Use and abuse of competition law in pursuit of an EU-electricity market

Lessons (and warning) for Chile?
Santiago - 22 July 2019
By Christian Bergqvist, ph.d.
What role for Competition?

• Its often claimed that competition law and DG COMP, EU principles enforcer, are unqualified to deal with the complexity of electricity

• Competition law should therefore be downgraded to a supporting role, only applied in full once a market have emerged and matured
Competition law might be unsuited?

- EU *Energy Sector Inquiry* (2007) provides indications of deficiencies in the single energy markets, including:
  1. Long-term supply agreements foreclosing the retail markets and in respect to gas restriction on the use e.g. prohibiting resale
  2. National wholesales marked with high level of concentrations giving ground for the exercise of market power
  3. Balancing regimes often favouring the incumbents, coupled with group favouring when procuring balancing power
  4. Insufficient unbundling between network and supply/generation creating risk of vertical foreclosure and group favouring
  5. Insufficient cross-border capacities, different market designs, and networks often controlled by the incumbents
  6. Insufficient access regimes in particular when it comes to cross-border connectors and long-distance transmission
- The perception of competition law as unqualified should thus rest on inability to address these deficits
Competition law have address these I

1. Long-term supply agreements foreclosing the retail markets and in respect to gas restriction on the use e.g. prohibiting resale
Competition law have address these I

1. Long-term supply agreements foreclosing the retail markets and in respect to gas restriction on the use e.g. prohibiting resale

Even accepting long-term agreement if involving new plants, restructuring of existing or providing for long-term planning

- In three UK cases (1991-1992) long-term electricity supply agreements were accepted under Article 101 (1) or exemptible under Article 101 (3)
- In Pego (1993) and REN/Turbogàs (1996) 15-year exclusive supply agreements tying a newly constructed power plant were accepted
- In Electrabel (1997) an exclusive supply agreement tying a local distributor until 2011 was accepted provided 25 % was freed up in 2006
- In Viking Cable (2001) 25-years exclusive use of a projected interconnector between Norway and Germany was accepted
Competition law have address these II

2. National wholesales marked with high level of concentrations giving ground for the exercise of market power

- In *German electricity wholesale market* (2008) the German energy incumbent E.ON strategically withheld available production capacity, thereby driving the wholesale price up incompatible with Article 102. Closed against commitments on divestment of production capacity
- In the merger *EDF/EnBW* (2000) commitments were accepted mandating divestment of wholesale electricity in France regardless of a merger limited to Germany
- In the merger *EDF/SEGEBEL* (2009) commitments were accepted mandating divestment of wholesale electricity in Belgium regardless of limited horizontal overlaps and a combined market share below 20 %
- In the merger *Synergen* (2002) commitments were accepted mandating divestment of wholesale electricity in Ireland inducing capacity into the wholesale market
Competition law have addressed these issues.

3. Balancing regimes often favouring the incumbents, coupled with group favouring when procuring balancing power.
   - In *German Electricity Balancing Market* (2008) the German TSO has preferred procuring balancing power, at a premium, from group-affiliated providers, passing on the higher costs to the competitors in imbalance and ultimately to the end users. Closed against commitments to divest the transmission network.
Competition law have address these IV

4. Insufficient unbundling between network and supply/generation activities creating risk of vertical foreclosure and group favouring

- In *SHG* (1992) the French and Italian TSO had colluded on paying an independent French electricity generator, linked exclusively to the Italian grid, under the lower French tariffs. Closed against commitments to pay the higher Italian price.

