

Legal Uncertainty and Competition Policy in European Deregulated Electricity Markets: the Case of Long-term Exclusive Supply Contracts

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The case of long-term exclusive supply contracts in the EU electricity markets is a highly topical example of the difficulties faced by competition authorities with the deregulation of energy markets. The ambiguous effects of these contracts on foreclosure, investment and consumer welfare in the long term made them logically become a priority for antitrust enforcement. However, due to the lack of precedents and the on-going modernization of EC competition law, the legal uncertainty currently perceived in the market place is strong. By analyzing the recent decisions of community and national competition authorities across energy industries, this article comes up with four conclusions. First, a new methodology to assess foreclosure effects in a market building context is emerging. Second, legal uncertainty in electricity is largely overstated as antitrust enforcement aligns across energy industries and quickly converges with enforcement in sectors where competition is more mature. Third, the European Commission is increasingly taking a unified approach under Articles 81 and 82 EC for long term exclusive dealing in energy. Fourth, the antitrust strategy of the European Commission demonstrates both the limits of the application of a rule of reason in energy and the importance of the politics of liberalization.

1. INTRODUCTION¹

European competition authorities face a considerable challenge with the liberalization of energy markets. In fast-evolving market settings, they must fight anti-competitive conducts while ensuring a fair degree of legal certainty to market players. This must often be achieved without being able to firmly rely on past case law, an intimate knowledge of the sector or even economic theory. In view of these difficulties, the modernization of EC Competition law and its 'more-economic' approach appears both as an opportunity and as a threat.² The opportunity lies in the alleged ability of competition authorities to

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² The modernization of EC Competition law has already been widely commented. See Ehlermann, 'The Modernization of EC Antitrust Policy: a Legal and Cultural Revolution', *Common Market Law Review* 37 (2000): 537 and Wesseling, *The Modernization of EC Antitrust Law* (Hart Publishing, 2000). On the 'more economic' approach, see Verouden, 'Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis', *Antitrust Law Journal* 71 (2003): 525; Bishop & Ridyard, 'EC Vertical Restraints Guidelines: Effects-based or Per Se Policy?', *European Competition Law Review* 23, no. 1 (2002), 35 and Röller, 'Economic Analysis and Competition Policy Enforcement in Europe', in *Modeling European Mergers. Theory, Competition Policy and Case Studies*, eds van Bergeijk & Kloosterhuis (Cheltenham: Elgar, 2005), 11-24.

devise the *rules of reason*³ required by the strong specificities of a market building context. The threat comes from the limited information at hand on the particular competition dynamics of these deregulation processes and the resulting probability of errors. In addition, the loss of legal certainty which might result from a case-by-case approach may not stabilize market players' expectations and undermine their ability to sink the high-fixed costs investments much needed for the long-term security of supply of Europe.

The case of long-term exclusive supply contracts (thereafter 'long-term contracts') in the EU electricity markets is a highly topical example of these difficulties. In the old era, European energy markets were characterized by legal monopolies, geographic demarcation, vertical integration and cooperation both on the supply and demand sides.⁴ To the opposite, the new paradigm of electricity restructuring prescribes electricity generation to be vertically de-integrated as much as possible from retailing and not committed in long-term contracts with retailers or large consumers in order to allow entry and development of effective competition on wholesale and retail markets.⁵ However, liberalization has not changed much the traditional sales patterns. Sometimes mere residuals of the former vertically integrated structure (e.g., stranded power purchase agreements in Hungary or legacy rights on interconnectors), long-term contracts today often constitute innovative ways to mitigate the new uncertainties born from liberalization. While the energy community increasingly doubts the ability of de-integrated markets to ensure an optimal level of investment and calls for more rigid vertical arrangements, the European Commission consistently emphasizes the risks of anti-competitive effects inherent in long-term contracts and made them a priority for antitrust enforcement.⁶ After *Distrigaz*⁷ in late 2007 in the gas sector,⁸ the electricity incumbents EDF and Electrabel are now under attack for their portfolios of long-term contracts with industrial customers.⁹ In electricity in particular, the small number of precedents and the on-going modernization of EC competition law cast doubts on the way the Commission will apply EC competition rules, which has fostered legal uncertainty. A clear methodology to analyze long-term contracts in the context of liberalized electricity markets is still missing,¹⁰ and much needed, which has lead the Commission to commit to provide guidance in the coming months.¹¹

This article proposes to explore how the European Commission and national competition authorities are currently dealing with the problem of long-term exclusive

³ As opposed to per se rules, *rules of reason* broadly refer to the idea that antitrust enforcement must be tailored to the specifics of each case.

⁴ Schaub, 'Liberalization of the European Energy Markets', in *European Integration and International Coordination: Studies in Transnational Economic Law in Honor of Claus-Dieter Ehlerman*, eds Bobdandy, Mavroidis & Meny (Kluwer Law International, 2002), 403-418.

⁵ DG Competition Report on Energy Sector Inquiry, SEC (2006) 1724, 10 Jan. 2007, 232-244 and 283-294.

⁶ *Ibid.*

⁷ Notice published pursuant to Art. 27(4) of Council Regulation (EC) No. 1/2003 in Case COMP/B-1/37966 – *Distrigaz*, O.J. 2007, C 77/48. References for *Distrigaz*, *E.ON Ruhrgas*, *Synergen*, *Repsol* and *Gas Natural/Endesa*, often cited in the text, will not be repeated to avoid footnotes proliferation.

⁸ GDF, the French gas incumbent, is now also under Commission scrutiny for its long-term reservation of transport capacity. See European Commission press release, MEMO/08/328 of 22 May 2008.

⁹ See European Commission press release MEMO/07/313 of 26 Jul. 2007.

¹⁰ This also recognized for instance in Talus and Wälde, 'Electricity Interconnectors: a Serious Challenge for EC Competition Law', *Competition and Regulation in Network Industries* 1, no. 3 (2006): 353-387.

¹¹ Explanatory Memorandum attached to the third legislative package, 18, available on the DG TREN website.

supply contracts across energy industries and how the modernization of EC competition law impacts antitrust enforcement in these sectors. Section 2 will present recent insights from the competition economics of long-term contracts and uncover the mechanics of the legal uncertainty currently perceived in the market place. Section 3 will then depict the methodology which is emerging from the recent line of cases in other energy sectors, most notably in gas. Section 4 will last derive from the case analysis relevant insights in terms of legal certainty for electricity and reflect on the impact of the politics of liberalization on the current antitrust strategy of the European Commission.

2. THE SOURCES OF LEGAL UNCERTAINTY ON LONG-TERM CONTRACTS IN ELECTRICITY: THE EVOLUTION OF THE JURISPRUDENCE AND THE MODERNIZATION OF EC COMPETITION LAW

There is a multiplicity of long-term bilateral contracts all along the electricity supply chain. They include fuel supply contracts to power producers, tolling agreements and diverse power purchase agreements with energy intensive users,¹² commercial and household customers, or resellers and traders without generation capacities. If all these long-term contracts may lead to varying degree of foreclosure, they also have different effects on consumer surplus, investment, risk management, entry and wholesale spot prices. From a competition point of view, contract clauses regarding duration, exclusive dealing and use restrictions are particularly relevant in electricity whereas exclusive distribution and destination clauses are more relevant in gas.¹³ Restraints relating to prices such as discrimination, predation or resale price maintenance might also be found but have so far rarely been addressed in the context of long-term contract cases at the Community level.

¹² Energy intensive users typically include electricity resellers and some industries where electricity represents an important part of variable costs (e.g., steel, chemistry). The latter have sometimes used complex contractual and financial arrangements to pool their electricity purchases. These contracting schemes for instance include risk-sharing in generation between industrial consumers and electricity operators (EPR, Zandvliet, Roslectra, TVO), partnership between consumers and generators valuing a secondary fuel (DK6) or consumers cooperative purchasing electricity (Exeltium).

