

APPLYING EU COMPETITION LAW
TO THE NEWLY LIBERALISED ENERGY MARKETS

by

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Ladies and Gentlemen,

It is a great honour for me to participate in this Forum today under the chairmanship of Senator Amato. I very much welcome this initiative which aims to bring US and EU approaches to competition policy even closer, in particular when applied to liberalising energy markets. I would like to thank the Mentor Group for having founded this Forum, and to congratulate the Mentor Group itself for its twentieth anniversary since its establishment in 1983 in Boston.

1. LIBERALISATION AND COMPETITION POLICY

Before going into the details on how we in the European Commission analyse the main competition enforcement issues in the EU, I should like to make a preliminary clarification in relation to how we understand the concept itself of liberalisation¹. Mr Jones has just given us a substantial insight into the contents of energy liberalisation, so I will try to avoid boring you with repetitions. But I would just like to make it clear that liberalisation and privatisation are two different notions, independent from one another. That is to say, liberalisation can occur in markets where public companies are present. The contrary is also true. There are examples of EU Member States where before the liberalisation companies were private². Furthermore, the EC Treaty is neutral as regards the property regime. Competition rules are thus implemented by the Commission irrespective of the type of ownership, private or public, of the companies concerned. The Commission does not seek to promote or discourage any particular option in relation to the ownership regime by Member States.

Liberalisation, as is currently taking place in the electricity and gas markets in the EU, and the application of competition law share the same objectives. Only the instruments differ.

¹ N.B.: the title of the presentation in the programme reads: "Applying EU Competition Law to the Newly Liberalized Energy Market: Likely Antitrust Enforcement Issues Important to an *Emerging Private Sector*" (emphasis added).

² For instance in Spain and in Germany.

Indeed, the Treaty rules on internal market and on competition complement each other to achieve common EU aims. Internal market rules help create an overall framework for an open market economy with free competition (Art. 4 EC). Competition rules are used by the Commission in this context to tackle the remaining factual barriers to an effectively functioning internal market. These barriers can derive, from contractual arrangements, such as joint selling agreements, as I will discuss in detail later on. You certainly remember the unique feature of competition rules in the EU. These are the only ones in the world which aim not only to protect the efficient allocation of economic resources, but also to promote the creation of an internal market, by tackling situations which affect trade among Member States.

The process of market integration is thus supported by the enforcement of the three main competition instruments, namely: antitrust (articles 81, 82, and 86 EC Treaty), merger control (Regulation n° 4064/89), and state aid control (articles 87 and 88 EC Treaty). All these instruments interact and reinforce each other in promoting competition, notably in liberalised markets.

Curiously, the process of energy liberalisation has also implied some short-term distortions of competition because of its own success. This is due to the positive and rapid advancement towards full market opening by some Member States ahead of EU requirements, which has sometimes resulted in uneven market opening among different Member States, and so the lack of a level playing field for market actors.

Therefore, the Directorate General for Competition that I lead has supported in a wholehearted and constructive manner Commission efforts aimed at full market opening throughout all Member States.

It is particularly crucial that we create a level playing field in terms of full market opening as soon as possible, so that all consumers can benefit from energy liberalisation, and not only the largest industrial consumers.

2. COMPETITION POLICY IN THE ENERGY SECTOR

In my view three conditions need to be fulfilled in order to achieve a market structure favourable to competition.

- First we need to introduce and maintain a supply structure that is favourable to competition.
- Secondly, we need to introduce an effective, transparent and non-discriminatory access regime to the transmission networks. Without such a regime, customers cannot be reached by alternative suppliers, which have to rely on the existing network.
- Thirdly, we must ensure that customers are not prevented from switching suppliers. Such obstacles could, for example, stem from customers being locked-in in long-term exclusive supply contracts with the incumbent supplier.

Of these three basic requirements, we have the least problems with eligible industrial customers who wish to switch supplier. We therefore concentrate our efforts mainly on the two first conditions for effective competition, namely the improvement of supply competition and the introduction of an effective, transparent and non-discriminatory network access regime, mostly for cross-border transmissions.

