

Workshop on Efficiency, Competition and Long Term Contracts in Electricity  
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# **Long-term Energy Supply Contracts in European Competition Policy: Fuzzy not Crazy**

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# Introduction

- Energy community increasingly doubts the ability of deregulated markets to solve the problem of vertical relationships >> call for more 'robust' vertical arrangements
- EU Commission consistently emphasizes anti-competitive effects and made them a priority for antitrust review
- New line of cases recently (e.g. *E.ON Ruhrgas*, *Distrigaz*) and new cases regularly open (EDF, Electrabel): is there a new methodology to analyze LTC in a market building context?
- Our main result: a methodology is emerging
  - It is still fuzzy
  - But less dogmatic than usually said



# Outline of the Presentation



1 Market Building Through Antitrust: Keys of Understanding &  
EU Commission Dilemma with LTC



2 EU Competition Policy Methodology for energy LTC is emerging



3 Concluding remarks

# Market Building Through Antitrust in the EU Energy Markets: keys of understanding

- *S1- Allocation of regulatory powers: Antitrust takes the lead*
  - European *ex ante* regulation is weak: no strong EU regulator at the Community level while EU Commission derives its antitrust powers from EC Treaty so EU Antitrust the sole “robust” policy driver for energy liberalization (e.g. *E.ON* & *RWE* settlements)

# Market Building Through Antitrust in Energy C<sup>ted</sup>

- S2 - *Antitrust as a 'market building' tool in the EU? The Difficulties:*
  - Antitrust is usually enforced in sectors where competition is more mature. In Gas & Elec, antitrust faces an incumbent monopoly or a quasi cartel in place for decades
  - DG Comp not an independent regulatory body. Antitrust formal decisions taken in the European Commission as executive branch of European Union >> Independent judicial review by European Community Courts
  - Few precedents

# Market Building Through Antitrust in Energy: C<sup>ted</sup>

## *S3- Modernization of EC Antitrust Policy : Opportunities and Threats*

Towards a more economic approach!

- The EU Commission tries to devise new methodologies and criterion to enforce antitrust in a context of market building
- high probability of errors if knowledge problem on competition dynamics
- Legal Certainty? Accuracy vs. predictability

# Market Building Through Antitrust in Energy: C<sup>ted</sup>

- Conclusion:

‘Market building’ in the EU is increasingly carried out through Antitrust

but DG COMP (as economists...) has limited information on all actual effects of LTC on competition dynamics in energy markets

so uncertainty is there for DG COMP as for market players

# “Actual Antitrust” Dilemma

## “Sector Enquiry”

### LTC Positive

- Enable entry if sufficiently long
- Help Investment in high fixed-costs technology
- Mitigate abuse of market power on the Day Ahead market

### Negative

- Foreclosure
- Dry out spot markets
- State Aid Problem for purchasing consortia and stranded PPA
- market partitioning: single EU market goal
- Discrimination

