint was only about the Öresun interconnector, the Commission enlarged the scope of investigation to include the interconnectors on all of Sweden's borders.

In the preliminary assessment, the Commission identified its concerns as follows. It stated that SvK may have abused its dominant position by limiting the transmission capacity on the interconnectors between Sweden and its neighbours in order to reduce congestion in the internal transmission networks within Sweden; in other words, in order to shift congestion from the internal bottlenecks to the interconnectors (so-called congestion shifting).[173] In order to achieve this aim, SvK may have artificially segmented the electricity market by treating requests for transmission for the purpose of consumption within Sweden differently from requests for transmission for the purpose of export. As a result, internal demand was satisfied whenever the network capacity was available whereas external demand was refused despite the availability of transmission networks.[174] In this regard, SvK discriminated against third party network users who were willing to have an access to the interconnector in order to export electricity. Thus, the Commission considered this practice as an infringement of one of the fundamental principles of EU law, which is the prohibition of discrimination on the grounds of nationality.

SvK defended itself by stating that it had adopted congestion shifting as a congestion management model rather than counter-trading[175] or market splitting[176] on the basis of

[173] Congestion shifting, like other methods such as market splitting and counter-trading, is used to manage congestion in transmission networks. According to congestion shifting, a network operator can reduce trading capacities with a neighbouring country in order to relieve congestion within a national transmission system. For instance, a transmission system operator can reduce the export capacity from a deficit area (where the demand is higher than the supply). This reduction will ultimately result in a decrease in demand for transmission capacity on the national transmission network, since the electricity will not be transported for exportation through the national transmission network. In the *SvK* case, SvK reduced the use of the national transmission system by limiting export from Sweden to Denmark, which relieved congestion.

[174] Sadowska, *supra* n 12, 173

[175] Counter-trading is another method that is used to relieve congestion in a transmission network. According to counter-trading, a network operator can affect the production and consumption patterns of market participants on both sides of the congestion line by taking action on the balancing markets through counter-trading. (Most electricity trade occurs on a day-ahead market. However, in case there is an imbalance between supply and demand, a transmission network operator can buy or sell electricity in real time, which is close to delivery, to bring the market back into balance. This is called regulating the market; the transmission network operator collects upward and downward regulating bids from the balance

objective justifications such as economic efficiency considerations as well as the legitimate public interest.[177] With the consideration of economic efficiency, SvK claimed that it had shifted congestion and that it preferred not to counter-trade because the cost of counter-trading was financed solely by Swedish grid users through the transmission tariffs. Although SvK offered several times to share the cost of counter-trading with the Danish transmission system operator these offers were declined.[178] As a result, SvK shifted the congestion within the internal transmission network since counter-trading was not economically efficient for Sweden. Market splitting was not an economically efficient option as it would have been harmful for competition in the electricity markets through decreasing the number of market players in each bidding zone as well as for a common social-economic policy of Sweden by creating different final prices for electricity. Therefore, regarding the legitimate public interest, SvK argued that maintaining a common electricity market with a common price was an advantage for Sweden.[179] There were genuine concerns that dividing the market into sub areas would have a negative effect on Sweden, as it would generate insufficient liquidity and a lack of competition in the wholesale and retail markets.[180] It seems that having one price within Sweden has always been a part of the wider social-economic policy. In this sense, supply of electricity at a uniform price within Sweden might be considered as a

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providers.) It makes arrangements with individual generators and large energy consumers. For instance, it pays generators on the surplus of bottlenecks to reduce their production. At the same time, generators on the other side of the bottleneck, in the deficit area, are paid to generate more. Alternatively, the network operator can also pay industrial consumers to change their consumption patterns. The generation system is re-dispatched but the electricity prices that consumers face do not change. They pay a uniform price within a country, no matter on which side of the bottleneck they consume electricity. Prices are only different for the counter-traded volumes. The cost of re-dispatching is born by the transmission system operator. It is then passed on to the grid users through the transmission network tariff.

[176] Market splitting is another congestion management method, which results in the division of the market into smaller price zones (price areas, bidding zones). Each price zone has its own day-ahead market in which sellers and purchasers participate. As a result, each bidding zone is cleared with different prices if there is congestion between the zones. Market splitting will be discussed in depth below.