5. Insufficient cross-border capacities, different market designs, and networks often controlled by the incumbents

- In *Skagerrak Cable* (2000) and *UK/France Interconnector* (2001) DG COMP acted against long-term reservations under Article 101, closing the investigation subject to relinquishing of capacity on the cross-border electricity connections
- In *Swedish Interconnectors* (2010) the Swedish TSO had strategic closed the connection to Denmark in response to congestion internally in the Swedish transmission network. Closed against commitments fragmenting Sweden into two different price zones with local congestion management
- In *TenneT* (2018) ineffective management of transmission capacity between Western Denmark and Germany was identified and addressed with commitment to increase available capacity
- Mergers as *VEBA/VIAG* (2000) and *Grupo Villar Mir/EnBW/Hidroelectrica del Cantabrico* (2001) were cleared against release of transmission capacity/commitments to construct new
Competition law have address these VI

6. Insufficient access regimes, in particular when it comes to cross-border connectors and long distances transmission

- In *Verbändevereinbarung* (1998) the German TSO had agreed on price and terms for the transmission of electricity thus greatly facilitating this. Regardless of a clear price cartel DG COMP decided not to pursue the matter.
- In *Thyssengas* (2001) third party access to a gas pipeline was secured by commitments, including improvement in the balancing and congestions regime.
- In *Electricity transmission tariffs in the Netherlands* (1999) DG COMP cautioned against tariffs based on distances as trading of electricity (and gas) does not per se require actual movements creating a risk of excessive pricing, referred to as *pancaking*, if linked to distance.
Competition law as unsuited?

• Labelling competition law as unsuited neither does justice to the eminent role played by competition law nor how DG COMP have engaged the matter.
Competition law as unsuited?

• I agree that competition law might be inadequate in some capacities or roles
  • German electricity wholesale market involved strategic withholding of electricity by a generator with a market share below 30% in a situation where market price exceeded MC
    • Is single dominance thereby expanded to cover below 30% market shares?
    • Is excessive pricing thereby redefined as \( p > MC \) when it comes to electricity?
  • In GDF Suez and ENI strategic under-investments in infrastructure were seen as an impediment but debatable if also abusive under Article 102 allowing for a formal decision
  • The slow French opening of the domestic markets would fall short of Article 101 and 102
• Making it open if all the cited cases could have been finalized void of commitments from the parties
Competition law has been applied

- Successful across the years by:
  - Freeing up wholesale capacity and preventing foreclosure of retail markets by long-term supply agreements
  - Improving transmission and access to infrastructure, including imperfections in pricing and balancing/congestion management
  - Securing expansion on available transmission capacity, including capacity offered to the market
  - Being applied in a prudent manner including non-application, if beneficial for the long-term development
  - Incenting member states to secure full implementation of adopted regulation by blocking mergers void of commitments
Competition law has been applied

• However, this is only part of the story and competition law has played a much more pivotal role in bringing the single energy market about.

• Void of competition law there might not have been any single market for energy.
Understanding the role of competition law

• Unlocking the role of competition law when it comes to the single energy market starts by understanding that there is neither a single market nor a coherent regulatory EU model.

• Rather a pattern has emerged of successful generations of models haunted by deficits and political compromises that can best be illustrated when it comes to electricity.
3 successive generations of EU-models

<table>
<thead>
<tr>
<th>1st electricity model</th>
<th>2nd electricity model</th>
<th>3rd electricity model</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Required a (limited) market opening</td>
<td>✓ Full market opening</td>
<td>✓ Full market opening</td>
</tr>
<tr>
<td>✓ Adoption of access rules</td>
<td>✓ Mandatory access rules</td>
<td>✓ Mandatory access rules</td>
</tr>
<tr>
<td>✓ Many derogations and special provisions</td>
<td>✓ Rules on NRA, TSO/DSO and regulatory unbundling</td>
<td>✓ Rules on NRA, TSO/DSO and regulatory unbundling</td>
</tr>
<tr>
<td>✓ Rules on PSO</td>
<td>✓ Ownership unbundling</td>
<td>✓ Ownership unbundling</td>
</tr>
<tr>
<td>✓ Rules on PSO</td>
<td>✓ Rules on PSO</td>
<td>✓ Delegation to EU</td>
</tr>
<tr>
<td>Deficits:</td>
<td>Deficits:</td>
<td>Deficits:</td>
</tr>
<tr>
<td>- No coordination</td>
<td>- Limited coordination</td>
<td>- Limited coordination</td>
</tr>
<tr>
<td>- No ownership unbundling</td>
<td>- No ownership unbundling</td>
<td>- No rules on construction</td>
</tr>
<tr>
<td>- High risk of regulatory abuse (No NRA rules)</td>
<td>- Risk of regulatory abuse</td>
<td>- No rules on construction</td>
</tr>
<tr>
<td>- Limited market opening</td>
<td>- No rules on congestion management pining crossborder trade</td>
<td>- No rules on construction</td>
</tr>
<tr>
<td>- No mandatory access</td>
<td></td>
<td>- No rules on construction</td>
</tr>
<tr>
<td>- No rules on construction</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Competition law as the anchor