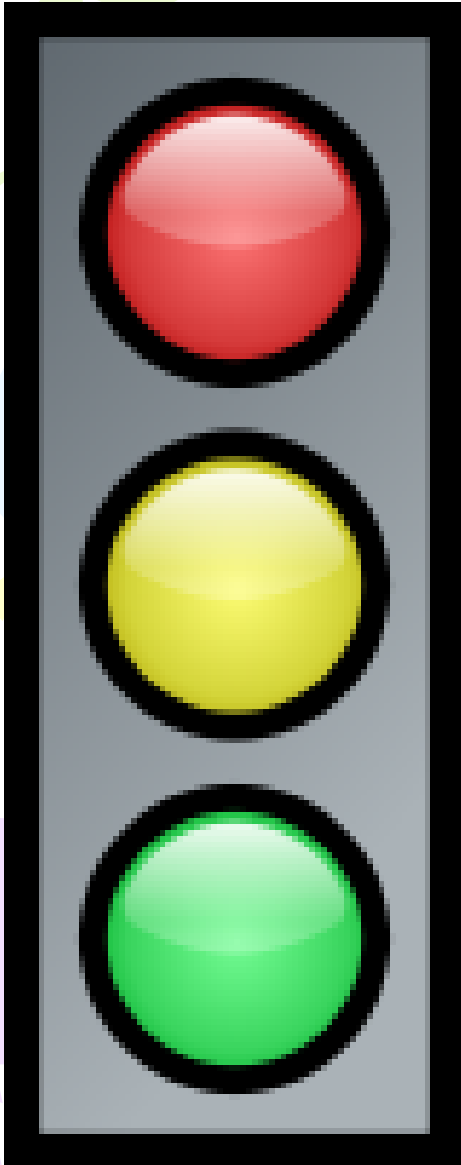
EU  
Market  
Building



## II- Emerging EU Competition Policy Towards Energy Long-term Contracts: Fuzzy not Crazy

- Methodology to analyze “access to customers” in long-term contracts emerged in recent cases: *Gas Natural/Endesa* (2000), *Synergen* (2001), *Repsol* (2005), *E.ON Ruhrgas* (2006) and most importantly *Distrigas* (2007)
- A four-steps methodology with a ‘pro-entry’ bias:
  1. Market share thresholds and ‘black-listed’ contract clauses
  2. Analysis of Anti-competitive Effects
  3. Balancing Anti-competitive Effects with Efficiencies
  4. Remedies

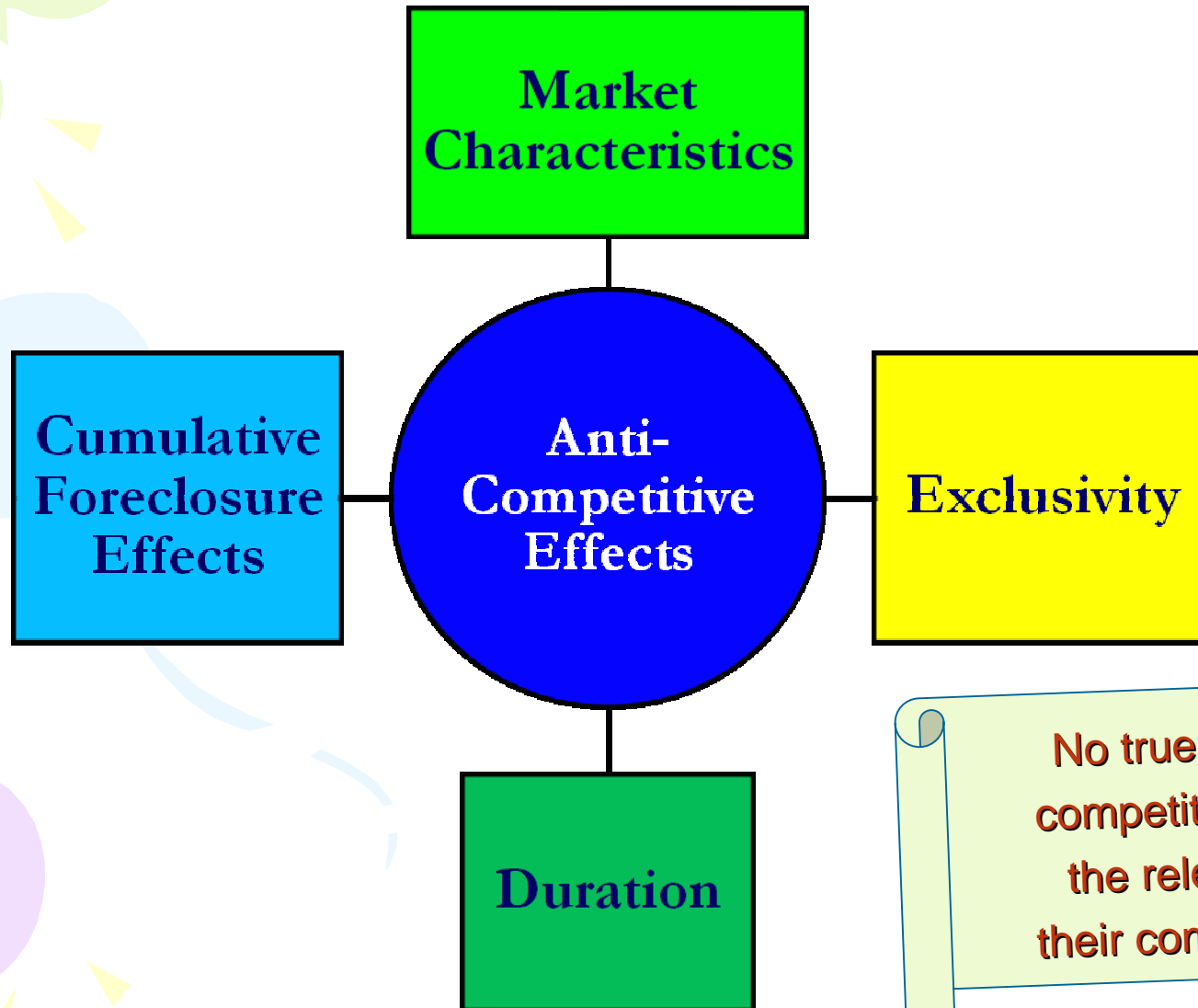
# Step 1: Market Share Thresholds and 'Black-listed' Contract Clauses