¹³ In electricity, exclusive purchase clauses are much more common than exclusive distribution clauses. This is not the case in gas where an important part of Commission enforcement took place in the upstream segment of the industry, essentially concerning territorial restrictions. On this see the following settlements: European Commission press releases IP/03/1345 *Gazprom/ENI* of 06 Oct. 2003, IP/05/710 *Gazprom/E.ON Ruhrgas* of 10 Jun. 2005, IP/05/195 *Gazprom/OMV* of 17 Feb. 2005, IP/07/1074 *Sonatrach* of 11 Jul. 2007, IP/02/1869 *NLNG* of 12 Dec. 2002 and IP/02/1084 *GFU* of 17 Jul. 2002. For commentaries see Nyssens, Cultrera & Schnichels, 'The Territorial Restrictions Case in the Gas Sector: a State of Play', *Competition Policy Newsletter* 1 (2004): 48-51; Cultrera, 'Les Décisions GDF: la Commission est Formelle: les Clauses de Restrictions Territoriales dans les Contrats de Gaz Violent l'Article 81', *Competition Policy Newsletter* 1 (2005): 45-48; Wäktare, 'Territorial restrictions and Profit Sharing Mechanisms in the Gas Sector: the Algerian Case', *Competition Policy Newsletter* 3 (2007): 19-21 and Talus, 'Long-term Gas Agreements and Security of Supply – Between Law and Politics', *European Law Review* 32, no. 4 (2007): 535-548. The only important exclusive supply cases in electricity since liberalization have been the remedy concerning CNR in Case M.1853 *EDF/EnBW* (see European Commission press release IP/01/175 of 07 Feb. 2001) and the stranded PPA cases in Hungary, Portugal, Ireland, Italy, United Kingdom, Greece and Poland dealt with under State Aid. CNR, an independent French power producer, was relieved from its long-term exclusive distribution obligation with EDF to foster competition in the French market after the loss of an important potential entrant (EnBW). In the stranded PPA cases, the issue was around the compensation schemes for the operators which suffered losses from liberalization due to their long-term commitments or guarantees. On this see Art. 24 of Directive 96/92/EC on common rules for the internal market in electricity, 19/12/1996, O.J. 1996, L 27/20; the Commission Communication on the *Methodology for analysing State Aid linked to stranded costs*, available on the website of the European Commission; Hancher, 'Energy', in *EC State Aids*, eds Hancher, Jan Slot & Ottervanger, 3rd edn (Sweet & Maxwell, 2006), 656-680 and the interesting expert of opinion of Eilmansberger, Jaeger & Thyri, *Compatibility of the Hungarian System of Long-term Capacity and Power Purchase Agreements with EU Energy and Competition Law* (2004).

It is fair to acknowledge that legal uncertainty does not concern all kinds of restraints and all market players. Vertical restraints with market partitioning or use restriction effects have been clearly litigated in energy¹⁴ and both the Vertical Block Exemption Regulation (VBER)¹⁵ and the Guidelines on Vertical restraints¹⁶ (GVR) provide, it is submitted, sufficient guidance for long-term contracts involving non-dominant firms. Legal uncertainty is now concentrated on the portfolio of long-term exclusive supply and purchase obligations of the former electricity incumbents. This section shows that the legal uncertainty currently felt in the market place comes from the limited guidance to be found in the case law and from the uncertain application of the 'more economic' approach on these contracts in the new market context.

2.1. THE RELEVANT CASE LAW DATES BACK TO THE MONOPOLY ERA

Despite their importance for the success of liberalization, long-term contracts are almost absent in gas and electricity secondary EC law¹⁷ so guidance must be sought in the case law. Prior to the first liberalization directive, enforcement of competition law did not occur on a very regular basis in energy and there were only few instances of long-term contract cases. Most of them concerned independent power producers supplying the national incumbent on an exclusive basis. Following the Single European Act, the directive on cross-border trade in electricity¹⁸ was enacted in 1990 and the Commission started to look at these contracts to limit their duration so that they would not hamper the future opening of markets to competition. The durations were in general limited to fifteen years as in *Electricidade de Portugal/Pego*,¹⁹ *Isab Energy/Enel*,²⁰ *Sarlux*,²¹ *Rosen*,²² *REN/Turbogas*,²³ *Scottish Nuclear*²⁴ or *Api Energia*.²⁵ Due to the monopolistic context, these decisions did not display any methodology for the analysis of foreclosure effects, leading to decisions unlikely to be replicated today, at least on the same terms. For instance, the formation of selling and purchasing consortia contracting on a long-term

¹⁴ For recent cases, see for instance *RWE/Taugas* in 2006 and 2007 where the Czech Office for the Protection of Competition dealt with problems of market partitioning through destination clauses and discriminatory treatments; and the EUR 208 millions fine imposed by the Bundeskartellamt on seven liquefied gas suppliers (see press release of 19 Dec. 2007).

¹⁵ Regulation 2790/1999 on the Application of Art. 81(3) to categories of vertical agreement and concerted practices, O.J. 1999, L 336/21.

¹⁶ Commission Notice on Guidelines on Vertical Restraints, O.J. 2000, C 291/1.

¹⁷ Except concerning long-term import gas contracts in the Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, 26/06/2003, O.J. 2003, L 176/57, in recital 25: 'Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objective of this directive and are compatible with the Treaty, including competition rules. It is therefore necessary to take them into account in the planning of supply and transportation capacity of gas undertakings.'

¹⁸ Directive 90/547/EEC on the transit of electricity through transmission grids, O.J. 1990, L 147/37.

¹⁹ *Electricidade de Portugal/Pego Project*, notice pursuant to Art. 19(3) of Regulation 17/62, O.J. 1993, C265/3 and Report on Competition Policy 1993, 222.

²⁰ *Isab Energy*, notice pursuant to Art. 19(3) of Regulation 17/62, O.J. 1996, C 138/3.

²¹ Report on Competition Policy 1996, 134.

²² *Ibid.*

²³ *REN/Turbogas*, notice pursuant to Art. 19(3) of Regulation 17/62, O.J. 1996, C 118/7.

²⁴ *Scottish Nuclear* decision of 6 Jul. 1991, O.J. 1991, L 178/31.

²⁵ Report on Competition Policy 1996, 134.

basis was accepted in *Jahrhundertvertrag*²⁶ to allow the development of local energy sources (coal in this case) for the sake of 'national security', despite the risks of foreclosure and collusion. However, we can note that the 'security of supply' argument²⁷ as a justification for the long duration was already accepted with some reluctance by the European Commission in *Jahrhundertvertrag* and *Ijsselcentrale*.²⁸

Market players anticipate today that the fifteen years duration will probably not be accepted but legal uncertainty remains strong as no methodology has ever been spelled out on how to assess foreclosure effects in the new context. Since liberalization and apart from *Synergen*²⁹ and *Gas Natural/Endesa*³⁰ which relate as much to gas as to electricity, relevant cases in this sector have essentially concerned the long-term reservation rights on cross-border interconnectors signed before liberalization, the so-called 'grandfathering' rights.³¹ In addition, since the early 2000's, the European Commission has repeatedly voiced strong concerns over the risks of anti-competitive effects inherent in long-term electricity supply contracts.³² The legal uncertainty created by the lack of precedents has therefore been amplified by the gap between the current state of Commission thinking, its relative inaction on this issue since liberalization and its past decisional practice.

2.2. MARKET PLAYERS CANNOT PREDICT HOW THE 'MORE ECONOMIC' APPROACH WILL BE APPLIED IN THE NEW MARKET CONTEXT

The legal uncertainty created by the lack of case law has not been softened by the on-going modernization of EC Competition law. While the modernization de facto grants more discretion to European competition authorities, the ambiguities of the competition economics of long-term contracts in electricity does not enable market players to anticipate how the 'more economic' approach will be applied in practice.

2.2.1. *The 'More Economic' Approach de facto gives more Discretion to European Competition Authorities*

The modernization aimed at implementing a 'more economic' approach based on long-term consumer welfare, which meant gradually shifting from a legal 'form-based' analysis of contracts to a more 'effect-based' approach where the real economic effects of competitive behaviours are more important than the drafting of contracts. This is

²⁶ Case IV/33.151 *Jahrhundertvertrag*, O.J. 1993, L 50/14.

²⁷ On the security of supply argument in the pre-liberalization period, see also the position of the ECJ in Case C-72/83 *Campus Oil Limited and Others v. Minister for Industry and Energy and Others*, [1984] ECR 2727, [1984] 3 CMLR 544; Case C-393/92, *Municipality of Almelo and Others v. Energiebedrijf IJsselmij NV*, [1994] ECR I-1477 and Case C-158/94, *Commission v. Italy*, [1997] ECR I-5789.

²⁸ Case IV/32.732 *Ijsselcentrale*, O.J. 1991, L 28/32.

²⁹ Report on Competition Policy 2002 at 192-193 and European Commission press release IP/02/792 of 31 May 2002.

³⁰ Report on Competition Policy 2000 and European Commission press release IP/00/297 of 27 Mar. 2000.

³¹ These cases will be touched upon in the next section.