[177] The Reply of SvK to the European commission, 'The Complaint from Dansk Energi regarding the Effects on the Danish Electricity Market of Svenska Kraftnat's Congestion Management Methods, 2006 <http://www.svk.se/global/01_om_oss/pdf/nattjanst/svar_danskarna2006.pdf> accessed 10 June 2014, pp. 4-9

[178] *Ibid*

[179] *Ibid*

[180] A latter from SvK's Director General, Mikael Odenberg, to the European Commission, 'Case No 39351 – Öresun interconnector' 356/2006/MA30 <http://www.svk.se/Global/02_Press_Info/Pdf/remissvar/080522_KOM.pdf> accessed 10 June 2014

public economic interest.[181] However, the Commission did not take the argumentations of SvK into consideration. It only mentioned in the decision that SvK did not provide sufficient evidence to objectively justify its conduct.

The Commission, in the preliminary assessment, listed a number of severe effects of the practice of SvK on competition as well as on consumers. First, there was an immediate price effect, as more expensive resources had to be used in place of the energy not delivered from Sweden. In addition, consumers in Sweden were protected from higher prices, because the capacity limitation kept more of the relatively cheap electricity inside the country. Second, the long-term efficiency of the market was distorted by changing the incentives of the market players to build new transmission lines in order to eliminate bottlenecks as the congestion problems within Sweden became less obvious. Electricity producers' incentives to develop generation plants in high-demand areas were also reduced as prices in those areas were lower than they would have been without any curtailment.[182]

a) The Commitments and Proportionality

In order to eliminate the concerns of the Commission SvK proposed to subdivide the Swedish transmission system into two or more price areas (bidding zones or price zones). In other words, it was proposed that the Swedish electricity market would be split into smaller markets (so-called market splitting). In each price zone, consumers and generators would submit day-ahead bids indicating what they want to consume or produce in this bidding zone. The capacity on the links between bidding zones would be fully available to the market. Even if congestion were to occur on the line between the two zones, a market-clearing mechanism[183] would automatically adjust the amount of supply and demand cleared in each zone and set different prices so that the amount of electricity transmitted between the zones would be equal to the transmission

[181] The attitude of SvK could be considered as a service in the general economic interest. Yet, it is not clear in the case whether SvK was entrusted with such a service. Also, the Commission did not take into account Article 106(2) TFEU during the investigation.
[182] P. Chauve et al., *supra* n 171, 1-4
[183] A day-ahead market cleaning mechanism closes (or clears) the market, after all supply and demand bids have been collected and a common day-ahead electricity price has been calculated for the markets on the basis of all of these bids. This price is called the market-clearing price. If the market is split into zones, a market-clearing price is set for each zone separately, based on the supply and demand bids in that zone only.

capacity.[184] The market-clearing mechanism would thus eliminate the congestion. As a consequence, SvK would no longer need to curtail capacity on the interconnectors to other countries or any other line. In situations where internal congestion occurs within a price area, SvK also offered not to reduce the capacity on the interconnector, but to carry out counter-trading with these zones to relieve the congestion.[185] In addition, as an interim remedy, SvK agreed that until market splitting was completed, it would reduce the transmission flow on internal bottlenecks preliminarily by counter-trading, and not by shifting it to the national borders.[186]

According to the Commission, the principle of proportionality was satisfied in the case, as the commitments were sufficient to address the Commission's concerns. Due to the introduction of two or more bidding zones into the Swedish transmission system, SvK would no longer need to curtail interconnector capacity on the Swedish border in order to relieve congestion in the internal transmission networks. The Commission also addressed the comments of respondents delivered to the Commission after the market test, and concluded that the commitments did not create any disproportionate disadvantages for SvK or third parties.[187]

[184] Once the day-ahead market is closed within both areas, the day-ahead prices differ from each other in both areas, depending on the local electricity demand and supply conditions. The surplus area, where supply is more than demand, gets a lower price than the deficit area, where demand is more than supply, gets on the other side of the bottleneck. In this way, congestion between the two zones is resolved by adjusting zonal prices, influencing zonal supply and demand. If there is no congestion between the price zones, prices in both zones even up, so that there is only one common day-ahead for all the market.