- *'Hard-core restraints' illegal per se*: destination clauses, use restrictions, min. resale price fixing + *When implemented by dominant firms*: fidelity rebates and retention strategies, tacit renewal are *per se* illegal.
- Market shares  $>30\%$ , analysis of anti-competitive aspects
- Market shares (of the supplier)  $<30\%$  without hard-core restraints: exempted

**Object: Limit Reg. Costs**

## Step 2: Analysis of Anti-competitive Effects



No true sequencing of competition analysis but the relevant facts and their combination is clear

## STEP 2 – b/ Exclusivity

### Exclusivity

- EU Commission considers Transaction Costs too high when negotiating for a small quantity

It may be uneconomic for an alternative supplier to provide less than (20%) >> 80%: threshold for *de facto* exclusivity

- EU Commission bases its analysis on quantities actually received
- Exclusivity is particularly detrimental if the buyer is big enough to motivate a new entry to serve his demand (*'critical customer'* concept)
- To be analysed along with duration

## STEP 2 – C/ Duration



### Duration

- No problem with buyer size and exclusivity if contracts  $< 1$  year.
- Duration threshold with existing reseller: 2-4y
  - *E.ON Ruhrgas* and *RWE*: 4y if buyer demand tied  $\leq 80\%$  and 2y if  $\geq 80\%$
- New entrant reseller trying to establish a market position: probably 5y
- For a moderately dominant supplier (*Repsol*):  $\leq 5y$
- Uncertainty for electricity intensive users

# STEP 3: Balancing Anti-competitive Effects with Efficiencies

- Analysis of efficiencies much weaker
- The two main efficiency gains recognized have been **investment** and **entry**
- The Commission has acknowledged that even dominant firm could claim for a certain level of security in fuel supply
- Securing loan not sufficient
- Assessment of proportionality: this is where the **problem** and **discretion** of competition authorities really lie.

# Final step: Remedies applied to LTC

- Traditional remedies in EC Competition
  - ***Tailoring***: shorten duration, tailor duration to the share of customer demand tied
  - ***Prohibiting***: delete clauses (e.g. destination clause), forbid vertical M&A for a while (*Repsol*)...
- New remedies for energy
  - increasing use of VPP and gas releases, even in the context of long term contracts case
  - **Flexible remedy mix**: the Distrigaz “paella”

# Distrigaz “paella”: a Superdominant Firm with Multiple Criteria rem.

- *Distrigaz manages contract durations as long as:*
  - \*No contracts over 5 years (2y. for resellers)
  - \*\*70% customers must come back to market (termination of existing contract) every year
- *Examples of duration flexibility management:*
  - 37.5% supplied under 5 year contracts and 62.5% supplied under 1 year contracts
  - 40% supplied under 4 year contracts and 60% supplied under 1 year contracts
  - 60% supplied under 2 year contracts and 40% supplied under 1 year contracts
- Commitments as long as Distrigaz market share  $>40\%$





## Distrigaz “flex/ remedy”: C<sup>ted</sup>

- However contracts with a buyer investing in new power plant exempted from duration and “market come back” remedy.
- Key remaining **uncertainty** concerns the ability of a dominant electricity firm to sign upstream and downstream LTC linked to a new investment in GEN, especially if the LTC could accommodate the needs of electro-intensive users

# Concluding Remarks (1)

- Clear methodology emerging: uncertainty perceived by players is incrementally reduced. Commission providing guidance through cases
- Strong suspicion against contracts longer than 5y when implemented by dominant firms
- Positive effects of LTC on market power abuse not considered
- VPP often imposed but their real effects on market structure is unconvincing >> ‘pro-entry’ bias but Commission is weak on understanding ‘patterns of entry’ in energy

## Concluding Remarks (2)

- EU antitrust authorities not as dogmatic as said
- DG Comp still in learning curve
- Uncertainties remain on:
  - the treatment of energy intensive users
  - LTC for High-fixed costs GEN investments (e.g nuclear) involving a dominant incumbent
- Is the lack of economic analysis really more detrimental to market building and social welfare than the lack of predictability?
- We would applaud the publication of non-binding guidelines on acceptable contract forms as a positive step forward the building of the EU internal market