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Legal uncertainty and competition policy in deregulated network industries. The case of long term contracts

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Summary : The case of long-term vertical contracts in the EU electricity markets is a topical example of the difficulties faced by Competition authorities with the liberalization of network industries. Their ambiguous effects on the competitive structure, 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. This article proposes to explore the implications deriving from the strategy implemented by the European Commission to cope with these trade-offs. The article comes up with three conclusions. First, legal uncertainty is largely overstated as both the methodology to analyze these contracts and its implementation principles are clearly emerging. Second, more legal certainty became possible because the coping strategy of the European Commission was to replicate methodologies it had devised in other sectors, especially beer and ice-cream, which upgrades legal certainty but does not guarantee the efficiency of future competition enforcement. Third, this methodology could even go counter the objectives of the European Union in terms of market building and security of supply in electricity.

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1. Introduction

Competition authorities face a considerable challenge with the liberalization of network industries. In fast-evolving market settings, they must fight anti-competitive practices while ensuring a fair degree of legal certainty to market players, without being able to firmly rely on past case law, an intimate knowledge of the market or even economic theory. This is particularly difficult in energy where liberalization opened new doors for sophisticated market abuse while the specifics of the sector are strong and the policy objectives of the European Union often contradictory in practice when enforcing EC Competition law.

The case of long-term vertical contracts (LTC) in the EU electricity markets is a topical example of these difficulties. European markets are still wrapped up with LTC and liberalization has not changed much this traditional sales patterns. Sometimes mere residuals of the former vertically integrated structure,[1] they might now constitute innovative ways to mitigate new uncertainties born from liberalization and facilitate the achievement of other policy objectives such as long-term generation adequacy. While the energy community increasingly doubts the ability of de-integrated markets to ensure an optimal allocation of risks and praises long-term contracting, the European Commission consistently emphasizes the risks of anti-competitive effects inherent in LTC[2] and made them a priority for antitrust enforcement as the recent proceedings in gas and oil show. In electricity however, the lack of precedents and the on-going modernization of EC competition law cast doubts on the way the Commission will apply competition rules, which has fostered legal uncertainty. This raises serious concerns in a sector where predictability of competition enforcement is crucial to stabilize market players' expectations and hence allow them to sink high fixed-cost investments.

This article proposes to explore how the European Commission and national competition authorities are dealing with one of the most important issues in energy markets since liberalization, the long-term supply and transport contracts in the electricity sector. Section 2 will present the basic competition economics of LTC in electricity and uncover the mechanics of the legal uncertainty currently perceived in the market place. Section 3 will then depict the methodology which emerged from recent proceedings in gas and oil. Section 4 will show why this methodology will be applied in electricity and what its consequences could be for efficiency in future competition enforcement.

2. Competition economics of LTC, legal uncertainty and the modernization of EC competition law

There is a multiplicity of long-term bilateral contracts, all along the electricity supply chain, which complement or replace arm's length market relationships taking place on spot markets. They include fuel supply contracts to power producers, long-term Virtual Power Plants (VPP)[3], tolling agreements[4] and diverse PPA with energy

[1] e.g. stranded power purchase agreements (thereafter PPA) in Hungary or Poland, legacy rights on interconnectors.

[2] DG Competition report on energy sector inquiry, SEC(2006) 1724, 10 January 2007, 232-244 and 283-294.

[3] VPP are a classical remedy in energy which forces dominant firms to make capacity options available for a pre-determined time horizon, which amounts to a virtual divestiture of capacity. See below at Section IV for a discussion.

intensive users,[5] commercial and household customers, or resellers and traders without generation capacities. Long-term reservation agreements on interconnectors must also be considered given their inherent vertical dimension.[6] If all these LTC lead somehow to varying degree of foreclosure, they also have diverse effects on consumer surplus, investment, risk management, entry and spot prices.[7] 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.[8] Restraints relating to prices such as discrimination, predation or resale price maintenance might also be found but have so far rarely been formally litigated in the context of LTC cases at the Community level. In view of the challenges ahead in terms of security of supply and cheaper prices for the consumers, LTC in electricity need to be carefully regulated by competition authorities. This section briefly shows the pros and cons of LTC in a context of market building and how the modernization of EC competition law as well as the strategy of the European Commission increased the legal uncertainty currently perceived in the market place.

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[4] e.g. Centrica's contract with Intergen for a 860 MW gas-fired power plant.

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

[6] Long-term horizontal contracts often raise the same sort of issues but are kept out with the scope of this paper. They include for instance joint-marketing, joint-infrastructure development or long-term energy SWAPS. A recent example of the latter is the agreement between EDF and POWEO signed in January 2007. The rationale of the deal was to swap actual base against future peak load capacity. POWEO gains access to EDF nuclear capacities from 2007 to 2021 and gives in return a future access to its CCGT currently in the construction phase, for the same capacity and the same period (160 MW per year over 15 years).

[7] EDF-IDEI Report, *Contrat de Long Terme, Concurrence et Efficacité*, December 2007.