2.1. Increasing energy supply competition

In order to increase supply competition we need to remove all obstacles, including contractual arrangements, that prevent suppliers from entering into competition with each other. In this sense, effective supply competition is the other side of the medal to effective customer choice.

We thus strive to improve the supply structure of both electricity and gas markets. Concretely we examine horizontal agreements detrimental to competition, focusing on joint marketing agreements in the upstream sector, and vertical arrangements having negative effects on supply competition. Among the vertical restraints, we concentrate currently on territorial sales restrictions, energy use restrictions and clauses having similar effects, such as profit splitting mechanisms, which are particularly prevalent in gas markets. All these restrictions limit the possibilities of the buyers to resell the gas and thus create more supply competition in the gas markets.

In order to tackle these situations we use all competition instruments at our disposal. To give you an idea of how this translates in practice, I will first mention some antitrust examples.

I would like to present to you a recent case brought to a conclusion last month by the Commission that seems to me paradigmatic to demonstrate clearly the different types of issues we usually deal with. I am thinking about the "DONG/DUC" case³, relating to the Danish gas market.

The three members of the Danish Underground Consortium, "DUC" - Shell, AP Moller, and ChevronTexaco - produced around 90 % of the gas for sale from the Danish continental shelf. This gas was sold under three large supply agreements to the dominant Danish incumbent gas supplier DONG. These contracts contained clauses amounting in the opinion of the Commission to horizontal or vertical restraints on competition.

The first aspect addressed in the DONG/DUC case was that of joint marketing by the gas producers, a horizontal restraint in our opinion. We could establish that the DUC partners had negotiated their supply agreements with DONG jointly while they had signed their contracts individually. This kind of joint marketing reduces the possibilities of customers to choose between suppliers/producers and thus appreciably restricts competition in violation of the Treaty.

DUC claimed that their joint marketing carried out by DUC was covered by the block exemption regulation on specialisation agreements. We could not agree with this argument. The joint marketing provided for "joint co-ordination of sales between independent producers" and not for "joint distribution" as referred to in the block exemption. It did also not have the objective of supplying more efficiently cheaper products.

In the end, DUC partners agreed to discontinue joint marketing activities for gas produced on the Danish continental shelf and to market all new gas individually in future. They also undertook to individually carry out negotiations concerning the renewal of existing contracts. Finally they promised to sell an important amount of

³ Press release IP/03/566 of 24 April 2003.

gas, approximately 7 billion cubic meters, over a period of five years to new customers, which in the past had not had the possibility to buy DUC gas.

The DONG/DUC case also raised a number of issues relating to vertical restraints. A first restraint concerned a "reduction clause" contained in one of the three agreements. This clause allowed for adjustments to the gas purchase obligations of DONG, if the DUC partners started selling gas into Denmark.

DONG argued that the reduction clause was necessary to counterbalance the "take-or-pay" obligations imposed by the DUC partners. We rejected this argument. Reduction clauses have effects similar to exclusivity clauses: hindering entrance by the DUC partners into the downstream Danish gas markets. Since DONG is dominant on the Danish markets this was unacceptable the moment DONG had other marketing outlets for its gas.

We obtained the elimination of the reduction clause. DONG committed itself to waive the reduction clause six months after a new pipeline linking the gas fields on the Danish continental shelf with other continental European countries is commissioned. Indeed, this pipeline is expected to be operational soon, which would allow DONG to sell abroad the amounts of gas which it cannot sell in Denmark, should for instance the DUC partners become suppliers in the Danish market. So from this date the DUC partners will be free to sell gas into the Danish market without DONG invoking the reduction clause⁴.

We identified a second vertical restraint, a use restriction, contained in the supply contracts imposed on DONG as buyer. DONG had to report to the DUC partners the volumes it sold to a certain customer, a Swedish gas wholesaler, and to a certain customer group, electricity generators, in order to benefit from special price formulas for these customers. For us, this clause was tantamount to use restrictions, since it limited DONG's freedom to sell gas to customers. Moreover, use restrictions are hardcore restrictions under European competition law. They lead de facto to market partitioning hampering the creation of an EC internal market.