[185] Commission Decision of 10.4.2010 related to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 the EEA Agreement (Case COMP/39351 – *Swedish Interconnectors*), para. 80

[186] The Reply of SvK to the European commission, 'The Complaint from Dansk Energi regarding the Effects on the Danish Electricity Market of Svenska Kraftnat's Congestion Management Methods, 2006 <http://www.svk.se/global/01_om_oss/pdf/nattjanst/svar_danskarna2006.pdf> accessed 10 June 2014, p. 11

[187] For example, some respondents argued that the introduction of bidding zones would be increasing concentration on the wholesale, retail and balancing market. The Commission claimed that there was no impact of market splitting on the concentration level of the markets. Besides, the market concentration already exited on these markets. However, its existence was hidden because of SvK's curtailing practices. Also, it was complained by some respondents that prices would go up due to the new system. The Commission stated that price increase or decrease resulting from the commitments would not lead to a disproportionate burden for third parties. The price increase in some areas is an unavoidable consequence of the commitment which would bring the alleged discrimination between Swedish and non-Swedish customers to an end.

Although the Commission seemed to be sure about the proportionality of these commitments, in order to scrutinise their appropriateness it seems necessary to examine them from an economic perspective as an economic analysis may provide precise information regarding the necessity and sufficiency of the commitments. According to Sadowska, the proportionality of commitments depends on whether the main objective of the Commission is economic efficiency or market integration.[188] If the main goal of the Commission were to ensure economic efficiency in the Swedish electricity market, the most efficient method for congestion management would have been a combination of congestion shifting and counter-trading rather than market splitting. In this way, there would have been less of a burden for SvK as there would have been no implementation costs, and a single electricity price policy would have remained in Sweden. Also, this would have been equally effective to meet the Commission's concerns regarding inefficient congestion management.

However, apparently the main aim of the Commission was market integration. In this sense, market splitting may have been found to be more efficient, as there would be no capacity restriction on interconnectors, which may facilitate competition. Yet, still, the proportionality of the commitments seems problematic. This is because, although market splitting may result in an efficient allocation of transmission capacity, this would not exactly address the anticompetitive concerns regarding SvK's abuse. SvK could still manipulate the declared cross-border capacities in order to keep prices at the same level within Sweden. Indeed, despite market splitting, it could still shift congestion for purely strategic reasons such as to achieve price uniformity. Therefore, market splitting alone, without a monitoring system, would not be sufficient to address the Commission's concerns. This means that the Commission might have breached the principle of proportionality, in the sense that the accepted commitments might not address the concerns set out in its preliminary assessment.

The proportionality of the commitments can also be assessed from a legal point of view. Under the existing *ex-ante* regulatory rules in force SvK could not be forced to introduce market splitting, as transmission system operators specify the congestion management

[188] Sadowska, *supra* n 12, 175 and 182-185

method, including congestion shifting, to relieve internal congestion.[189] However, the implementation of congestion shifting is bound to certain conditions by the congestion management guideline annexed to Regulation 714/2009, as congestion shifting might be detrimental to competition, international trade and market integration.[190] According to the annexed guideline, transmission system operators are allowed to shift congestion when needed and justify it on grounds of (i) operational security, (ii) cost-effectiveness, and (iii) the minimisation of negative impacts on the internal electricity market. Therefore, SvK could have shifted its internal congestion on the basis of cost-effectiveness since congestion shifting not only increases economic welfare as it keeps relatively cheap electricity inside the national market, it also promotes cost-effectiveness for the network operator, as the network operator does not have to meet the cost arising from counter-trading.[191] On the other hand, the annexed guideline explicitly states that congestion shifting can be used as a short-term solution until more efficient long-term solution is adapted. In this sense, it is remarkable to note that the implementation of

[189] This approach has been changed with the adaptation of the Network Code on capacity allocation and congestion management developed by ENTSO-e (Chapter 3). According to the new system, the Network Code still cannot interfere with the regulation of congestion management at the national level. However, the Network Code states that transmission system operators should use a set of remedies to deal with internal as well as cross-zonal congestion, and that they shall coordinate the use of remedies in capacity calculation to facilitate more efficient capacity allocation. Therefore, the Network Code anticipates the application of similar congestion management methods for both internal and cross-border networks. Furthermore, it states that bidding zones will be defined to ensure efficient congestion management, and that they can be modified by splitting, merging and adjusting the zone borders. In addition, it specifies congestion management methods including cross-zonal re-dispatching and counter-trading. As a consequence, it implicitly requires transmission network operators to implement the same methods to relieve internal congestion (Recital 22 and 24 of the Network Codes on capacity allocation and congestion management final 22 September 2012). Note that re-dispatching is defined under the Network Code as a measure activated by one or several system operators by altering the generation and/or load pattern, in order to change physical flows in transmission systems and relieve the physical congestion.