[8] 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: Commission press releases IP/03/1345 *Gazprom/ENI* of 06.10.2003, IP/05/710 *Gazprom/E.ON Ruhrgas* of 10.06.2005, IP/05/195 *Gazprom/OMV* of 17.02.2005, IP/07/1074 *Sonatrach of 11.07.2007*, IP/02/1869 *NLNG* of 12.12.2002 and *IP/02/1084 GFU* of 17.07.2002. For commentaries see Nyssens, Cultrera and Schnichels, "The Territorial Restrictions Case in the Gas Sector: a State of Play", 1 *Competition Policy Newsletter* (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", 1 *Competition Policy Newsletter* (2005), 45-48; Wäktare, "Territorial restrictions and profit sharing mechanisms in the gas sector: the Algerian Case", 3 *Competition Policy Newsletter* (2007), 19-21, and Talus, "Long-term Gas Agreements and Security of Supply – Between Law and Politics", 32(4) *European Law Review* (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 07.02.2001) 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 from liberalisation due to their long-term commitments or guarantees. On this see Art 24 of Directive 96/92 EC, 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 Hancher, Jan Slot and Ottervanger (eds.), *EC State Aids* (Sweet & Maxwell; 3rd ed., 2006), 656-680 and the interesting expert of opinion of Eilmansberger, Jaeger and Thyri, *Compatibility of the Hungarian System of Long-term Capacity and Power Purchase Agreements with EU Energy and Competition Law* (2004).

2.1. The basic competition economics of LCT in the electricity sector and its ambiguities

Whereas vertical restraints generally tend to be viewed more leniently than horizontal restraints by competition authorities, this is not the case in energy where the disintegration of vertical market relationships has been one of the key policy items put forward by the European Commission since the first liberalization directive.[9] However, the current volatility of spot prices, the non-storability of the commodity and the unbundling imposed[10] lead market players to call for more rigid vertical arrangements. The usually concentrated market structure, inelastic demand and high investment costs have also contributed to make LTC, at least as a complement to spot market contracting, a useful contractual structure for individual market players. However, LTC may in parallel hinder market building efforts.

The basic rationale for LTC in electricity is hedging price and quantity risks over a certain period of time, so duration is crucial. Besides, LTC 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. Indeed, bilateral contracting does not only enable market players to hedge price and quantity risks, it also expresses and channels their ability to distort competition. In *Gas Natural/Endesa*[11] for instance, the Commission[12] explicitly states that the structure of the contract in itself demonstrates the dominant position of Gas Natural. Therefore, as contracting parties take into account *ex ante* the regulatory framework applied to them when devising contracts, competition policy is a way to impact the structuring of competitive behaviors and ultimately to limit abuse of market power.[13]

The main competition concern associated with LTC in electricity is the risk of foreclosure of more 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. LTC may thus constitute a barrier to entry and a negative externality on third parties.[14] Conversely, if the market structure at the producer level is very concentrated, which is usually the case in European energy markets, input foreclosure may occur and prevent entry in retail. LTC by incumbents in electricity became a priority for antitrust enforcement due to these foreclosure effects both in generation and retail.

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[9] Directive 96/92/EC on common rules for the internal market in electricity, O.J. 1996, L 27/20.

[10] See Art 10 and 15 of Directive 2003/54/EC concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, O.J. 2003, L 176/37. See also the proposal of the Commission for furthering vertical unbundling in recital (5) to (15) and Art 8 and 10 of the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity 2007/0195 (COD).

[11] See XXXth Report on Competition Policy (2000) and European Commission press release IP/00/297 of 27.03.2000.

[12] The 'Commission' or the 'European Commission' will be used interchangeably except if specified.

[13] Lohmann for instance shows 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 in *The German Path to Natural Gas Liberalisation* (NG14, Oxford Institute for Energy Studies), 92-93.

[14] Aghion and Bolton, "Contracts as a Barrier to Entry", 77 *American Economic Review* (1987), 388-401.

Much theoretical ambiguity still remains around the impact of long-term supply contracts on spot market deepening,[15] a cornerstone of competition policy in European energy markets.[16] Large, liquid and stable spot markets are 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, spot market development is limited and price volatility increases, which complicates entry and incentivizes market players towards vertical (re)integration or long-term contracting (feed-back effect). However, theoretical arguments[17] have been developed which tend to show that long-term contracting by dominant players incentivize them not to exercise their market power on spot markets as increases in prices would only be profitable on the un-contracted part of their supplies.

LTC effects on welfare are neither clear in the short run nor from a more dynamic, long-term perspective. In the short term, LTC tend to prevent double marginalization problems,[18] which results in both higher profits and lower prices, and facilitate entry when sufficiently long.[19] In the longer term, LTC enable contracting parties to sink high investment costs, by-pass the lack of liquidity on spot markets and avoid the transaction costs of repeat business. They also facilitate bank involvement in project financing and might thus be necessary for investments and entry in a capital intensive industry, hence for long-term generation adequacy. LTC may even contribute to approaching optimal diversity in the fuel mix by enabling high fixed-costs investment in nuclear or coal power stations which might not be financed otherwise.[20] However, if LTC are generally viewed as facilitating high fixed costs investments, this view needs to be contrasted in electricity as several other criteria are required to reach that effect.

