Is a specific antitrust treatment required in electricity and gas markets?

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Motivations of the paper

- An intense antitrust activity
  - EC Merger Regulation
    - Suez/GdF (notified in April 2006)
    - Endesa/GN (rejected as outside Commission's jurisdiction in November 2005)
  - Art. 17 of the Council Regulation 1/2003
    - Commission launched an energy sector enquiry in March 2005; draft report issued in February 2006.
  - Art. 81 of the Treaty
    - Removing of territorial exclusivity clauses in gas contracts between OMV and Gasprom (February 2005)
  - Art. 82 of the Treaty
    - Distrigas is accused by the Commission to delay the entry on the market of new suppliers by concluding long-term contracts with many of its industrial customers (Statement of objections, May 2006)
- Economic literature emphasis
  - Specific features of electricity (and gas to a lower extent)
    - non storability: demand must be cleared with 'just in time' production continuously
    - short-run demand elasticity very small
    - supply gets very inelastic at high demand level
    - High potential for market power even with low market share (Pivotal Supplier Index, Bushnell 1999; Residual Supply Index, Sheffrin, 2001)
    - but hard task to prove it has been exercised (physical and financial withholding, Stoft, 2001)
- **Is a specific antitrust treatment required ?**

Mergers and Acquisitions (1/2)

- Pre-merger competition is generally low and often non-existent at the beginning of the liberalization process
  - The objective of merger remedies to restore competition is not well suited
  - ⬇ Drop the neutrality principle

‘“*In making [its assessment] the Commission shall take into account the need to maintain and <u>develop</u> effective competition”(recital 23rd’* ECMR 139/2004)

- National M&As are likely
  - to raise anticompetitive effects
  - not to be reviewed by the Commission
  - to be authorized by national governments (e.g., Eon/Rurhgas, Endesa/GN)
  - ⬇ The 2/3 rule is not well suited to energy sector. Needs to change it

Mergers and Acquisitions (2/2)

- Risk of mistakes in M&As assessment is high because antitrust authorities have to look into the crystal ball three times
  - To predict the most likely competition regime within two years
  - To assess the probability of anticompetitive effects in that hypothetical regime
  - To gauge whether remedies can eliminate the expected anticompetitive effects in the anticipated competition regime
- Type II error (false positive/underdeterence) is more costly than type I error (false negative/overdeterence)
  - low elasticity of demand makes the exercising of market power very harmful to consumers
  - whereas low synergies (Anderson, 1999) makes the loss of efficiencies tolerable when a procompetitive merger is wrongly stopped

⇑ Competition authorities must be more stringent (e.g., more divestitures)

Art. 81: Long term contracts (1/2)

- Especially useful in energy
  - To mitigate risk in large scale and sunk investments (nuclear plants, gas pipelines, etc…)
  - To reduce incentives in exercising market power on spot markets (Allaz and Vila, 1993)
- Of course, purchasing long term contracts can also raise foreclosure effects

Art. 81: Long term contracts (2/2)

- Article 81 is well-suited to balance pro- and anticompetitive effect
- However, the interpretation of the 4th criterion of 81(3) is controversial (agreements must not afford 'undertakings the possibility of eliminating competition in respect of a substantial part of the products in question')
- According to the Commission, a long term energy purchasing contract seems to always eliminate competition (less liquidity on wholesale markets, more price volatility, lower signal quality, more risks for potential entrants)

Articles 81 and 82

- Potential for market power (i.e., collusion and unilateral effects) is huge
- Getting evidence on the exercising of market power is difficult
  - How to distinguish whether high prices reflect scarcity or market power
  - Example: Market power in California
    - Who is right? Hogan or Joskow?

⇩ Act ex ante

⇩ Develop competition advocacy, especially towards regulatory authorities

⇩ Set market (and interconnections) surveillance committees

Art. 82(a): Excessive Prices

- 4 decisions in 40 years (Motta and de Streel, 2003)
- Lower standard of proof
  - price comparison, price-cost margin
- Art.17 makes art. 82(a) more powerful
  - Sector enquiries provide a huge amount of data, including on costs, on several companies, on several markets, on several countries
- Art. 82(a) makes the threat of sector enquiries more dissuasive and market surveillance committees more effective
- Is it worth to use more Art. 82(a) in energy markets?
  - More discretionary power to the Commission will facilitate the mitigating of market power in electricity and gas and will pass on more rapidly the benefits of liberalization to EU citizens; however, the use of article 82(a) may disincentivizes investments, entails a risk to go back to administrative pricing and a risk of contamination in other sectors

Conclusions

- Change the 2/3 rule to review national mergers
- Be more stringent for type II errors are very costly for consumers
- Allow remedies that develop competition not only restore competition
- Use cautiously the test of competition elimination in assessing long term contract exemption
- Develop competition advocacy
- Set market (and interconnections) surveillance committees and use Article 82(a) as a threat