[190] Para.1.7 of Regulation 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15: 'When defining appropriate network areas in and between which congestion management is to apply, TSOs shall be guided by *the principles of cost-effectiveness* and *minimisation of negative impacts on the internal market in electricity*. Specifically, TSOs shall not limit interconnection capacity in order to solve congestion inside their own control area, save for the abovementioned reasons and reasons of *operational security*. If such a situation occurs, this shall be described and transparently presented by the TSOs to all the system users. Such a situation shall be tolerated only until a long-term solution is found. The methodology and projects for achieving the long-term solution shall be described and transparently presented by the TSOs to all the system users'.
Note that this provision was introduced by the second regulatory package, yet it remains under the third regulatory package the same as it was under the former Regulation. Furthermore, the Network Code on capacity allocation and congestion management developed by ENTSO-e further regulates the management of congestion which may occur in internal and cross-border transmission networks.

[191] Sadowska, *supra* n 12, 154-157

congestion shifting would be difficult to justify in an instance where other kinds of methods such as market splitting are considered as a long-term solution to internal congestion.

As a result, it can be stated that SvK seems to have proposed a set of commitments which go slightly beyond what the Commission could have achieved through EU secondary law, because, first, the *ex-ante* regulatory rules in force do not entirely forbid transmission system operators from shifting internal congestion to the borders, even though the implementation of congestion shifting is limited with certain conditions, and should be kept short. Second, EU secondary law could only promote efficient management of internal congestion, without imposing a particular method on transmission system operators. If transmission system operators restrict the capacity of interconnectors so as to relieve internal congestion, the *ex-ante* regulatory rules could only require them to develop an alternative method which would not harm electricity flow through cross-border lines. Nevertheless, this alternative method and its introduction date would be chosen by the transmission system operators.[192] Consequently, in the *SvK* decision, the Commission actually pushed through market splitting into Sweden on the basis of commitment-based enforcement.

This decision demonstrates several significant points in terms of energy regulation. First, unlike other decisions examined within this chapter, in the *SvK* decision, the transmission system operator is a fully unbundled network company. This implies that even full ownership unbundling may not eliminate all barriers to market integration (Chapter 3). Therefore, in order to promote the objective of a single energy market, perhaps there should be a monitoring mechanism to supervise the behaviour of network companies. Second, SvK seems to pursue certain practices for the socioeconomic public interest such as, without an extra counter-trading cost, maintaining a uniform price within the Swedish electricity market regardless of any profit maximisation objective. However, apparently the Commission did not consider the existence of public interest and cost efficiency as objective justifications. Instead, it pursued and favoured the aim of market integration in the EU. Third, the decision shows that commitment-

[192] Sadowska, *supra* n 12, 157

based enforcement can be a suitable tool to eliminate internal market problems when these problems are not solved or handled by Member States in a way that harms the objective of the EU to create a single integrated energy market. In this regard, the decision sends a signal to all network operators within the Member States to consider the sake of the common market objective of the EU when solving their internal congestion problems.[193]

Having analysed the cases handled by the Commission on the basis of Article 9 of Regulation 1/2009, the chapter will attempt to provide a proposal for more efficient and sustainable use of commitment proceedings by taking into account the previous observations of the Chapter regarding the commitment-based enforcement policy of the EU.

IV. More Efficient and Sustainable Use of Commitment Proceedings: Is It Possible?

Antitrust settlements under Article 9 of Regulation 1/2003 no doubt result in procedural economy. However, this procedural economy must be weighed against the value of deterrence and legal certainty in order to obtain a balance between administrative efficiency and a clear precedent.[194] An attempt to create this balance might be the first step towards more efficient and sustainable use of commitment proceedings and it can be achieved with a more comprehensive guideline that provides further clarification and additional measures on the basis of substantive and procedural law.

As mentioned above, within the Competition Policy Brief, the Commission points out that a prohibition proceeding should be followed if it is significant to set a legal precedent that clarifies the theory of harm more exhaustively and gives more guidance to market players and national authorities. The Commission however may wish to take a further step so as to increase legal certainty and predictability for other market players, in particular for potential entrants and investors in the energy markets, by elaborating on the relevant factors used to choose the proceedings. The Commission may indicate that, even though the theory of harm rests on well-established case law, commitment

[193] *Ibid*, 101
[194] Schweitzer, *supra* n 90, 22

proceedings might not be appropriate in a situation where the deterrence effect of an antitrust enforcement is important to prevent other market players from engaging in similar anticompetitive conduct. For instance, sending deterrence signals to other market participants through prohibition decisions can be crucial in the energy markets, given that most of the market operators are former state-owned vertically integrated monopolies, which are most likely to abuse their dominant positions in both upstream and downstream markets through similar anticompetitive behaviours.