³² DG Competition Report on Energy Sector Inquiry, *supra* n. 5.

expressed by the regular statements of the Commission on the fact that it will take a 'case by case' approach. Applying a sort of *rule of reason* is already a challenge for competition authorities in most sectors, but applying it in newly liberalized energy markets where the rate of technical change is too low to allow a fast development of competition, as in the telecommunication sector, could soon appear intractable in practice and in any case likely to undermine the predictability of antitrust enforcement. However, one could argue that the deregulation of network industries rendered the modernization of EC competition policy inevitable. The complexity of competition dynamics in these sectors would indeed render a *per se* approach very inefficient due to the absence of balancing between anti-competitive effects and potential efficiencies. Overall, the uncertain gains in terms of efficiency should not be offset by the inevitable welfare loss arising from less predictability.³³

2.2.2. *The 'More Economic' Approach to be Predictable would require Clearer Guidance from Economic Theory*

The current state of economic theory on long-term contracts in deregulated electricity markets brings interesting insights but the policy recommendations remain ambiguous. Whereas vertical restraints generally tend to be viewed more leniently than horizontal restraints, this is not the case in electricity where the disintegration of vertical market relationships has been one of the key policy items put forward both by the academic community and the European Commission since the first liberalization directive.³⁴ However, the concentrated market structure, inelastic demand and high investment costs have contributed to make long-term contracts, at least as a complement to wholesale spot market contracting, a useful contractual structure for individual market players.

The basic rationale for long-term contracts in electricity is hedging price and quantity risks over a certain period of time, so duration is crucial. However, long-term contracts in electricity not only define duration but also other features of the transaction such as use restrictions, renegotiation conditions, quantity and price, with some flexibility. It would thus be wrong to solely focus on duration as anti-competitive effects lie as much in other contract clauses and on the competitive structure of the market. Bilateral contracting does not only enable market players to hedge price and quantity risks, it also expresses and channels their ability to distort competition. Therefore, as contracting parties take into account *ex ante* the regulatory framework applied to them when

³³ From a more theoretical point of view, the deregulation of network industries obliges European competition authorities to arbitrate between the post-Chicago approach which advocates a light case-specific approach to antitrust policy and the followers of the Ordoliberal tradition which claim that the cost of tailoring will in most cases outweigh the gains. Applying the 'more economic' approach in deregulated network industries is a good test of the capacity of European competition authorities to fine tune the balancing between predictability and accuracy given a certain level of information. This is also a test of the gains which the EU may expect from the modernization of EC competition law.

³⁴ *Supra* n. 13.

devising contracts, competition policy is a way to impact the structuring of competitive behaviours and ultimately to deter abuses of market power.³⁵

The main competition concern associated with long-term contracts in electricity in the new context is the risk of foreclosure of more or as efficient players, deemed to equate to a loss of long-term consumer welfare. If a significant part of demand is tied in the long run, a lack of retail outlets may lead to significant output foreclosure at the production level and tied consumers will not be able to benefit from future and potentially more profitable offers by new entrants. Long-term contracts may thus constitute a barrier to entry.³⁶ Much theoretical ambiguity however remains around the impact of long-term contracts on wholesale spot market development,³⁷ a cornerstone of competition policy in Europe.³⁸ Large, liquid and stable spot markets are indeed deemed to facilitate entry in retail and trading, and thus foster competition as well as provide reliable investment signals. If a significant part of electricity flows is contracted on a long-term bilateral basis, the development of wholesale spot market is limited and price volatility increases, which complicate entry and encourage market players towards vertical integration or long-term contracting. However, theoretical arguments have been developed which tend to show that long-term contracting by dominant players incentivize them not to exercise their market power on wholesale spot markets as increases in prices would only be profitable on the un-contracted part of their supplies.³⁹

If long-term contracts may be useful for individual contracting parties, their impact on a market building process is much harder to assess than the traditional problem of foreclosure in sectors where competition is more mature. A blind enforcement of competition law in electricity may thus create incentives to further vertical integration and undermine the best contractual allocation of risks among parties, which would go counter the objectives of the European Union in terms of market efficiency and investment.

2.3. CONCLUSION

Competition enforcement is widely recognized as a key policy tool to overcome the current shortcomings of energy liberalization in Europe⁴⁰ and the new context of EC competition law raises fundamental problems for policy predictability and accuracy. The current legal uncertainty does not only come from the lack of decisions since the opening up of markets or from the legitimate difficulties that the European competition authorities face with long-term contracts in electricity. It also directly stems from the on-going evolution of antitrust tools. The next section turns to the analysis of the recent line

³⁵ Lohmann for instance showed how the modernization of German competition law and the re-inclusion of energy within its ambit led to a natural re-engineering of certain gas contracts in the late 1990's. See Lohmann, *The German Path to Natural Gas Liberalisation* (NG14, Oxford Institute for Energy Studies: 2006), 92-93.

³⁶ Aghion & Bolton, 'Contracts as a Barrier to Entry', *American Economic Review* 77 (1987): 388-401.

³⁷ Bonasina, Creti & Manca, 'Im-perfectly Competitive Contract Markets for Electricity', Working Paper (2007).

³⁸ DG Competition Report on Energy Sector Inquiry, *supra* n. 5.

³⁹ Allaz & Vila, 'Cournot Competition, Forward Markets and Efficiency', *Journal of Economic Theory* 59 (1993): 1-16.

⁴⁰ Cameron, *Competition in Energy Markets. Law and Regulation in the European Union*, 2nd edn (OUP, 2007), 280.

of cases in other energy sectors and shows that a new methodology to assess foreclosure in a market building context is emerging.

3. THE ANALYSIS OF RECENT CASES IN OTHER ENERGY INDUSTRIES REVEALS THAT A NEW METHODOLOGY IS EMERGING

For the first time in late 2007, the beginnings of a comprehensive methodology for better analyzing long-term contracts in energy have been sketched out in the *Distrigaz* case. The Commission had concerns about liquidity problems on the Belgian wholesale gas market due to long-term contracts concluded by the incumbent with industrial customers and thus opened an Article 82 EC proceeding. This section shows that, by mixing the *Distrigaz* methodology with relevant insights from *Synergen*,⁴¹ *Gas Natural/Endesa, Repsol*⁴² and *E.ON Ruhrgas*,⁴³ the legal uncertainty on the methodology, the relevant facts taken into account and the Commission's point of view on the combined relationships of these facts has to a large extent come to an end.⁴⁴ The statements of the VBER, GVR and guidelines on the application of Article 81(3)⁴⁵ applied in these cases will also be highlighted.

When assessing individual cases in energy, the Commission will from now on focus on interactions among several key elements once the 30% threshold⁴⁶ is exceeded: (i) market characteristics, (ii) competitive position of contracting parties, (iii) the share of the customer's demand tied, (iv) duration, (v) the overall share of the market covered by contracts containing such ties and (vi) efficiencies.⁴⁷

3.1. ANALYSIS OF MARKET CHARACTERISTICS

When assessing energy market characteristics, the Commission will primarily look at future entry in supply and demand, and their real impact on competition. In *Synergen* for instance, the Commission stated that the future entry of Viridian which had to develop a 340MW power plant would not increase competition intensity due to the

⁴¹ Commission Competition Report 2002 at 192-193 and European Commission press release IP/02/792 of 31 May 2002.

⁴² Notice pursuant to Art. 27(4) of Regulation 1/2003 in Case COMP/B-1/38348, O.J. 2004, C 258 and summary of commitments decision in the same case, O.J. 2006, L 176/104.

⁴³ *E.ON Ruhrgas* is not a case dealt with by the Commission but by the Bundeskartellamt. See Bundeskartellamt, Discussion Paper, 2005 and G. Kühne, 'Long-term Gas Contracts in Germany: an Assessment of the German Competition Authority', *Energy Law Report* (2006). However, the Commission in the *Distrigaz* proceeding referred several times to *E.ON Ruhrgas* and clearly endorsed its conclusions.

⁴⁴ Other relevant cases from national competition authorities will also be used when relevant. The remedies will also be touched upon in the different paragraphs.

⁴⁵ Guidelines on the application of Art. 81(3) of the Treaty, O.J. 2004, C 101/97.

⁴⁶ Article 3 VBER presumes all vertical non-hardcore restraints to be legal so long as the market share threshold of 30% is not exceeded and duration is not indefinite or over five years. However, we note that as a general rule exemptions granted under the VBER cannot be pursued when the agreement is between competitors or potential competitors operating at several levels of trade (Art. 4). In this case, vertical aspects will be dealt with under the GVR and collusion aspects under the Guidelines on the applicability of Art. 81 EC to horizontal cooperation agreements, O.J. 2000, C 118/3.

⁴⁷ This broadly follows the European Commission's typology in MEMO/07/40 of 11 Oct. 2007 and in the DG Competition Report on Energy Sector Inquiry, *supra* n. 5, 235.