⁴ It is expected that this new pipeline, to be built by the DUC partners and by DONG, will become operational by 1 January 2005 at the latest.

Here again, DUC and DONG agreed to allow DONG to sell the gas wherever and to whomever it deems appropriate, and in particular without informing the DUC partners about any of these sales and the prices applied.

Finally, in order to facilitate the entry of the DUC partners and potentially other suppliers into Denmark, DONG undertook to introduce an improved third-party-access regime for its off-shore pipelines linking the Danish gas field with the Danish main land⁵.

I think that this antitrust case has illustrated to you not only the issues raised by the application of competition rules in the energy sector, but also how competition policy contributes to the liberalisation process.

By the way, this case also demonstrates the ability of the Commission and of national competition authorities to work together to obtain complex settlements in politically sensitive cases. Both the Commission and the Danish competition authority conducted the settlement discussions together, and the commitments given by DUC and DONG will be monitored by the Danish competition authority. We were successful in co-ordinating our parallel proceedings under different legal regimes. The Commission's case was initiated *ex-officio* under European competition law, and the Danish authority opened its case under national law following the notification of the DUC/DONG agreements by the parties. This way different or conflicting rulings were excluded.

As to the liberalisation of the electricity markets, an example I could cite is the acquisition of a potential competitor on the French market by the dominant state-owned EDF, which brings me to the application of merger control. This case was dealt with at the time of my predecessor Alexander Schaub, who will today present the internal market perspective on these questions.

As a general remark, I would like to indicate that mergers can have pro-competitive effects when they allow new operators to enter national markets dominated by

⁵ In particular, DONG committed itself to increase the transparency of the system by publishing information on available capacity, to allow for short term trading in line with the access regime applying to its on-shore pipelines and to introduce interruptible transport contracts.

former legal monopolies. They can, however, have negative effects on competition when they strengthen the dominant position of a former monopoly.

In the EDF⁶ case to which I was referring, we avoided the strengthening of the dominant position of EDF which would have resulted from EDF's acquisition of joint control of Energie Baden-Wuerttemberg (EnBW), the third largest German generator whose traditional supply area is close to the French border. The operation would have reinforced EDF's dominant position because of the elimination of EnBW as one of the few potential rivals.

The Commission only accepted the merger after a series of commitments had been offered by EDF. I will present the two main commitments to you.

First, EDF undertook to terminate its contractual links with a French electricity producer: the Compagnie Nationale du Rhône (CNR). CNR was contractually required to sell all its electricity to EDF. These links meant that CNR could not sell freely in France or elsewhere. As a result of the Commission's intervention, an end was put to the contract between CNR and EDF. Today CNR is free to compete with EDF for customers in particular in France. In tackling this aspect of the case, we used both antitrust and merger instruments.

Secondly, EDF undertook to guarantee competitors access to its generation capacity in France for a period of five years through auctions of virtual power generation capacity. This generation capacity, which represented around one third of the demand of eligible customers in France, means that new entrants have electricity to offer to French consumers without depending on imports through potentially congested interconnectors.

Finally the third instrument of European competition policy, the control of state aid, also enables the Commission to ensure effective and undistorted supply competition by preventing firms from enjoying unfair financial advantages over competitors.

⁶ Press release IP/01/175 of 07 February 2001.

An example will illustrate how this works in practice. I refer to the case of an advantage conferred by the French State to EDF: an unlimited State guarantee for EDF's liabilities. It is thus impossible for EDF to go bankrupt.

This financial advantage is linked to EDF's status as a public company. EDF was granted this status in 1946, before the creation of the European Community. The Commission seeks thus simply to remove the unlimited guarantee.

Since France has not dispelled our concerns, we decided last month to open a formal procedure⁷. An in-depth examination of the conditions on which the guarantee is based will now be undertaken.