The Commission may also consider providing additional measures in order to facilitate the proportionality between commitments and its concerns. This might be achieved, first, by increasing the knowledge of the undertakings concerned regarding the subject matter through providing a clear identification of the antitrust violation. Unclear information over possible infringements implies that no guidance is provided to companies so that they can appraise the appropriateness of the commitments they offer.[195] The undertakings under investigations should thus be fully and properly informed about the Commission's concerns.[196] In addition, in order to prevent far-reaching commitments the parties should be reminded of their procedural rights such as the right to access to the file, and also, that structural remedies can be imposed as long as there are no more efficient and less burdensome behavioural remedies. This could help to reduce the incentives to utilise commitment to enhance market regulations instead of to bring competition problems to an end.

Second, the proportionality of commitments could be improved by increasing the transparency of commitment procedures not only for the parties under investigation but also for the business community, thereby safeguarding commitment-based antitrust enforcement from any political interference.[197] Transparency within the context of commitment proceedings could be cultivated by giving more detailed rights to complainants (and to interested third parties only if the commitments imposed have a

[195] Mariniello, *supra* n 67, 1-8
[196] This seems to be achieved as clarified in the Antitrust Manual of Procedure. The concerns of the Commission should be well-structured and presented in a way to allow the parties to understand exactly the theory of harm and the underlying factual evidence.
[197] Georgiev, *supra* n 47, 1018; Mariniello, *supra* n 67, 1-8

significant impact on them).[198] For instance, under prohibition proceedings complainants (and even sometimes interested third parties) can be heard and provided with a non-confidential version of the Statement of Objections, whereas complainants do not have such a formal right under the Article 9 procedures.[199] They can only make their view known during the Market Test stage on the basis of a brief summary of the case.[200] Although in practice the Commission may consult with complainants in order to assess the suitability of the commitments, a formal consultation mechanism, or providing complainants with the right to be heard, would be more helpful in evaluating the proportionality of the commitments imposed.[201]

In addition to all of these, the scope of judicial scrutiny of commitment decisions might be extended beyond a manifest error standard, and a new approach similar to that developed under merger appeals might be adapted.[202] Even though the Commission has wide discretion within Article 9 proceedings, the European Courts should be able to review commitment decisions in such a way that they can scrutinise '…whether that [existing] evidence [the Commission] relied on is factually accurate, reliable and consistent [and] also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it'.[203] The European Courts should also pay more attention to the appraisal of whether the commitments imposed are capable of

[198] In the context of the chapter, two different kinds of persons can be considered as complainants: first, natural or legal persons who file a formal complaint, and second, those who justify their legitimate interests by demonstrating that the alleged infringement might harm their economic interests. Commission, 'Antitrust Manual of Procedures: Internal DG Competition working documents on procedures for the application of Article 101 and 102 TFEU' (Commitment Decision) (2012) (Section 13)

[199] 'The market test notice usually invites interested third parties to submit their observations on the proposed commitments' (para. 58). 'If the case is based on a complaint, the market test should be sent to the complainant. The Commission is also entitled to send the publication of market test to other interested third parties known to be potentially concerned by the outcome of the case (i.e. third parties admitted to the procedure) and explicitly ask their view. This ensures full involvement of these undertakings most concerned' (para. 61). 'The case team must also decide to discuss the draft commitments orally with market participants' (para. 63) Commission, 'Antitrust Manual of Procedures: Internal DG Competition working documents on procedures for the application of Article 101 and 102 TFEU' (Commitment Decision) (2012) (Section 16)

[200] Article 27 of Council Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1

[201] Botteman and Patsa, *supra* n 44, 4

[202] Case C-12/03P *Tetra Laval v Commission* [2005] ECR I-987; Case C-413/06 P *Bertelsmann AG and Sony Corporation of America v Impala* [2008] ECR I-4951

[203] Case C-12/03P *Tetra Laval v Commission* [2005] ECR I-987, para.39

addressing the concerns of the Commission drafted within the preliminary assessment, given that in some energy settlements it has been argued that the commitments imposed have failed to properly deal with the Commission's concerns. In this way, not only the proportionality but also the effectiveness of proceedings under Article 9 might be promoted.