'*equilibrium of potential competitive threat*' which would then prevail. The likelihood of new entry in energy depends a great deal on the existence of potential competitors, usually foreign incumbents, especially in neighbouring markets. In *Synergen*, the Commission also clarified what a potential competitor could be. A potential competitor is usually a firm able to undertake the required investments to enter the relevant market within one year following a small but significant increase in prices. Here the Commission confirmed that a potential competitor must be judged on the basis of its internal competitive strength: its brand image in the relevant market, ready available capacity in this market and large financial surface. The definition of what is a potential competitor is important as the 30% exemption threshold does not apply to vertical restraints between actual or potential competitors. Other barriers to entry such as the level of vertical integration in the market and difficulties in setting up a parallel network of resellers are also key factors to consider (*Repsol*). Forbidding the dominant firm to carry over additional acquisitions of downstream resellers (during two years in *Repsol*) will then be a possible remedy.

Assessing dominance in newly liberalized or emerging markets has been a constant problem in competition policy. Dominance in an emerging market is usually not considered harmful as it often results from an innovative breakthrough and is usually transitory. The Commission is right not to take that path in energy. In the long-term gas supply contract between Spanish incumbents Gas Natural and Endesa, the Commission concluded that dominance must be assessed even more strictly in highly concentrated liberalizing markets than in more mature settings to avoid long-lasting lock-in effects. Gas Natural being the sole importer and holding more than 90% market share on both free and regulated markets, its dominant position could not be considered transitory.⁴⁸ This conclusion has been confirmed in *Distrigaz*.

However, some doubts remain concerning the definition of the relevant product market. True, the limited development of cross-border interconnections and the restrictions on long-term reservation capacities make long-term contracts between countries unlikely, so the relevant geographic market is likely to remain national for some time. But recent decisions did not completely settle the question as to whether the wholesale market will be sub-divided according to the different types of customer, namely resellers and big energy users, whose pattern of consumptions is arguably substantially different.

3.2. THE MARKET POSITION OF THE DOMINANT SUPPLIER OR GROUP OF DOMINANT SUPPLIERS

After having analyzed market conditions and their likely evolutions, the focus will be on the market shares of the dominant firm and its portfolio of contracts as '*long-term*

⁴⁸ On this see Fernandez Salas, 'Long-term Supply Agreements in the Context of Gas Market Liberalization: Commission Closes Investigation of Gas Natural', *Competition Policy Newsletter* 2 (2000): 55-58.

contracts concluded by other suppliers will generally not give rise to concerns'.⁴⁹ As in any other sector, the higher the market share of the dominant supplier, the sooner the cumulative market coverage of its long-term contracts will be deemed to create foreclosure. This has to be weighted against the presence of buyer power and whether buyers who represent a substantial part of total market demand on their own are tied for the long term with the dominant supplier (*Gas Natural/Endesa*). In the case of a group of leading suppliers, the Commission will look similarly at the cumulative effects of their long-term contracts but there will be no need to prove that they lead to tacit collusion (collective dominance) to show that significant foreclosure effects occur.⁵⁰ Of course and as recalled in the Sector Enquiry, long-term contracts can be deemed incompatible with Article 81 EC if they result in stabilizing suppliers' market shares over a long period of time and hence lead to collusion. In energy, sole or joint dominance is in most cases self-evident but except in the old *Almelo* case,⁵¹ the Commission has not yet dealt with collective dominance in an anti-competitive long-term contracts contract case.

3.3. THE SHARE OF THE CUSTOMER'S DEMAND TIED UNDER THE CONTRACT

The share of the customer's demand tied is one of the main sources of foreclosure effect. If a customer, especially one representing a big part of total demand (critical customer concept),⁵² must meet all or a big part of its needs with a particular supplier, he does not constitute any longer an available outlet for a potential entrant.⁵³ The analysis of the share of the customer's demand tied is closely linked with that of the pattern of consumption. In gas for instance, transaction costs may become too high when negotiating for a small quantity and it may become uneconomic for an alternative supplier to provide less than a certain amount. Competition authorities consider that 20% of a customer demand is the threshold for having incentives to enter into a relationship with a second supplier.⁵⁴ Some commentators think that the Commission could find foreclosure effects for contracts amounting as low as 50% of a customer demand in case of a network of parallel contracts with the same terms.⁵⁵ In the Commission's view, signing such contract is a way for dominant firms to '*maintain or strengthen their ability to set prices and other conditions*

⁴⁹ European Commission MEMO, *supra* n. 47.

⁵⁰ Kjolbye, 'Vertical Agreements', in *EU Energy Law Volume II: EU Competition Law and Energy Markets*, ed. Jones, 2nd edn (Clay's and Casteels, 2007).

⁵¹ Case C-393/92, *Municipality of Almelo and Others v. Energiebedrijf IJsselmij NV*, [1994] ECR I-1477.

⁵² In *Gas Natural/Endesa*, the Commission reduced the size of the contract from nearly 100% to 75% of Endesa global purchases as Endesa was one of the leading electricity producers in Spain and thus could motivate entry in its own right. In *ThyssenGas/STAWAG*, the Bundeskartellamt considered that supplying more than 50% of a major buyer demand on a long-term basis (more than four years) could raise antitrust issues (See Lohmann, *supra* n. 35, 95 for the history of the case and Bundeskartellamt press release, 7 Nov. 2003).

⁵³ We note that if a customer signs several contracts with the same supplier, the Commission will analyze them as one contract to compute the part of the demand tied.

⁵⁴ Implicitly in Art. 1(b) VBER, confirmed in *E.ON Ruhrgas*.

⁵⁵ Schinichels & Nyssens, 'Energy', in *The EC Law of Competition*, eds Faull & Nikpay, 2nd edn (OUP, 2007).

on the market'⁵⁶ (confirmed in *Gas Natural/Endesa*). In addition, reduction clauses,⁵⁷ the so-called 'English clauses'⁵⁸ and fidelity rebates granted by dominant firms on remaining volumes are also most likely to infringe competition rules.

3.4. THE DURATION OF THE CONTRACTS

The duration has to be analyzed along with the share of the customer's demand tied under the contract. Even if 100% of a customer demand is tied to a particular supplier, foreclosure will not occur if this customer can return to the market every year. However, long-term contracts constitute a barrier to entry when they preclude customers to switch for a more efficient supplier. As a general rule, the Commission is very suspicious of contracts longer than five years and considers that efficiencies generally do not offset foreclosure effects beyond that limit.⁵⁹ It is noteworthy that the Commission considers contracts with tacit renewal clauses or no last delivery date as contracts of indefinite duration (confirmed in *E.ON Ruhrgas*) and several contracts signed with the same supplier as one contract.

The duration has been and still is an enduring question for competition policy in energy markets. However, recent cases provide, it is submitted, a certain dose of legal certainty. Duration of contracts accepted by the Commission will mainly depend on the competition position of the counterparty. If the counterparty is an established reseller, duration will not exceed two years as in *Distrigaz*. The Bundeskartellamt accepted in *E.ON Ruhrgas* a duration of four years maximum for resellers with more than 50% of overall demand tied, but only two years above 80%.⁶⁰ Competition authorities will thus play with the two factors. Where demand requirements are satisfied by several suppliers, the Bundeskartellamt specified that contracts should distribute the risk of demand

⁵⁶ European Commission MEMO, *supra* n. 47.

⁵⁷ Reduction clauses allow the buyer to reduce off-take in case the supplier starts reselling in its commercial area. This merely means protecting the buyer's market, which contravenes the fundamental principle of market integration (see *EDF Trading/Wingas, Report on Competition Policy 2002*, 196). These clauses thus have similar market partitioning effects than exclusive distribution clauses, except that they often entail horizontal restrictions of competition. Clauses of 'right of first refusal' or 'most favored customer' will receive a similar treatment. They remain nonetheless more relevant for gas than for electricity. For a complete treatment see Kjolbye, *supra* n. 50, 252-270.

⁵⁸ 'English clauses' allow incumbents a right to match the offer of an alternative supplier in case the consumer wants to switch (para. 152 GVR). It is worth pointing out that the European Commission has so far never dealt with long-term contracts involving household customers. However, national competition authorities have dealt under Art. 82 EC and relevant national provisions with related problems of customer retention strategies by incumbent firms. According to Ofgem (see the Gas and Electricity Market Authority's Decision on *London Electricity*, 2005), London Electricity abused its dominant position by providing excessive financial incentives to returning customers and subsequently locking them in for a period of thirteen months. In *Enel Distribuzione* (Autorita Garante della Concorrenza e del Mercato, press release of 24 Oct. 2007), the Italian competition authority considered several abusive practices of the incumbent and forced the firm to bring its commercial practice in line with competition law principles. In *KalibraXE/EDF* (decision no 07-MC-01 of 25 Apr. 2007), the French Competition Council did not wait the end of its enquiry on the exclusive dealing clauses of its 2/3 year retail contracts to estimate that the risk of foreclosure was high enough to impose as interim remedy the inclusion of clear termination clauses (appeal is pending). See on this issue: Harker & Waddams Price, 'Introducing Competition and Deregulating the British Domestic Markets: a Legal and Economic Discussion', *Journal of Business Law* (2007): 244-268.