2.2. Network related issues

I wish to address a second set of issues arising in the liberalising gas and electricity markets. Since gas and electricity networks are natural monopolies and their duplication is not economically sound, third-party access to the network is a key requisite for effective competition on energy markets.

I will refer here to two concrete aspects of network access: tarification and refusal to give access.

2.2.1. Tarification

An essential element for effective third party access is non-discriminatory, cost-reflective tariffs. Competition rules provide an instrument to act against tariffs which do not meet these requirements.

For example, the Commission informed the parties to a German association agreement that the transmission tarification system they had proposed network operators to apply was discriminatory because it protected the supply interests of local and regional generators. Indeed, this tariff included a charge, the so-called "T-component", levied on individual cross-border transactions. This would have led to the establishment of an entry barrier around Germany, threatening the EU internal market for electricity. We informed the parties of our opinion that this was contrary

⁷ Press release IP/03/477 of 2 April 2003.

to European competition rules, and, as a result, they removed the "T-component" from the transmission tariff.

As shown by this case, competition rules can be applied to make restrictive tariffs or tariff components disappear, in particular when cross-border tariffs are concerned. European competition rules are, however, not apt to develop pro-competitive tariffs. This is rather the task of regulators, hence, the importance of having independent regulators in all Member States.

2.2.2. *Refusal to give access*

Another crucial element for effective third party access to networks is the existence of sound electricity and gas transport capacity allocation methods in case of insufficient capacity, which minimises the cases to which access to the network is refused. This is particularly important for cross-border trade between neighbouring Member States since interconnectors linking them become easily congested.

The settlements reached by the Commission with Thyssengas⁸ and with Gasunie⁹ in the Marathon case offer an example of our policy in the area of access to gas networks. Thyssengas and Gasunie are German and Dutch gas network operators respectively. They are both part of a group of continental gas companies which, before liberalisation, refused network access to Marathon, the subsidiary of a US company¹⁰, for transporting Norwegian gas. In order to settle the case, Thyssengas and Gasunie offered commitments for improving third-party access to their pipelines, which the Commission accepted. For example, the companies improved transparency through publication of available transmission capacities. They also improved their congestion management system and introduced facilitated booking procedures. In addition, Gasunie offered the possibility to link other pipelines to its

⁸ Press release IP/01/1641 of 23 November 2001.

⁹ Press release IP/03/547 of 16 April 2003.

¹⁰ Marathon Oil Company, part of the Marathon Oil Corporation (US Steel Group).

own pipeline system. As you see, the Commission is determined to intervene in favour of all new entrants into EU energy markets when applying competition rules.

This prompts, en passant, a reflection of the evident need for co-operation and exchange of ideas across the Atlantic in view of the ever increasing world-wide activity of economic actors, a need that this Forum is clearly well placed to respond to.

Regulatory involvement in transmission capacity allocation methods are however insufficient to develop an appropriate interconnection level between Member States. The Trans-European network infrastructure has to be substantially improved to allow trade to grow and import competition to become more effective. We thus fully support the efforts of our colleagues in the Directorate General for Transport and Energy, to stimulate investments in infrastructure.

3. FINAL REMARKS

Allow me to underline as a conclusion the complementary nature of EU internal market, competition and energy policies, whose combined effect should, at least in the medium term, lead to the emergence of fully competitive energy markets in Europe.

Of course, the Commission is not the only authority promoting liberalisation and competition. National competition authorities play an important role in this respect, as do energy regulators. Mr Vasconcelos [*if presence confirmed*], with whom we have developed a very good co-operation, knows this well. Of course, the question of the respective roles of sector specific regulators and general competition law in network industries is not new to this Forum, which debated this topic in Rome in September last year.

To conclude, I hope that our discussion today will usefully contribute to further develop liberalisation and our competition issues. I fully support the development of this exchange of ideas, which seems to me very useful to achieve our shared objectives to increase consumer welfare in the US and the EU.

Thank you very much.