The judicial review of Article 9 decisions on the other hand should be limited to the Commission's economic assessment, i.e. it should not be substituted by that of the General Court. The European Courts should not go beyond the Commission's methodological choices while analysing the case.[204] They should not engage in an attempt to examine the appropriateness of commitments based on new economic evidence or on their own analytical methodologies.[205] Yet, the plausibility and persuasiveness of the Commission's theories should be fully monitored regarding the factual evidence that it provides.[206]

A legal framework clarifying the competence of the Commission in deciding which route to follow for antitrust enforcement and promoting the proportionality of commitments and also a new approach extending the limit of judicial scrutiny could bring more efficient and sustainable use of commitment proceedings. Such a novelty, while retaining the main advantages gained from commitment decisions such as the swift and efficient resolution of competition concerns, could reduce the risk of misuse of antitrust settlements by the Commission with the purpose of achieving its sector-specific regulatory goals. This may also increase legal certainty.

V. Conclusion

With the modernisation of EU competition law the Commission has been provided with the discretion to choose between prohibition and commitment proceedings as devices for antitrust enforcement. Although initially the Article 9 procedure was introduced as an alternative mechanism for case disposition where investigations might otherwise result in a prohibition, it has become one of the bases of antitrust enforcement in the EU since

[204] Schweitzer, *supra* n 73, 491
[205] Case C-441/07 P *Alrosa Company Ltd v Commission* [2010] ECR I-5949, para. 59-68 and 88; Case C-413/06 P *Bertelsmann AG and Sony Corporation of America v Impala* [2008] ECR I-4951, para. 145
[206] Schweitzer, *supra* n 73, 491

2004. However, the application of commitment proceedings, as well as bringing some advantages for the Commission, the parties concerned and national authorities, also gives rise to some problems. This chapter thus attempted to display the possible efficiencies, such as a fast and more economical solution to competition problems, and the deficiencies, such as legal uncertainty, a lack of proportionality and the risk of political interference, of commitment decisions.

Moreover, given the importance of commitment decisions in the energy markets, the chapter focused on the energy decisions of the Commission, which included structural/behavioural commitments imposed under the Article 9 procedure, namely the *E.ON, CEZ*, *RWE*, *ENI* and *SvK* decisions. These five decisions show that, under commitment proceedings, the commitments imposed on the undertakings concerned may go beyond what is necessary and sufficient and fail to address the concerns of the Commission. As a result, the chapter pointed out two important observations: first, under the Article 9 procedure, a lack of proportionality between the commitments and the alleged infringements is very likely by virtue of the characteristics of the proceedings. Second, this possibility increases instances of abusive use of commitment decisions so as to eliminate regulatory failure, thereby facilitating legal uncertainty and political intervention in the energy markets.

To remove the deficiencies that stem from commitment-based enforcement the chapter proposed that it might be helpful to provide for market operators and national authorities a legal framework, for example a guideline. In this regard, the chapter argued that this hypothetical guideline might specifically clarify the circumstances under which the Commission prefers to follow commitment proceedings. For instance, the Commission might be required to pursue prohibition proceedings if there is a need for a deterrence effect of an antitrust enforcement for other market players.

Moreover, the chapter suggested that more detailed mechanisms that enhance the proportionality of commitment as well as the transparency of producers could be provided. For example, the principle of proportionality could be facilitated by granting more information to the undertakings concerned regarding the subject matter of investigations. In addition, the transparency of the procedure could be improved by

increasing the participation of complainants in commitment proceedings. Furthermore, the chapter argued that the judicial review of commitment decisions could cover the appropriateness of the commitments in order to increase the capability of the decisions to dispel any serious concerns of the Commission.

CHAPTER 5

CONCLUSION

The objective of this thesis was to critically examine the approach that the Commission adopted for competition investigations in the newly liberalised energy markets. The overarching finding of the thesis was that there has been a generalised trend in the use of commitment-based antitrust enforcement in the energy markets, which has eased the employment of competition law as a *quasi*-regulatory tool, and this trend seems to have generated problems in terms of legal uncertainty, economic efficiency along with political interventions in the energy markets.

The decisions of the Commission in the energy sectors constituted a decisive role in determining the substance and shaping the structure of this thesis. The thesis addressed the problem of long-term supply contracts concluded within and between Member States, the problem of preferential reservations of cross-border transmission networks as well as the problem of the generalisation of formal antitrust settlements in the energy sectors.