⁵⁹ Article 5(a) VBER and para. 141 GVR.

⁶⁰ Following *E.ON Ruhrgas*, four major gas transmission companies committed in Jun. 2007 to ensure the compatibility of their long-term contracts with EC and German Competition law. See Bundeskartellamt, Decisions B8-113/03-6 Bayerngas, B8-113/03-7 Gas-Union, B8-113/03-8 Saar Ferngas and decision B8-113/03-15 Wingas of 29 Jan. 2007.

fluctuations among suppliers according to the actual supply share provided by each of them so as not to advantage the main supplier. For a new entrant in retail, duration of five years is most likely to be accepted.⁶¹ One notes here that the Commission always thinks in terms of quantities effectively received and not only in terms of quantities contracted. In *Repsol*, a duration of five years was accepted for contracts with established resellers (from twenty-five to forty years originally) but the market shares of the dominant firm only reached 30% to 50%, which hardly exceeds the dominance threshold. One also notices a more lenient approach of the Commission towards fuel supply contracts than towards producer/reseller contracts. In *Gas Natural/Endesa* for instance, the duration was reduced from fifteen to twelve years. This rather long duration, as compared to the five years accepted in *Distrigaz* for gas supply contracts with power producers and other industrial customers, may be explained by different levels of market opening, the evolution of Commission thinking between 2000 and 2007 and the fact that even dominant firms can claim for some degree of long term security of fuel supply.

3.5. THE OVERALL SHARE OF THE MARKET COVERED BY CONTRACTS CONTAINING SUCH TIES

The Commission assesses here the cumulative effect of the parallel network of vertical restraints on market foreclosure. Indeed, long-term contracts can foreclose markets to new entrants only to the extent that a substantial part of market demand is tied for the long term. The fact that a dominant firm be involved in the contract does not change that conclusion from a competition point of view. As a general rule, the Commission considers that a significant cumulative foreclosure effect is unlikely to arise if the total market demand tied does not exceed 30% of global demand. In *E.ON Ruhrgas*, the Bundeskartellamt estimated that the firm contributed significantly to cumulative foreclosure with 75% market shares in its supply area, within a national market where 80% of total demand was tied in the long term. Interestingly, as opposed to the Bundeskartellamt and its rather form-based approach, the Commission in the *Distrigaz* case included flexibility parameters for the dominant firm itself. *Distrigaz* was allowed to adjust its portfolio of contracts to its own needs as long as it complies with a maximum duration of five years and that 65%-70% of its customers come back to the market every year. The firm retains by this a fair level of flexibility. *Distrigaz* can thus indifferently have for instance 37.5% of customers supplied under five year contracts and 62.5% supplied under one year contracts or 40% supplied under four year contracts and 60% supplied under one year contracts. Further flexibility is guaranteed as to protect *Distrigaz* from having to re-open existing long-term gas supply agreements if the volume of gas it supplies decreased. The net effect is that *Distrigaz* can tie under long-term contracts at most 30% of its existing gas supply volumes or 20% of the market, whichever is higher.

⁶¹ We note that in *Direct Energy*, the French Competition Council did not criticize the five years duration of the original contract. On *Direct Energy*, see Decision n°07-MC-04 of 28 Jun. 2007 and Decision n°07-1)-43 of 10 Dec. 2007.

These commitments will last for a minimum of four years and until Distrigaz' market shares decrease below 40% (or another supplier reaches the level of Distrigaz market shares minus 20%).

3.6. EFFICIENCIES

The Commission clearly acknowledges that a long-term contract might be efficiency-enhancing for an individual market player or even for competition in the longer run in case of exemption from Third Party Access for new infrastructure building. However and as a general rule, the Commission tends to consider that the aggregate effect of those contracts will be detrimental to economic efficiency and the consumers from a long-term perspective. In the course of its enforcement practice in recent years, the Commission has made fairly clear what could constitute a pertinent efficiency defense and how it will manage the inter-temporal policy trade-offs raised by long-term contracts.

At first, the Commission has repeatedly accepted the need of long-term contracts for new power plants erection and entry in general.⁶² In *Distrigaz and E.ON Ruhrgas*, restrictions on duration did not apply to new investments in gas fired power plants. In *Synergen*, the Commission accepted both a five years gas supply contract with Statoil for 100% of the new power plant needs and a fifteen years power purchase agreement for 50% of its production with the electricity incumbent ESB, acknowledging the need of secure dispatch levels to mirror long-term upstream fuel commitments and facilitate project financing. Setting up new power plants is beneficial because it will help ensure long-term generation adequacy and perhaps some diversity in the fuel mix.⁶³ Indeed, traditional project finance structures require fuel supply and dispatch contracts lasting longer than five years, even in the case of the new hybrid merchant/long-term contracts financial structures. If an investment enables entry, the Commission is highly likely to consider that consumers will receive a fair share of benefits from the vertical restraints, which will fulfil the condition under Article 81(3)(b). The Commission has taken this view to an even greater extent in the field of infrastructure development.⁶⁴ Promoters of new interconnectors have indeed been granted either exclusive rights of indefinite duration on the full capacity or a 20/25 years exemption from third party access (*Viking Cable*,⁶⁵ *Rovigo LNG*, *Grain 1/2/3*, *South Hook LNG*, *Dragon LNG*),⁶⁶ with use-it or lose-it principle though.⁶⁷ Similarly, on the UK-Belgium gas pipeline,⁶⁸ no third party

⁶² Paragraph 44, Commission Guidelines on the application of Art. 81(3); confirmed in *Synergen* and *Distrigaz*.

⁶³ Finon and Perez, 'Investment Risk Allocation in Restructured Electricity Markets: The Need of Vertical Arrangements', LARSEN Working Paper (2008).

⁶⁴ See European Commission press release, MEMO/01/76 of 13/03/2001.

⁶⁵ *Viking Cable*, notice pursuant to Art. 19(3) of Regulation 17, OJ. 2001, C 247/11.

⁶⁶ On *Rovigo LNG*, *Grain 1/2/3*, *South Hook LNG*, *Dragon LNG* and other exemptions based on Art. 22 of the Gas directive 2003/55/EC, see DG TREN website.

⁶⁷ In Britned, the exemption was limited by the Commission to ten years as National grid international and Nlink International BV, the two national transmission operators, were deemed to have under-calibrate the capacity of the interconnector to maximize profit.

⁶⁸ *UK/Belgium interconnector*, informal settlement, European Commission press release IP/02/401 of 13 Mar. 2002.

access was required as the Commission judged that the important number of users would allow development of a secondary market. On the other hand, for already existing and amortized interconnectors owned by dominant firms, the Commission deemed long-term capacity reservations to be abuse of a dominant position and required that 100% of capacities be freed up (UK-French submarine interconnector,⁶⁹ Dutch-German interconnector,⁷⁰ Norway-Denmark and Denmark-Germany interconnectors following the merger *VEBA/VIAG*).⁷¹

However, the mere objective of securing loans might not be sufficient to get exemption as the Commission in other sectors did not always consider it indispensable.⁷² In future cases, it is likely that energy providers will be required not to prevent their buyers from terminating the exclusive purchase clause and repaying the outstanding part of the loan at any point in time and without payment of penalties.⁷³ In addition, the *Synergen* and *Gas Natural/Endesa* decisions clearly showed a different treatment according to the market position of the sponsors and contracting parties. If the sponsor is dominant, the duration will be shortened. Similarly, if the off-taker in *Synergen* had not been dominant downstream, the power plant would have probably been allowed to contract 100% of its output over fifteen years. It also explains why different remedies have been applied.

One notes here that if long-term generation adequacy is clearly a critical goal of the Commission,⁷⁴ the vague concept of 'security of supply' is approached with much skepticism in competition cases. Prior to liberalization, the idea of ensuring security of supply through fuel mix diversity allowed Member States to secure 20% of the relevant market through long-term contracts between industrial consumers and local producers (*Jahrhundertvertrag*).⁷⁵ Today, only long-term gas import contracts have a good chance to be accepted on the basis of a 'security of supply' argument,⁷⁶ as long as territorial restrictions are not included.