The duration of the contract needs to be long enough and this requires finding counterparties sufficiently capable of predicting their needs to be able to commit. Given the strong uncertainty resulting from the fast-evolving regulatory context and the spot price volatility, such potential contractors can only go slowly upward the learning curve in this sector, which may limit opportunities for long term contracting.[21] This is particularly visible for producer/retailer relationships as retailers face risk of switching of final consumers which are tied for much shorter periods.[22] In case spot prices are lower than the price of the LTC concluded, alternative retailers will be able to propose lower retail prices which will incentivize consumers to switch. The retailer, which contracted for the long term in the previous period, then cannot but align with its rivals and be squeezed.

[15] Bonasina, Creti and Manca, “Imperfectly Competitive Contract Markets for Electricity” (2007), Working Paper.
[16] DG Competition report on energy sector inquiry, see above note 2.
[17] Allaz and Vila, “Cournot Competition, Forward Markets and Efficiency”, 59 *Journal of Economic Theory* (1993), 1-16.
[18] Onofri, “Electricity market restructuring and energy contracts: a critical note on the EU Commission’s NEA Decision”, 20 *European Journal of Law and Economics* (2005), 71-85.
[19] Newbery, “Competition, Contracts and Entry in the Electricity Spot Market”, 29 *RAND Journal of Economics* (1998), 726-749.
[20] Finon and Perez, “Investment Risk Allocation in Restructured Electricity Markets: The Need of Vertical Arrangements”, LARSEN Working Paper (2008).
[21] Vasquez, Rivier and Pérez-Arriaga, “A Market Approach to Long-term Security of Supply”, 17(2) *IEEE Transactions on Power Systems* (2002), 349-357.
[22] Neuhoff and De Vries, “Insufficient Incentives for Investment in Electricity Generations”, 12 *Utilities Policy* (2004), 253-267.

Overall, competition economics in electricity provides useful insights but theoretical ambiguities remain and the body of empirical work is still limited. In particular, the pattern of entry in generation and the effects of LTC on spot markets are unclear. If LTC may be useful for individual contracting parties, their impact on market building in a deregulated network industry is much harder to regulate than the traditional problem of foreclosure in sectors where competition is more mature. As a result, the policy question is more how to approach a workable mix of contract durations than what is the optimal contract length in a deregulated industry, a question far to being settled. This is indeed what antitrust authorities try to do when they impose remedies. A blind enforcement of competition law in electricity may create incentives to further vertical (re)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 in this industry. In the face of such difficulties, disregarding sector specifics and using the usual methods of competition policy maybe tempting. However, this is not the reception of recent insights from the new energy economics which created legal uncertainty but the strategy of the Commission and the evolution of competition tools.

2.2. The evolution of the jurisprudence and the modernization of EC competition law

Legal uncertainty and the evolution of the case law. Despite their importance for the success of liberalization, LTC are almost absent in gas and electricity secondary EC law so guidance must be sought in past case law.[23] The first source of legal uncertainty comes from the limited number of decisions on LTC in electricity since the opening-up of markets. Prior to the first liberalization directive, enforcement of competition law did not occur on a regular basis and there were only few instances of LTC cases. Most of them concerned independent power producer supplying the national incumbent on an exclusive basis. Following the Single European Act, the directive on cross-border trade in electricity[24] was enacted in 1990 and the Commission started to look at these LTC to limit their duration so that they do not hamper the future opening of markets to competition. The durations were in general limited to 15 years as in *Electricidade de Portugal/Pego*,[25] *Isab Energy/Enel*,[26] *Sarlux*,[27] *Rosen,*[28] *REN/Turbogas,*[29] *Scottish Nuclear*[30] or *Api Energia*[31] and 25 years in *Transgas/Turbogas*.[32]

[23] Except in the Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, 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*."
[24] Directive 90/547/EEC on the transit of electricity through transmission grids, O.J. 1990, L 147/37.
[25] *Electricidade de Portugal/Pego Project*, notice pursuant to Art 19(3) of Regulation 17/62, O.J. 1993, C265/3 and XXIII[rd] Report on Competition Policy (1993),222.
[26] *Isab Energy*, notice pursuant to Art 19(3) of Regulation 17/62, O.J. 1996, C 138/3.
[27] XXVIth Report on Competition Policy (1996), 134.
[28] XXVIth Report on Competition Policy (1996), 134.
[29] *REN/Turbogas*, notice pursuant to Art 19(3) of Regulation 17/62, O.J. 1996, C 118/7.
[30] See Section IV for more on this case.
[31] XXVIth Report on Competition Policy (1996), 134.
[32] XXVIth Report on Competition Policy (1996), 135. The 25 years duration was justified by an improvement of security of supply due to the development of alternative sources of gas supply.