While analysing the case law, the thesis bore in mind that the traditional way of functioning in the European energy markets, which consisted of long-term contracting between vertically integrated incumbents, had had a significant impact on the determination of the dynamics of regulatory measures and also competitive reforms. The thesis also underlined that the idiosyncrasy of the European energy markets (i.e. insufficient vertical unbundling, inefficient implementation of third party access, undersized competition, and inadequate single market integration) has provided the Commission with the grounds for significant regulatory steps as well as antitrust investigations. Therefore, it seems that the Commission is compelled to tailor antitrust enforcement with regard to the characteristics of the energy markets.

As regards the problem of long-term supply contracts within Member States, the thesis indicated that the assessment of the contracts from a competition law point of view is rather complicated, regarding the ambiguous economic theories and empirical works examining the effects of these contracts. The Commission and national competition authorities may therefore need to trade-off between foreclosure and the positive effects of the contracts such as risk hedging and increasing the credibility of the contracting parties. Moreover, the thesis pointed out that the detrimental effects of the contracts could also stem from the contract clauses. Each long-term contract thus needs to be analysed individually by taking into consideration both the volume and duration of the contracts and the effects of these contract clauses. Consequently, policy instructions in each case are very much context specific. Yet, overall, the objective of the Commission and competition authorities should be to reach a compromise, which enables both effective spot market trading and a satisfactory degree of long-term contracting within the energy markets.

While considering the problem of preferential reservations of interconnectors in electricity and cross-border pipelines in gas, the thesis indicated that the legitimate assessment of these reservations under EU competition law is rather complicated due to the fact that, first, transmission markets are under the scope of *ex-ante* market regulation, i.e. these reservations can be assessed under EU secondary law as well as EU competition law, and second, they can be made pursuant to two purposes: (i) in order to fulfil pre-liberalisation long-term supply contracts concluded among Member States; or (ii) in order to foreclose relevant downstream markets to actual or potential rivals. The case law demonstrated that under both scenarios the Commission tends to deem these reservations unlawful, regardless of the associated long-term supply contracts, unless there is a major investment in a transmission network, which could be proposed as an objective justification, or an exemption granted by *ex-ante* regulatory rules. This approach by the Commission could be justified from both an economic perspective and a regulatory policy point of view. According to the former, given the scarcity of capacity of cross-border transmission networks, the only way to allocate long-term competitive network capacity seems to enhance the physical capacity of these networks. According to the latter, one policy objective of market regulation is to

promote short-term, transparent and non-discriminatory allocation and use of transmission capacities in order to facilitate competition and market integration in energy. As these regulatory objectives cannot be realised through market liberalisation, the Commission employs competition law as a relevant instrument in order to achieve them.

Furthermore, the thesis showed that the approach of the Commission to examining these preferential network reservations by dissociating them from existing long-term supply contracts might not be appropriate under certain circumstances given that long-term supply contracts among Member States may result in competitive outcomes dissimilar to the contracts signed within Member states. Consequently, the thesis proposed that the Commission should take into consideration the existing long-term supply contracts underpinning preferential network reservations, as these contracts could be competitive depending on the markets structures of the importing or exporting Member States. However, with regard to the general approach of the Commission to objective justification defence under Article 102 TFEU, the thesis concluded that it seems that there is a very little chance of the Commission considering associated long-term supply contracts as an objective justification for preferential network reservations.

Finally, the thesis disclosed the generalised use of commitment-based antitrust enforcement in energy on the grounds of competition investigations finalised through Article 9 proceedings. In this regard, the thesis indicated the tendency of the Commission and the undertakings concerned to conclude competition investigations in energy through commitments. In addition, the thesis underlined that building energy markets through commitments seems rather risky given that competition dynamics are limited and not necessarily developed to generate efficient measures/remedies for market design. Also, the thesis highlighted that the commitments offered by the undertakings concerned are not necessarily capable of completely addressing the competition concerns of the Commission. Furthermore, general pro-entry bias competition decisions may reduce the predictability of competition investigations. As a result, it was argued that the cost of concluding competition investigations through commitments might be to destroy legal certainty and thus sacrifice the enhancement of

the energy markets. Overall, regarding the excessive use of commitment decisions in energy, the thesis proposed a framework guideline which may facilitate more efficient and sustainable use of public settlements without damaging the market development and legal certainty.