**1st electricity model**
- 1st Electricity Directive & Transmission Directive
- Required a (limited) market opening
- Adoption of access rules
- Many derogations and special provisions

**Deficits:**
- No coordination
- No ownership unbundling
- High risk of regulatory abuse (No NRA rules)
- Limited market opening
- No mandatory access
- No rules on construction
- Many derogations

- The pre-liberalization model (*Utility-model*) utilized a system of reserved rights that most likely could be accommodated by Article 106
- The Commission’s first attempt to create a single electricity market (1988) would have used Article 106 (3) as basis for a Commission Directive. A step that found no support with the Council compelling the Commission to table a normal Directive in 1992, only to be meet with further resistance
- A redrafted and watered-down version was then introduced accompanied by a number of infringement cases before the Court of Justice (the electricity cases). A copy of the process successfully utilized in telecom a decade earlier
- However, not only would this stall the process, but eventually backfire when it became apparent that the Court of Justice would not rule favorable with the Commission
- An amputated version was eventually adopted in 1996 as the *1st Electricity Directive* (96/92)
Competition law secured implementation

**1st electricity model**
- 1st Electricity Directive & Transmission Directive
- Required a (limited) market opening
- Adoption of access rules
- Many derogations and special provisions

**Deficits:**
- No coordination
- No ownership unbundling
- High risk of regulatory abuse (No NRA rules)
- Limited market opening
- No mandatory access
- No rules on construction
- Many derogations

- Initially, the regulatory model would have been anchored on competition law with a series of Article 106 (3) directives adopted by DG COMP
- Lacking support for this an amputated model was adopted where competition law closed gaps
  - The lack of mandatory unbundling created a high risk of abuses that could be checked by Article 106
  - Competition law would give DG COMP the power to check the national implementation
  - Article 101 (3) was used to check and reduce long-term supply agreement to a maximum of 15 years
  - Article 101 (3) was used in *Jahre­hundertvertrag* to request moderations in the German endorsement of indigenous energy under the national PSO
  - Article 101 (1) was used to monitor *Verbändevereinbarung*, where the German TSO had agreed on price and terms for the transmission of electricity. While closing a gap it remains a cartel
  - The Merger Regulation allowed DG COMP to request release of capacity on international interconnectors in e.g. *VEBA/VIAG*
Competition law closed lacunas

2nd electricity model
• 2nd Electricity Directive & 1st Crossborder Transmission Regulation
✓ Full market opening
✓ Mandatory access rules
✓ Rules on NRA, TSO/DSO and regulatory unbundling
✓ Rules on PSO

2nd Electricity Directive and 1st Crossborder Transmission Regulation closed many gaps. However, a large number of market imperfections would still hamper the single market ambition.

• Competition law gave the DG COMP the power to address some of these

  ✓ Article 101 (3) was used to endorse the construction of new interconnectors in Wiking Cable
  ✓ The Merger Regulation allowed the DG COMP to request the expansion of transmission capacity in Grupo Villar Mir/EnBW/Hidroelectrica del Cantabrico on international interconnectors, injection of electricity into pools in EDF/EnBW and Synergen and the relish of balancing power in Verbund/Energie Alianz)
  ✓ The Merger Regulation allowed the DG COMP to address the slow French implementation of obligations in EDF/EnBW by designing a commitment package to the domestic French market regardless of the merger limited to Germany
Competition law as a sledgehammer