These cases were characterized by a lack of methodology for the analysis of foreclosure effects, leading to decisions unlikely to be accepted today on the same terms. For instance, the formation of selling and purchasing consortia contracting on a long-term basis was accepted in *Jahrhundertvertrag*[33] to allow the development of local energy sources (coal) for the sake of "national security". However, we can note that the "security of supply" argument as a justification for the long duration was already accepted with some reluctance by the European Commission which refused in *Jahrhundertvertrag* and *Ijssselcentrale*[34] to proceed under Art 86(2) and preferred to use Art 81(3).[35] In the new context, market players can anticipate that the 15 years duration will probably not be accepted but they cannot get legal uncertainty from this case law.

Since liberalization and apart from *Synergen* and *Gas Natural/Endesa*, relevant cases in this sector have essentially concerned long-term reservation rights on interconnectors signed before liberalization. In fact, most cases concerning LTC in energy have taken place in gas and essentially in the upstream part of the industry (long-term import contracts) where the problems are different due to the geopolitical dimension. In addition, since the early 2000's, DG Competition has publicly and repeatedly voiced strong concerns over the risks of anti-competitive effects inherent in electricity LTC[36] whereas long durations had been repeatedly accepted in the former period. The legal uncertainty created by the lack of precedents has been amplified by the split between the current state of Commission thinking and its past decisional practice.

Legal uncertainty and the modernization of EC competition law. Antitrust is a key policy tools to overcome the current shortcomings of energy liberalization in Europe[37] and the new context of EC competition law raises several fundamental problems for legal certainty.

First and from a more procedural point of view, in the old system, legal certainty came from the possibility to notify LTC *ex ante* to the Commission in order to get clearance in case the agreement was not covered by an exemption regulation.[38] Since Regulation 1/2003,[39] firms and their legal counsels must define the relevant market and self-assess their agreements on that market as well as potential efficiencies pursuant to Art 81(3).[40] This has increased the regulatory burden on firms and added considerable legal uncertainty, especially in energy.[41]

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[33] Case IV/33.151 *Jahrhundertvertrag*, O.J. 1993, L 50/14.
[34] Case IV/32.732 *Ijsselcentrale*, O.J. 1991 L 28/32.
[35] 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.
[36] DG Competition report on energy sector inquiry, see above note 2.
[37] Cameron, *Competition in Energy Markets* (OUP, 2nd ed., 2007), 280.
[38] Art 2 and 4(1) Regulation 17: First Regulation implementing Articles 85 and 86 of the Treaty, O.J. 1962, 13. However, most notifications were dealt with under comfort letter.
[39] Council Regulation 1/2003 on the implementation of the rules on competition laid down in article 81 and 82 of the Treaty, O.J. 2003, L1/1.
[40] Art 2 Regulation 1/2003.
[41] Even if the Commission may issue in certain cases a guidance letter, see notice on informal guidance relating to novel questions concerning Art 81 and 82 of the Treaty that arise in individual cases, O.J. 2004, C 101/78. However, the length of the exemption procedure and the lack of binding effect hindered the efficiency of the old system.

In the former system, considerable uncertainty could already come from the definition of the relevant market.[42] In liberalizing energy markets, relevant markets are consistently moving with the development of interconnections, which also complicates the self-assessment of efficiencies. In addition, Regulation 1/2003 has organized decentralization by aligning national competition regimes with EC competition law[43] and organizing the shared enforcement of competition rules between the Commission, national competition authorities and national courts, especially as concerns the right to exempt agreements under Art 81(3).[44] Given the highly political nature of energy markets in most member states, firms fear inconsistent enforcement of competition rules.

Second and more importantly, 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 behaviors are more important than the drafting of contracts.[45] This is expressed in the regular statements of the Commission on the fact that it will take a "case by case" approach to energy cases. 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 telecommunication might seem intractable in practice and likely to undermine 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, as depicted above in the case of LTC, renders a *per se* approach very inefficient. On the other hand, the gains in terms of efficiency must not be offset by the welfare loss from less legal certainty. 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 society may expect from the modernization of competition law.

Third, given the highly concentrated market structures in most European electricity markets, LTC are most likely to be caught both under Art 81(1) and Art 82 EC. There is thus a *continuum*[46] between Art 81 and 82 EC when enforcing EC competition rules in LTC cases.[47] Art 81 EC which deals with anti-competitive practices, together with relevant guidelines and notices, does not *a priori* allow or ban LTC, even when

[42] Hawk, "System Failure: Vertical Restraints and EC Competition Law", 32 *Common Market Law Review* (1995), 973.
[43] Art 16 Regulation 1/2003.
[44] Art 5 and 6 Regulation 1/2003.
[45] The modernization of EC Competition law has already been widely commented. For a legal account see Ehlermann, 2000. "The Modernization of EC Antitrust Policy: a Legal and Cultural Revolution", 37 *Common Market Law Review* (2000), 537 or Wesseling, *The Modernization of EC Antitrust Law* (Hart Publishing, 2000). For an economic account see Neven, "Competition economics and antitrust in Europe", 21:48 *Economic Policy* (2006), 741-791.
[46] This expression comes from Lianos, *La Transformation du Droit de la Concurrence par le Recours à l'Analyse Economique* (Sakkroulas, 2007).
[47] 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", 28(4) *World Competition* (2005), 461-463. At last, we note that in the case where the LTC has been imposed on the firm by a public authority, the assessment of the agreement with the EC Treaty rules on competition will be pursued under Art 86 EC. See on this the analysis of Eilmansberger, Jaeger and Thyri.