To sum up, the thesis addressed the problem of the use of competition law by the Commission in the energy markets in order to achieve regulatory objectives, namely opening the markets to competition (i.e. market liberalisation), and promoting cross-border trade that reinforces competition among Member States (i.e. market integration). Overall, the findings of the thesis lead to a more empirical research area. Further research could build on the analyses of commitment decisions in terms of their empirical effects within relevant national energy markets.

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GLOSSARY

Balancing - all actions and processes through which transmission system operators ensure that total energy withdrawals are equalled by total injections in a continuous way, in order to maintain the system frequency within a predefined stability range.

Balancing energy - energy activated by transmission system operators to maintain the balance between injections and withdrawals

Bidding zone - the largest geographical area within which market participants are able to exchange energy without capacity allocation.

Capacity allocation - the attribution of cross-zonal capacity.

Congestion - a situation in which an interconnection linking national transmission networks cannot accommodate all physical flows resulting from international trade requested by market participants, because of a lack of capacity of the interconnectors and/or the national transmission systems concerned

Congestion management - management of the capacity portfolio of the transmission system operator with a view to optimal and maximum use of the technical capacity and the timely detection of future congestion and saturation points

Congestion management methods - congestion shifting, counter trading and market splitting

Congestion shifting - a network operator through congestion shifting can reduce trading capacities with a neighbouring country in order to relieve congestion within a national transmission system. In other words, through this method congestion in the internal transmission networks is shifted to external transmission networks.

Contractual congestion - a situation where the level of firm capacity demand exceeds the technical capacity

Counter-trading - a network operator through counter-trading can affect the production and consumption patterns of market participants on both sides of the congestion line in order to reduce congestion. The network operator makes arrangements with individual

generators and/or large energy consumers. Accordingly, it pays generators to decrease or to increase their production in order to reduce the surplus or deficit of electricity. Alternatively, the network operator pays industrial consumers to change their consumption patterns.

Cross-border balancing – exchanges of balancing energy and/or reserves between control areas and/or between bidding zones

Day ahead market - means the market timeframe where commercial electricity transactions are executed the day prior to the day of delivery of traded products

Explicit capacity allocation (explicit auction) - allocation of cross-zonal capacity only, without the energy transfer. Thus, market participants bid for available interconnector capacity which is purchased separately from the electricity that is the subject of the transaction. The capacity is auctioned for different time periods namely year, month, week, hour.

Forward markets - electricity markets in which the duration of contracts concluded for electricity trade are set for more than 24-hours

Forward capacity allocation - the attribution of long-term cross-zonal capacity through explicit auctions

Market splitting - a division of the market into smaller price zones (price areas, bidding zones). Each price zone has its own day-ahead market in which sellers and purchasers participate.

Implicit capacity allocation (implicit auction) - transmission capacity is managed implicitly by two or more neighbouring spot markets: network users submit purchase or sale bids for energy in the power exchange in the geographical zone where they wish to generate or consume, and the market clearing procedure determines the most efficient amount and direction of physical power exchange between the market zones. Hence, border capacity and energy are traded together. Implicit auctioning requires at least one power exchange in the area importing from the interconnector in question.

Interconnector - a transmission line which crosses or spans a border between Member States and which connects the national transmission systems of the Member State

Intraday market - means the electricity market which operates within the day where commercial electricity transections are executed prior to the delivery of traded products

Physical congestion - a situation where the level of demand for actual deliveries exceeds the technical capacity at some point in time

Primary market - the market of the capacity traded directly by the transmission system operator

Reservation of cross-border transmission capacity - a portion of available cross-border capacity which is reserved for cross-border exchange of balancing reserves and thus is not accessible to market participants for cross-border energy trade.

Secondary market - means the market of the capacity traded otherwise than on the primary market

Storage facility - a facility used for the stocking of natural gas and owned and/or operated by a natural gas undertaking, including the part of LNG facilities used for storage but excluding the portion used for production operations, and excluding facilities reserved exclusively for transmission system operators in carrying out their functions

Transmission - the transport of energy on the extra high-voltage and high-voltage interconnected system with a view to its delivery to final customers or to distributors, but does not include supply

Transmission system operator - a natural or legal person responsible for operating, ensuring the maintenance of and, if necessary, developing the transmission system in a given area and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity

*Source: Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation 1228/2003 [2009] OJ L 211/15; ENTSO-E, Network Code on Capacity Allocation and Congestion Management, 27 September 2012; ENTSO-E, Network Code on Forward Capacity Allocation, 1 October 2013