- **3rd Electricity Directive** and **2nd Crossborder Transmission Regulation** closed most of the remaining gaps. However, their adoption was somewhat of a marathon

✓ Competition law smoothed the adoption and implementation

  ✓ Article 102 was used in **German electricity wholesale market** and **German electricity balancing market** to secure ownership unbundling in Germany (and divestment of generation capacity) paving the way for incorporating this into the **3rd Electricity Directive**

  ✓ Article 102 was used in **Swedish Interconnectors** to remedy a dubious Swedish congestion management where internal bottlenecks were addressed by closing the connection to Denmark

  ✓ Article 102 was used in **CEZ** against hoaxing of transmission capacity foreclosing the market

  ✓ Article 102 was used in **BEH Electricity** against clauses preventing resale of wholesale electricity. Closed against commitment to participate in the creation of a power exchange

<table>
<thead>
<tr>
<th>3rd electricity model</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 3rd Electricity Directive &amp; 2nd Crossborder Transmission Regulation</td>
</tr>
<tr>
<td>✓ Full market opening</td>
</tr>
<tr>
<td>✓ Mandatory access rules</td>
</tr>
<tr>
<td>✓ Rules on NRA, TSO/DSO and regulatory unbundling</td>
</tr>
<tr>
<td>✓ Ownership unbundling</td>
</tr>
<tr>
<td>✓ Rules on PSO</td>
</tr>
<tr>
<td>✓ Delegation to EU</td>
</tr>
</tbody>
</table>

Deficits:
- Limited coordination
- No rules on construction
- (Need for pools, more interconnectors and market coupling)
Competition law have contributed

• Competition law has been successful in facilitating the adoption of sector specific regulation
• The Sector Inquiry (2007) and Capacity Remuneration Mechanism inquiry (2016) have highlighted potential impediments to the single market and secured a better understanding of the sectors with the DG COMP (and NRA)
• Competition law can check many anti-competitive moves once a market and competition starts to emerge. A special role (on EU-level) henceforth would be the issue of state aid
Warnings for Chile?

• The persistent deficits have drafted competition law to serve in a regulatory role
• The priorities of DG COMP have been tainted by this and not all cases could not have been finalized
• Cases might even have been opened for the purpose of secure leverage over the member states
Want to know more?

CHRISTIAN BERGQVIST

BETWEEN REGULATION AND Deregulation

Studies on the limitations of competition law and its ambiguous application to the supply of electricity and telecommunications in the EU

Jurist- og Økonomforbundets Forlag
Cases cited

- IV/33.473 - Scottish Nuclear, O.J. 1991L 178/31
- IV/33.151 - Jahrhundertvertrag
- Pego, XXIII Report on Competition Policy (1993) recital 222
- COMP/E/37.125 - Statkraft/Elsam - Interconnector capacity
- IP/01/1641 - Commission settles Marathon case with Thyssengas.
- IP/01/341 - UK-French electricity interconnector opens up, increasing scope for competition
- IV/E3/37.770 – Electricity transmission tariffs in the Netherlands
- IP/03/1345 – Commission reaches breakthrough with Gazprom and ENI on territorial restriction clauses.
- COMP/E-4/37.732 - Synergen
- COMP/M.2947 - Verbund/Energie Allianz
- COMP/M.1853 - EDF/EnB COMP/M.5549 – EDF/SEGBEL
- COMP/39.388 - German electricity wholesale market
- COMP/39.389 - German Electricity balancing market
- COMP/39.351 - Swedish Interconnectors
- COMP/39.316 - GDF foreclosure.
- AT.39.816 - Upstream gas supplies in Central and Eastern Europe
- AT.39.727 – CEZ
- Case 39.315 - ENI.
- Case COMP 39.767 - BEH Electricity
- COMP/M.1673 - VEBA/VIAG
- COMP/E-3/37.921 - Wiking Cable
- COMP/M.2434 - Grupo Villar Mir/EnBW/Hidroelectric del Cantabrico
- SEC 2006 1724 – DG Competition report on energy sector inquiry, 10 January 2007
Questions

Or contact me on cbe@jur.ku.dk