they involve dominant firms, unless the agreement contains the so-called 'hard-core' restraints.[48] 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. Nonetheless, this has not been the case so far with Art 82 EC which tackles abuse of a dominant position. Indeed, the reform of Art 82 EC is recent and still going forward.[49] This has fostered legal uncertainty since the degree of economic analysis, competition law objectives and methodologies have substantially diverged. Art 82 EC is still based on legal forms and, to a certain extent, protection of competitors, especially when it comes to assessing exclusive dealing clauses.[50] In particular, pro-competitive and efficiency justifications have been scarcely used under Art 82 EC, which has increased the need to reform in order to achieve consistency between Art 81 and 82 as they overlap when it comes to contractual abuses.[51] As a result, the current legal uncertainty regarding LTC in electricity 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 when regulating the inter-temporal policy trade-offs at stake. It also directly stems from the on-going evolution of antitrust tools and the flows in their coherence.

However, 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 energy[52] and both the Vertical Block Exemption Regulation (VBER)[53] and Guidelines on Vertical restraints[54] (GVR) provide, it is submitted, sufficient guidance for LTC involving non-dominant firms. In fact, legal uncertainty is now concentrated on long-term exclusive supply and purchase obligations involving the former electricity incumbents. Since liberalization, the legal uncertainty arising from the usual lack of precision of Art 81 and 82 EC is aggravated by a lack of consistent, stable and widely accepted methodology for interpretation and application of the EC Treaty rules on competition in a context of

[48] Hard-core restraints relevant for electricity are market partitioning clauses, use restrictions, minimum resale price maintenance and contractual provisions having similar effects. These restraints contravene the fundamental Treaty objective of market integration and hence will almost never be accepted, which amounts to a *quasi-per se* prohibition.

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

[50] Sher, "The last of the Steam-powered Trains: Modernizing Art 82", *European Competition Law Review* (2004), 244; Jan Slot, "A View from the Mountain: 40 years of developments in EC Competition Law", 41 Common Market Law Review (2004), 462; Bellamy and Child, *European Community Law of Competition* (London 2001), 42. Ridyard, "Exclusive Pricing and Price Discrimination Abuses Under Article 82- an Economic Analysis" 23 *European Competition Law Review* (2002), 290-291. For a somehow more contrasting 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", 42(1) *Common Market Law Review* (2005), 138.

[51] See Rousseva, "Modernizing by Eradicating: How the Commission's New Approach to Article 81EC Dispenses with the Need to Apply Article 82 to Vertical Restraints", 42 *Common Market Law Review* (2005), 587-638. Vickers, *Abuse of Market Power*, Speech to the 31st conference of the European Association for Research in Industrial Economics (2004). Kallangher and Sher, "Rebate Revisited: Anti-Competitive Effects and Exclusionary Abuse under Art 82", *European Competition Law Review* (2004). Loewenthal, above note 47.

[52] For recent cases, see for instance *RWE/Transgas* 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 19.12.2007).

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

[54] Commission Notice on Guidelines on Vertical Retraints, O.J. 2000, C 291/1.

market building. This is all the more detrimental to market players given the fast evolutions of both the sector-specific legal framework and the market environment in general. This is thus *in fine* detrimental to final consumers in a sector where the ability to commit in the long-term is crucial to ensure a socially beneficial level of investment. In view of the structural under-investment in generation capacity which the European Union may start to face from the next four or five years onwards, the legal uncertainty currently perceived in the market place becomes a major issue.

3. Digging deeper into the new commission methodology

Under a long-term exclusive dealing agreement, the energy company is obliged to meet its entire demand or supply its entire output, or at least a significant part thereof, for the product concerned from or to the dominant firm (usually an incumbent), during an arguably excessive period of time. In the new context, more legal certainty could only come from the clear statement of the relevant facts taken account of by the European Commission and how to interpret these facts in the context of liberalization. Both were missing, it is submitted, until fairly recently. However, for the first time in late 2007, the beginnings of a comprehensive methodology for better analyzing LTC in energy has been sketched out in the *Distrigas* case. This is a clear departure from the pre and even post liberalization period on this issue. The Commission had concerns about liquidity problems on the Belgian wholesale gas market due to LTC concluded by Distrigas with industrial customers and thus opened an Art 82 EC proceeding. The objective of this new methodology was to propose a more integrated framework able to capture the real economic effects of LTC on competition as well as to provide a sound rationale for negotiating remedies. This section shows that, by mixing the Distrigas methodology with relevant insights from *Synergen*, *Gas Natural/Endesa, Repsol* and *E.ON Ruhrgas*,[55] the legal uncertainty on the methodology, the relevant facts and the Commission's point of view on the combined relationships of these facts has to a large extent come to an end.[56] This paper will then show in section IV why this methodology is most likely to be applied in future proceedings across energy sectors, the far reaching consequences in terms of legal certainty and efficiency it will have and the conclusions we may draw on the evolution of antitrust enforcement in the face of the radical uncertainties raised by the liberalization of network industries. When assessing individual cases in energy, the Commission will from now on focus on interactions among several key elements once the 30% threshold[57] 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.[58]