As shown in the *Synergen* and *Gas Natural/Endesa* cases, long-term contracts often enable the buyer to get cheaper prices. Nonetheless, the parties will have to demonstrate

⁶⁹ *UK/France Interconnector*, informal settlement, European Commission press release IP/01/341 of 12 F Mar. 2001.

⁷⁰ Case C-17/03 *Vereiniging voor Energie, Milieu en Water, Amsterdam Power Exchange Spotmarket BV/ Eneco NV v Directeur van de Dienst uitvoering en toezicht energie* [2005] ECR I-4983. See Commission Staff Working Paper on the decision C-17/03 of 7 Jun. 2005 of the Court of Justice of the European Communities, SEC (2006) 547, 26 Apr. 2006 and Cameron, *supra* n. 40, 343-354. See also Talus and Wälde, 'Electricity Interconnectors in EU Law: Energy Security, Long-term Infrastructure Contracts and Competition Law', *European Law Review* 32, no. 1 (2007): 125-137, where they argue that the ECJ ruling in C-17/03 does not imply, contrary to the European Commission's position, a general ban on long-term contracts on interconnectors, at least for non-dominant firms.

⁷¹ Case M.1673 *VEBA/VIAG*, O.J. 2000, L 188.

⁷² *Schnichels & Nissens*, *supra* n. 55.

⁷³ In case the loan comes from the dominant supplier, it will be considered as an efficiency gain only if it cannot be obtained on the same terms with commercial or investment banks. As a result, to remedy the long duration in *Repsol*, the Commission gave the right to usufruct stations to repay their loan at market value.

⁷⁴ As evidenced by the new directive on security of supply, Directive 2005/89/EC concerning measures to safeguard security of electricity supply and infrastructure investment, O.J. 2006, L 33/22.

⁷⁵ Hancher, *EU Electricity Law* (Wiley Law Publishing, 1992). See also *Electrabel/Mixed Intercommunal Electricity Distribution Companies* in 1997 where the Commission accepted that a substantial part of the local authorities' electricity requirements continues to be procured with Electrabel (see Report on Competition Policy 1997, 150 and European Commission press release IP/97/351 of 25 Apr. 1997).

⁷⁶ See Gas Directive, recital 25, quoted *supra* n. 17.

clearly that price efficiencies are linked with the long duration. Cost savings from coordination will be hard to compute and it will be hard to prove that the consumer benefit outweighs the negative effects of the restriction on competition. In view of the rather large and flexible treatment of Article 81(3)(b) EC by the Commission in energy, a neutral effect on final consumers should be sufficient to pass this test. Once again, cost efficiencies will not be assessed the same way given the market position of the contracting parties. In *Synergen*, the price formula benefited a new power plant and was explicitly acknowledged as an efficiency to be counted toward exemption under Article 81(3) EC. To the contrary, the price efficiency in *Gas Natural/Endesa* is considered to grant an unfair competitive advantage to Endesa and had to be removed. To that extent, *Gas Natural/Endesa* could have been a decision based on price discrimination. At last, resale price fixing which does not appear to be a common feature of electricity for the moment, but might become so in the future, are not forbidden per se as long as it does not eliminate price competition. Therefore, minimum resale price maintenance will be banned but a maximum price ceiling will be accepted as long as price competition among resellers is economically possible and alignment effects do not occur.⁷⁷

3.7. CONCLUSION

More legal certainty could only come from the clear statement of the relevant facts taken into account by the European Commission and how to interpret these facts in the new context of liberalization. The methodology displayed in the *Distrigaz* case combined with the analysis of relevant cases provides, it is submitted, clear insights on the current position of the European Commission. The next section puts this recent line of cases into perspective which reinforces these conclusions and brings lights on the determinants of competition policy in energy.

4. COMPETITION ENFORCEMENT IN ELECTRICITY IN THE AFTERMATH OF *DISTRIGAZ*: WHAT CAN WE INFER FROM RECENT CASES?

The Commission opened in July 2007 two proceedings against two electricity incumbents, EDF and Electrabel, for possible breaches of EC Treaty rules on abuse of a dominant position due to their long-term contracts with industrial customers. The Commission argued that '*the cases will take account of the reasoning developed in a competition case concerning Distrigaz and the gas markets in Belgium.*'⁷⁸ This is a first indication as to how the Commission will approach long-term contracts in electricity. However, beyond the fact that enforcement in other energy sectors and particularly in gas is logically the best proxy to anticipate future enforcement in electricity, this paper argues that the methodology depicted above has recently upgraded legal certainty, in electricity but also across energy

⁷⁷ Article 4(a) VBER and para. 225-228 GVR, confirmed in Repsol.

⁷⁸ See European Commission press release, *supra* n. 9.

industries, more than market players and commentators tend to usually think. It also shows that interesting conclusions can be drawn on the antitrust strategy of the European Commission in a sector where national politics still matters.

4.1. THE EUROPEAN COMMISSION IS INCREASINGLY TAKING A UNIFIED APPROACH UNDER ARTICLE 81 AND ARTICLE 82 EC

Deregulated network industries are a fertile ground for the modernization of Article 82 EC. European electricity and gas incumbents are usually super-dominant⁷⁹ and potentially infringe EC competition law in many ways. Their portfolio of contracts in particular naturally calls for an approach under Article 82 EC, even if it could be argued that Article 81 EC could suffice.⁸⁰ Our analysis shows that the European Commission is increasingly taking a unified approach under Articles 81 and 82 EC. This is important as the degree of economic analysis, methodologies and even competition law objectives have traditionally diverged between the two competition provisions. Article 81 EC, together with relevant guidelines and notices, does not *a priori* allow or ban long-term contracts, even when they involve dominant firms, unless the agreement contains the so-called 'hard-core' restraints. It rather provides a framework of analysis to balance anti-competitive aspects and efficiencies according to the contracting parties' market shares and the nature of the restraint involved. To the opposite, this has not clearly been the case so far under Article 82 EC which tends to be based on legal forms and, to a certain extent, protection of competitors, especially when it comes to assessing exclusive dealing clauses.⁸¹ In particular, pro-competitive and efficiency justifications have been scarcely used under Article 82 EC,⁸² which has increased the need to reform in order to achieve consistency between Articles 81 and 82 EC.⁸³ Overall, the reform of Article 82 EC is recent and slowly going forward.⁸⁴

⁷⁹ As defined by Advocate General Fennelly in Case C-395/96P & C-396/96P, *Compagnie Maritime Belge Transports SA and Others v Commission*, [2000] ECR II-1365, para. 137; see also *Deutsche Post AG – Interception of cross border mail*, OJ 2002, L331/40.

⁸⁰ Rousseva, 'Modernizing by Eradicating: How the Commission's New Approach to Article 81 EC Dispenses with the Need to Apply Article 82 to Vertical Restraints', *Common Market Law Review* 42 (2005): 587-638. As a general rule an agreement exempted under Art. 81(3) EC is unlikely to infringe Art. 82 EC, even though the Court has already ruled otherwise, see Case T-51/89, *Tetra Pak Rausing SA v Commission*, [1990] ECR II-309. For an interesting discussion, see Loewenthal, 'The Defense of "Objective Justification" in the Application of Article 82 EC', *World Competition* 28, no. 4 (2005): 461-463.

⁸¹ Sher, 'The last of the Steam-powered Trains: Modernizing Art 82', *European Competition Law Review* (2004): 244; Slot, 'A View from the Mountain: 40 years of developments in EC Competition Law', *Common Market Law Review* 41 (2004): 462; Bellamy & Child, *European Community Law of Competition* (London, 2001), 42; Ridyard, 'Exclusive Pricing and Price Discrimination Abuses under Article 82 – an Economic Analysis', *European Competition Law Review* 23 (2002): 290-291. For a more contrasted view, see Eilmansberger, 'How to Distinguish Good from Bad Competition under Article 82 EC: in Search of Clearer and More Coherent Standards for Anti-Competitive Abuses', *Common Market Law Review* 42, no. 1 (2005), 138.

⁸² See the argument by Tample Lang and O'Donogue in 'The Concept of a Exclusionary Abuse under Art 82' (Working Paper, Global Competition Law Center, Jun. 2005) on 'objective justification': 'This issue deserves serious consideration, since a defense that is recognised in theory, but not in practice, is the same as no defence.'

⁸³ Rousseva, *supra* n. 80; Vickers, *Abuse of Market Power*, Speech to the 31st conference of the European Association for Research in Industrial Economics (2004); Kallagher & Sher, 'Rebate Revisited: Anti-Competitive Effects and Exclusionary Abuse under Art 82', *European Competition Law Review* (2004) and Loewenthal, *supra* n. 52.