[55] Other relevant cases from national competition authorities will also be used when relevant.
[56] The remedies will be touched upon in the different paragraphs and discussed in Section IV. The statements of the VBER and GVR confirmed in energy decisions will be highlighted.
[57] Art 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 5 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.
[58] This broadly follows the Commission's typology in MEMO/07/40 of 11.10.2007 and in the Sector Enquiry, p.235.

3.1. Analysis of market characteristics

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 has concluded that dominance must be assessed even more strictly in highly concentrated liberalizing markets than in more mature settings. 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.[59] This conclusion has been confirmed in *Distrigas*.

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

When assessing market characteristics, the Commission will primarily look at future entry in supply and demand, and their real impact on competition. Indeed, in *Synergen*, the Commission stated that the future entry of Viridian which will develop a 340MW power plant would not increase competition intensity due to the "*equilibrium of potential competitive threat*" which should then prevail. The likelihood of new entry in energy depends a great deal on the existence of potential competitors, usually foreign incumbents, especially in markets close geographically. In *Synergen*, the Commission 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 stated 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 the relevant (gas) market and large financial capacities. 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.

3.2. The market position of the dominant suppliers

After having analyzed market conditions and their likely evolutions, the focus will be on market shares of the dominant firm and its portfolio of contracts as "*LTC concluded by other suppliers will generally not give rise to concern.*[60] As in any other sector, the higher the market share of the dominant supplier, the sooner the cumulative market coverage of its LTC will be deemed to create foreclosure. This

[59] On this see Fernandez Salas, "Long-term Supply agreements in the context of gas market liberalization: Commission closes investigation of Gas Natural", 2 *Competition Policy Newsletter* (2000), 55-58.
[60] European Commission, MEMO/07/407, 11.10.2007.

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 LTC but there will be no need to prove that they lead to tacit collusion (collective dominance) to show that significant foreclosure effects occur.[61] Of course and as recalled in the Sector Enquiry, LTC can be deemed incompatible with Art 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. Except in the old *Almelo* case,[62] the Commission has not yet dealt with collective dominance in an anti-competitive LTC contract case.

3.3. The share of the customer's demand tied under the contract

It is one of the main sources of foreclosure effect. If a customer, all the more if it could have fostered entry for itself,[63] 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.[64] 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 seem to consider that 20% of a customer demand is the threshold for having incentives to enter into a relationship with a second supplier (implicitly in Art 1(b) VBER, confirmed in *E.ON Ruhrgas*). 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.[65] 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 on the market*"[66] (confirmed in *Gas Natural/Endesa*). In addition, reduction clauses,[67] the

[61] Kjolbye, "Vertical Agreements" in. Jones (ed), *EU Energy Law Volume II: EU Competition Law and Energy Markets*, (Claeys and Casteels, 2nd ed., 2007).

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

[63][63] In *Gas Natual/Endesa* (XXXth Report on Competition Policy, 2000 and European Commission press release IP/00/297 of 27.03.2000), 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 4 years) could raise antitrust issues (See Lohmann note 13, 95, for the history of the case and Bundeskartellamt press release, November 7 2003).

[64] 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.

[65] Schnichels and Nyssens, "Energy" in Faull and Nikpay, *The EC Law of Competition*, (OUP, 2nd ed., 2007).

[66] European Commission, supra note 58.

[67] 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, XXXIInd 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. The Commission will also apply the cumulative effect doctrine to analyze their anti-competitive effects. Clauses of 'right of first refusal' or 'most favored customer' will receive a similar treatment. They remain nonetheless more relevant for gas than electricity. For a complete treatment see Kjolbye, supra note 61, 252-270.

so-called 'English clauses'[68] 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 share of the customer's demand tied under the contract has to be analyzed along with its duration. 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.[69] As a general rule, the Commission is very suspicious of contracts longer than 5 years and considers that efficiencies generally do not offset foreclosure effects beyond that limit.[70] 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 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 *Distrigas*. 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%.[71] Competition authorities will thus play with the two factors. Where demand requirements are satisfied by several suppliers, the Bundeskartellamt specifies that contracts should distribute the risk of demand fluctuations among suppliers according to the actual supply share provided by each of them so as not to disadvantage the second supplier. In 2005, the Danish Competition Council intervened against a 6 years LTC between the dominant incumbent DONG and the distributors Hovedstadsregionens Naturgas and Naturgas Midt-Nord. It shortened the duration by 2 years to have it terminated by January 2007 and cancelled the exclusive supply clause with a prohibition of such clause in future contracts if they were to renegotiate the