⁸⁴ See on this the EAGCP report 'An Economic Approach to Article 82' (Jul. 2005), the DG Competition discussion paper on the application of Art. 82 of the Treaty to exclusionary abuses (Dec. 2005) and Lowe, 'DG Competition's Review of the Policy on Abuse of Dominance', in *International Antitrust and Policy: Annual Proceedings of the Fordham Corporate Law Institute 2003*, ed. Hawk (New York: Juris Publishing, 2004), 163.

As a result, proceedings under Article 82 EC and relevant national provisions such as *Distrigaz* and *E.ON Ruhrgas* could have entailed a *quasi*-automatic per se prohibition. Although the case law is at least ambiguous on whether or not per se prohibition exists under Article 82 EC, it remained likely that 'objective justifications' could not immunize super-dominant energy firms from liability. To the opposite, efficiencies and insights from the traditional competition economics of foreclosure are clearly taken into account in these cases. On this, the Commission has clearly followed the approach of its Discussion Paper.⁸⁵ We can notice that the reasoning used under Article 82 in *Distrigaz* is similar to the methodology which would have been applied under Article 81 EC and is in line with the VBER and the GVR. This is indeed primarily the cumulative effect of the network of contracts concluded by the firm which grounds the infringement of Article 82 EC. Historically, the doctrine of cumulative foreclosure effect had been a cornerstone of the modernization of Article 81 EC and has been regularly endorsed by Community Courts.⁸⁶ It was first treated in the Article 81 EC cases *Brasserie de Haecht* (1967),⁸⁷ *Delimitis* (1991)⁸⁸ and more recently *Langnese-Iglo* (1995),⁸⁹ *Schöller* (1995),⁹⁰ *Neste* (2000)⁹¹ or *Van den Bergh Foods* (2003).⁹² This is a well-established tool of competition analysis which *in fine* will help dominant firms analyze themselves if their portfolio of long-term contracts infringes EC Competition law.

Interestingly, traditional market share thresholds under Article 81 EC such as the 30% for automatic exemption defined in the VBER became a benchmark for applying remedies in *Distrigaz*. The Commission indeed imposed that 70% of the firm's customers come back to the market every year as long as *Distrigaz*' market shares still exceed 40%. The one year duration which renders any exclusive purchase obligation acceptable under Article 81 EC⁹³ has thus also become an explicit target under Article 82 EC. These recent decisions show that, before any publication of draft guidelines on the modernization of Article 82 EC, the reform of the European provision on abuse of dominance is still going forward. In the future, energy companies should thus less and less face discrepancies between enforcement under Articles 81 and 82 EC, which removes in itself a source of legal uncertainty.⁹⁴ We can now safely state that dominant energy firms can implement long-term contracts if the economic and legal contexts allow and that there is no market share threshold beyond which contractual practices, safe hard-core restraints, becomes per se illegal in energy.

⁸⁵ DG Competition discussion paper, *supra* n. 84.

⁸⁶ Verouden, *supra* n. 2.

⁸⁷ Case 23/67, *Brasserie De Haecht v. Wilkin*, [1967] ECR 407.

⁸⁸ Case C-234/89, *Stergios Delimitis v. Henninger Bräu*, [1991] ECR I-935.

⁸⁹ Case T-7/93, *Langnese-Iglo GmbH v. Commission*, [1995] ECR II-1533.

⁹⁰ Case T-9/93, *Schöller Lebensmittel GmbH & Co KG v. Commission*, [1995] ECR II-1610.

⁹¹ Case C-214/99, *Neste Markkinointi Oy v. Yhtäuli Ky and Others*, [2000] ECR I-11121.

⁹² Case T-65/98, *Van den Bergh Foods Ltd v. Commission*, [2003] ECR II-4653, para. 82-83.

⁹³ para. 141 GVR.

⁹⁴ This effect, which was predicted in the EAGC report, *supra* n. 84, and Rey, 'On the right test for exclusive dealing', in *European Competition Law Annual 2007: A Reformed Approach to Article 82 EC*, eds Ehlermann & Marquis (2008), is substantiated here.

4.2. LEGAL UNCERTAINTY IN ELECTRICITY IS OVERSTATED AS ANTITRUST
ENFORCEMENT ALIGNS ACROSS ENERGY INDUSTRIES AND QUICKLY CONVERGES
WITH ENFORCEMENT IN SECTORS WHERE COMPETITION IS MORE MATURE

A conclusion of this article is that enforcement in energy quickly converges with enforcement in other sectors. In fact, the policy statements of the VBER and GVR have almost all been confirmed in the course of recent cases in energy. The way to analyze market characteristics and patterns of consumption, the suspicion towards contracts longer than one year and tacit renewal clauses or even the principles to analyze efficiencies, which are in line with the Guidelines on the application of Article 81(3), all show that antitrust enforcement in energy aligns with enforcement in sectors where competition is more mature. This can also be seen in the field of remedies.

A first example concerns the termination rights for existing contracts granted to buyers which can be found in *E.ON Ruhrgas* and *Distrigaz*. In *Distrigaz*, existing contracts with energy intensive industries (resellers excluded) enjoyed unilateral termination rights. This is a classical remedy and the fact that long-term contracts with indefinite durations and unclear termination rights create switching costs and are more restrictive than long-term contracts concluded for several years has once again been recalled. Second, one can notice that the criterion used to define the duration of commitments comes in line with what happens in other sectors. In *Distrigaz* for instance, the fact that the commitments will only apply as long as the firm has a market share exceeding 40% or the share of its closest competitors is no less than 20% of its own, mirrors a similar approach adopted in the recent *Coca-Cola* case⁹⁵ where the commitments only applied if Coca Cola's market shares were over 40% or where its sales were more than twice those of its nearest competitor.

Furthermore, one can note that the few remedies imposed in electricity since liberalization tend to indicate that the Commission's view on the mix of short and long-term contracts acceptable in a market building context is the same in electricity and in other energy industries. Remedies are a laboratory for reform experimentation and the Commission clarifies its strategy over time. Its main goal when imposing remedies is to improve liquidity in the wholesale market and find a workable mix of contract durations able to accommodate the different market players' needs while limiting foreclosure effects. As shown above, a maximum duration of about three to four years for contracts with big energy users has been regularly applied in recent decisions. When looking at the mix of contracts imposed as remedies in electricity, the so-called Virtual Power Plants (thereafter VPP), it is interesting to note that the Commission broadly imposed the same durations.

VPP are a classical remedy in electricity which forces dominant firms to make capacity options available for a pre-determined time horizon, which amounts to a virtual divestiture of capacity. This has been imposed in the context of both merger and antitrust cases. In the 2000 *EDF/EnBW* merger proceeding for instance,⁹⁶ EDF was required to

⁹⁵ Case C-39.116 *The Coca-Cola Company*, OJ. 2005, L 253.

⁹⁶ Case M.1853 *EDF/EnBW*, OJ. 2002, L 159/1.

auction blocks with durations of three months to three years, amounting overall to one third of the eligible consumers' demand, for a period of five years minimum. In 2001, for the UK-French submarine interconnector, 100% of the capacity had to be freed and auctioned on the basis of three years bilateral contracts (1500MW divided in 50MW blocks) and concurrently annual (50MW in 1MW blocks) and daily (150MW in 1MW blocks) auctions. In 2002, in *Synergen*, the original plan submitted to the Commission foresaw that the dominant incumbent ECB would hold 70% of the new 400MW gas-fired power station with the entire plant output to be sold through its retail subsidiary ESBIE, which would clearly reinforce the incumbent's market power on the relevant market. To remedy that situation, the Commission imposed a 600 MW VPP, including 200MW from the Synergen power plant (equivalent to half of eligible consumer demand). The 600MW would have to be sold on the basis of three years bilateral contracts, and subsequently through auctions in case bilateral contracting would not work. This shows that the Commission thinks that duration of three years should not be exceeded in the new market context. VPP are the most important occasions for European competition authorities to take on a *quasi-ex ante* regulatory role, which displays with clarity the advancement of their thinking on what a workable mix of contract duration should be. The durations imposed are similar to what can be found in other energy sectors, which tends to show that the Commission takes similar views across energy sectors and reinforces the idea that the methodology recently devised will be applied in electricity.

4.3. THE LIMITS OF A RULE OF REASON IN ENERGY AND THE INFLUENCE OF THE POLITICS OF LIBERALIZATION

This last section argues that the alignment of enforcement in energy with traditional competition policy demonstrates the current limits of the 'more-economic' approach in energy and explores the impact of the politics of liberalization on the current antitrust strategy of the European Commission.

4.3.1. *The Quick Alignment of Antitrust Enforcement in Energy Demonstrates the limits of the 'More-Economic' Approach in a Market Building Context*

The rationale of the 'more economic' approach in EC competition law is to better capture industry specifics. Yet, there is no reason to believe that energy at this stage of the liberalization process must be analyzed as the beer or ice-cream sectors, except if energy truly converged with these industries, which is not the picture we find in the Energy Sector Enquiry.⁹⁷ True, applying some analytical devices such as the cumulative effect doctrine brings some relevant insights for competition analysis in energy. Seeking consistency in enforcement across sectors is also a legitimate goal of competition policy. However, it seems that the replication of the usual methodology, with the same

⁹⁷ DG Competition Report on Energy Sector Inquiry, *supra* n. 5.

thresholds and the same contract durations in particular, also expresses a path dependency in competition enforcement and the difficulties which the Commission currently faces in energy.⁹⁸ When this paper argues that legal certainty has recently been upgraded in electricity, this does not come from a new methodology able to capture real economic effects with a high level of consistency, an objective highlighted in the EAGCP report,⁹⁹ but from a methodology which the Commission knows, can easily apply and which can *in fine* be anticipated. The only real breakthrough introduced by the European Commission in the recent line of cases is the flexibility granted to the dominant firm in *Distrigaz* for applying remedies. This has to be recognized but the Commission could have gone further. Remedies could for instance have been gradually decreasing in strength before the dominance threshold, which would be the proof that a proportionality test is really applied under Article 82 EC and that remedies evolve with a firm going from a 'super-dominant' to a dominant position.

Given both the limited information at hand on the specific competition dynamics of the market building process and the limited practical insights to be drawn from energy economics, it is not sure that simply aligning enforcement in energy with enforcement in other sectors be sub-optimal from an efficiency point of view. The superiority of rules over discretion has been clearly demonstrated in numerous policy contexts, especially in presence of strong interest groups as in energy, and when the necessary knowledge for a satisfactory tailoring of antitrust enforcement is missing as with long-term contracts.¹⁰⁰ The gains from clearer rules in terms of legal certainty could indeed well offset the uncertain gains of the 'more economic' approach. However, this would require a clear acknowledgment that antitrust enforcement in energy is aligned with traditional EC competition policy. In addition, we cannot but notice that in this case a limited level of discretion is probably more suitable to a decentralized application of EC competition law, even if the recent case law tends to show that national competition authorities broadly align with the European Commission.

4.3.2. *The Politics of Liberalization Influences the Antitrust Strategy of the European Commission in Energy*

The antitrust strategy of the European Commission in energy can hardly be understood without taking into account the politics of liberalization. After two liberalization directives in 1996¹⁰¹ and 2003,¹⁰² the current difficulties around the enactment of a third legislative

⁹⁸ On path dependency in competition enforcement, see Gambardella & Maria Salerno, 'Vertical Agreements: Was the Commission's Response Adequate? On the Commission's Ability to Reform Long-standing Policies', in *EC Competition Law: a Critical Assessment*, eds Amato & Ehlermann (Hart Publishing, 2007).

⁹⁹ EAGCP Report, *supra* n. 84.

¹⁰⁰ Supporting this general line of argument, see Hayek, *Law, Legislation and Liberty*, Vol. 1: Rules and Order (Chicago University Press, 1973) and Heiner, 'Rule-Governed Behaviour in Evolution and Human Society', *Constitutional Political Economy* 1, no. 1 (1990), 19-46.

¹⁰¹ Directive 96/92/EC, *supra* n. 13.

¹⁰² Directive 2003/54 concerning common rules for the internal market in electricity and repealing Directive 96/92, 15/07/03, O.J. 2003, L76.

package¹⁰³ show once again that the on-going opposition of several major Member States and the resulting gaps in the sector-specific regulatory framework continue to hinder the completion of a single European market for energy. The institutional structure of the European Union does not give to the European Commission the power to alter property rights in the different Member States and thus to carry an aggressive policy of horizontal and vertical de-integration which would probably deliver better and faster results.¹⁰⁴ The lack of an EU-wide energy regulator with effective power to monitor and regulate market developments *ex ante*, especially cross-border trade issues, is particularly detrimental to the integration and the well-functioning of European energy markets.¹⁰⁵ The allocation of regulatory powers in the EU is thus biased in favour of the *ex post* enforcement of EC competition law. While the sector-specific regulatory framework shows obvious signs of weakness, the European Commission has announced it would use its antitrust power with even more strength in the coming years.¹⁰⁶ In this context, antitrust law seems to remain the main policy driver able to achieve large scale improvements in the competitive structure. This can be seen for instance in the recent E.ON settlement¹⁰⁷ where the incumbent decided to divest its transmission network to avoid further antitrust scrutiny, while the German government was strongly opposing any significant improvement on the current provisions for ownership unbundling of the network. In a context of strong opposition at the Member State level, continuing to advocate a case-by-case approach has advantages for the European Commission. Its current antitrust strategy on long-term contracts certainly fully fulfils neither the objective of predictability nor the objective of the 'more-economic' approach but the recent decision of E.ON tends to show that retaining some flexibility for future bargaining with the former incumbents may be the only way forward at the present time. Bargaining through antitrust indeed has the obvious advantage to bring large improvements in the competitive structure without waiting for the slow development of EC electricity law and without risking being overturned by Community Courts.¹⁰⁸ But this comes at an unknown cost.¹⁰⁹

¹⁰³ The draft of the third legislative package can be accessed on the DG TREN website.

¹⁰⁴ On this, see Green & Newbery, 'Competition in the Electricity Industry in England and Wales', *Oxford Review of Economic Policy* 13, no. 1 (1997): 27-46 and Newbery, van Damme & von der Fehr, 'Benelux Market Integration: Market Power Concerns' (2003), Report of the Market Surveillance Committee, Dutch Competition Authorities.

¹⁰⁵ Glachant & Lévêque, 'Electricity Internal Market in the European Union: What to do Next?' (2006), EPRG Working Papers 0605, University of Cambridge.

¹⁰⁶ On this see for instance the DG Competition Report on Energy Sector Inquiry, *supra* n. 5, and Monti, 'Applying EU Competition Law to the Newly Liberalized Energy Markets' (2003), Communication to the World Forum on Energy Regulation, Rome.

¹⁰⁷ See O.J. 2008, C 146/09 and European Commission MEMO/08/396 of 12 Jun. 2006.

¹⁰⁸ However, it could also be argued that Community Courts could follow the Commission in case of appeal when looking at the opinion of Advocate General Damasco Ruiz-Jarabo Colomer in *Glaxosmithkline* (C-468/06 to C-478/06) presented the 1 April 2008. He indeed encouraged the European Court of Justice to clearly state that a *per se* approach is not applied any more under Art. 82 EC, even if there is no doubt about the eliminatory intent of the dominant firm, and that anti-competitive effects must be weighed against potential gains for the consumer as is current under Art. 81 EC.

¹⁰⁹ We can also notice that the incomplete modernization of Art. 82 EC also enables the European Commission to operate under less stringent constraints than would have been the case under Art. 81 EC whose modernization and case law are much more established.

5. CONCLUSION

Due to their ambiguous effects on competition, investment and welfare, long-term exclusive supply contracts will remain a key issue for antitrust enforcement in the EU energy markets for many years to come. Even if some uncertainty remains, this paper has showed that a clear methodology to analyze foreclosure effects in a market building context has emerged from the recent line of cases and that this methodology is most likely to be applied in electricity. The strong legal uncertainty currently perceived in the market place is thus largely overstated. This article also showed that the liberalization of network industries was a particularly fertile ground to advance the modernization of Article 82 EC and that the Commission is increasingly taking a unified approach among the EC Treaty provisions on competition for long term exclusive dealing in energy.

The analysis of the impact of the 'more-economic' approach on antitrust enforcement in European deregulated energy markets raised interesting insights. The objective of the new methodology depicted was to propose a more integrated framework able to capture the real economic effects of long-term contracts on competition as well as to provide a sound rationale for negotiating remedies. However, in the face of a radically new context, the European Commission largely disregarded sector specificities. It did not only replicate methodologies it had devised in other sectors where competition is more mature but also strictly applied the VBER and the GVR, most notably on durations. This cannot only be explained by the general objective of fostering consistency across sectors. It also demonstrates both the limits of the 'more-economic' approach when information is scarce and the impact of the politics of liberalization on the antitrust strategy of the European Commission.