[68] '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 LTC 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: see *London Electricity* (see the Gas and Electricity Market Authority's Decision under the Competition Act 1998 that London Electricity plc has not infringed the Prohibition Imposed by Section 18(1) of the Act with Regard to a 'Win Back' Offer, 2003), *ENEL Distribuzione* (see Autorita Garante della Concorrenza e del Mercato, press release of 24.10.2007) and *KalibraXE/EDF* (see decision no 07-MC-01 of 25.04.2007, available on the website of the French Competition Council). According to Ofgem, London Electricity abused its dominant position by providing excessive financial incentives to returning customers and subsequently locking them in for a period of 13 months. In *Enel Distribuzione*, the Italian competition authority considered a web of abusive practices of the incumbent and forced the firm to bring its commercial practice in line with competition law principles. In *KalibraXE/EDF,* 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 and Waddams Price, "Introducing Competition and Deregulating the British Domestic Markets: a Legal and Economic Discussion", *Journal of Business Law* (2007), 244-268.
[69] Aghion and Bolton, supra note 14.
[70] Art 5(a) VBER and para.141 GVR.
[71] Following *E.ON Ruhrgas*, four major gas transmission companies committed in June 2007 to ensure the compatibility of their LTC 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 of 29 January 2007 and decision B8 - 113/03-15 Wingas.

agreement. For a new entrant in retail, a duration of 5 years is most likely to be accepted.[72] One note here that the Commission always thinks in terms of quantities effectively received and not only in terms of contracted quantities. In *Repsol*, a duration of 5 years was accepted for contracts with established resellers (from 25-40 years originally) but the market shares of the dominant firm only reached 30% to 50% in that case, which hardly exceeds the dominance threshold (40%).

One also notices a more lenient approach of the Commission towards fuel supply contracts than to producer/reseller contracts. In *Gas Natual/Endesa*, the duration has been reduced from 15 to 12 years. This rather long duration, as compared to the 5 years accepted in *Distrigas* 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 in 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, LTC 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 *Distrigas* case included flexibility parameters for the dominant firm itself. Distrigas was allowed to adjust its portfolio of contracts to its own needs as long as it complies with the duration limitation of 5 years and the 65-70% target. The firm retains by this a fair level of flexibility. Distrigas can thus indifferently have 37.5% of customers supplied under 5 year contracts and 62.5% supplied under one year contracts or 40% supplied under 4 year contracts and 60% supplied under one year contracts. Further flexibility is guaranteed as to protect Distrigas from having to re-open existing long-term gas supply agreements if the volume of gas it supplied decreased. The net effect is that Distrigas can tie under LTC at most 30% of its existing gas supply volumes or 20% of the market, whichever is higher. These commitments will last for a minimum of four years and until Distrigas' market shares decrease below 40% (or another supplier reaches the level of Distrigas market shares minus 20%). Distrigas' dominance is thus deemed to stop below 40% market shares, which is the traditional threshold for dominance in EC Competition policy.

3.6. Efficiencies

The Commission clearly acknowledges that a LTC 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

[72] We note that in *Direct Energy*, the French Competition Council did not criticize the 5 years duration of the original contract. On *Direct Energy*, see Section IV below and Decision n°07-MC-04 of 28.06.2007 and Decision n°07-D-43 of 10.12.2007, available on the website of the French Competition Council.

a general rule, the Commission tends to consider that the aggregate effect of those contracts will be detrimental to economic efficiency and 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 LTC.

At first, the Commission has repeatedly accepted the need of LTC for new power plants erection and entry in general.[73] In *Distrigas and E.ON Ruhrgas*, restrictions on duration do not apply to new investments in gas fired power plants. In *Synergen*, the Commission accepts both a 15 years gas supply contract with Statoil for 100% of the new power plant needs and a 15 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 fuel mix diversity.[74] Indeed, traditional project finance structures require fuel supply and dispatch contracts lasting longer than 5 years, even in the case of the new hybrid merchant/LTC 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 fulfill the condition under Art 81(3)b.

The Commission has taken this view to an even greater extent in the field of infrastructure development.[75] Promoters of new interconnectors have been granted either exclusive rights of indefinite duration on the full capacity or a 25 years exemption from third party access (*Viking Cable*,[76] *Rovigo LNG*, *Grain 1/2/3*, *South Hook LNG*, *Dragon LNG*),[77] with use-it or lose-it principle though.[78] Similarly, on the UK-Belgium gas pipeline,[79] no third party 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,[80] Dutch-German interconnector,[81] Norway-Denmark and Denmark-Germany interconnectors following the merger *VEBA/VIAG*[82]).

[73] para.44, Commission Guidelines on the application of Article 81(3) of the Treaty, O.J. 2004, C 101/97; confirmed in *Synergen* and *Distrigas.*
[74] Finon and Perez, supra note 20.
[75] See European Commission press release MEMO/01/76 of 13/03/2001.
[76] *Viking Cable*, notice pursuant to Art 19(3) of Regulation 17, O.J. 2001, C 247/11.
[77] On *Rovigo LNG*, *Grain 1/2/3*, *South Hook LNG*, *Dragon LNG*, see DG TREN website.
[78] In Britned, the exemption was limited by the Commission to 10 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.
[79] *UK/Belgium interconnector*, informal settlement, IP/02/401 of 13.03.2002.
[80] *UK/France Interconnector*, informal settlement, IP/01/341 of 12.03.2001.
[81] Case C-17/03 *Vereniging 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 June 2005 of the Court of Justice of the European Communities, SEC (2006) 547, 26 April 2006 and Cameron, supra note 37, 343-354. See also Talus and Wälde, "Electricity Interconnectors in EU Law: Energy Security, Long-term Infrastructure Contracts and Competition Law, 32(1) European Law Review (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 undertakings.
[82] Case M.1673 *VEBA/VIAG*.

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.[83] 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.[84] In addition, the *Synergen* and *Gas Natural/Endesa* decisions clearly showed a different treatment according to the market position of the sponsor and contracting parties. If the sponsor is dominant, the duration will be shortened. The reduction of 15 to 12 years in *Gas Natural/Endesa* in 2000 would probably become 5 years today in a more mature market. 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 15 years. It also explains why different remedies will be applied.

One notes here that if long-term generation adequacy is clearly a critical goal of the Commission,[85] the vague concept of ‘security of supply’ is approached with much skepticism under competition rules. 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 LTC between industrial consumers and local producers (*Jahrhundertvertrag*).[86] Today, only long-term gas import contracts are sure to be accepted on the basis of a ‘security of supply’ argument,[87] as long as territorial restrictions re 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 clearly that cost 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 addition, it will be challenging to demonstrate that a sufficient part of the cost efficiency will be passed on to final consumers and that this will outweigh the negative effect of the restriction. In view of the rather large and flexible treatment of Art 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 benefits a new power plant and is explicitly acknowledged as an efficiency to be counted toward exemption under Art 81(3) EC. To the contrary, the cost 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 proceeding 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

[83] Nissens and Schnichels, supra note 65.
[84] 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.
[85] 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.
[86] 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 still be procured with Electrabel (see XXVIIth Report on Competition Policy, 150 and European Commission press release IP/97/351 of 25.04.1997.
[87] See Gas Directive, recital 25, quoted above 23.

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

4. Competition enforcement : legal uncertainty vs. efficiency in the aftermath of *Distrigas*

This paper argues in this section that the methodology depicted above has recently upgraded legal certainty more than market players and commentators tend to usually think and that interesting conclusions can be drawn on the relationship between legal uncertainty and the modernization of EC Competition law. It also argues that the alignment of competition enforcement in energy with enforcement in other sectors expresses the difficulties which the Commission faces when enforcing competition law in deregulated network industries and that it may raise serious concerns for efficiency of future competition enforcement.

4.1. The new methodology, legal uncertainty and the modernization of EC competition law

Proposition 1: Legal uncertainty is overstated as the European Commission takes similar views on the optimal mix of contract durations across energy sectors.

The Commission opened in July 2007 two proceedings against EDF and Electrabel for possible breaches of EC Treaty rules on abuse of a dominant position due to their LTC 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*."[88] This is a first indication as to how the Commission will approach LTC in electricity. Beyond the fact that enforcement in gas is logically the best proxy to anticipate future enforcement in electricity, one can see that the few cases we have in electricity since liberalization show that the Commission's view regarding the optimal mix of short and long-term contracts is the same in electricity and in other energy sectors.

Remedies are a laboratory for reform experimentation and DG Competition 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. As shown above, a maximum duration of about three to four years for contracts with big energy users has been regularly applied in recent oil and gas decisions. When looking at the mix of contracts imposed in remedies in electricity (the so-called Virtual Power Plants), it is interesting to note that the Commission broadly imposed the same durations.

Indeed, in the 2000 *EDF/EnBW* merger proceeding,[89] EDF was required to auction blocks with durations of three months to three years, amounting overall for one third of eligible consumer demand, during 5 years minimum. In 2001, for the UK-French

[88] See European Commission press release MEMO/07/313 of 26 July 2007.
[89] Case M.1853 *EDF/EnBW*.

submarine interconnector, 100% of the capacity had to be freed and auctioned on the basis of 3 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 group'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 (so for 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. VPP or gas release programs are the most important occasions for 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 look like. The durations shown above are similar to what can be found in other energy sectors, which thus tends to show that the Commission takes similar views across energy sectors, at least on durations, and reinforces the idea that the methodology devised in gas will be applied in electricity. Similarly, long durations of 20/25 years were accepted in both sectors for investments in new infrastructure.

Proposition 2: Legal uncertainty is overstated as antitrust enforcement in energy quickly converges with enforcement in other sectors.

In line with past case law, proceedings under Art 82 EC and relevant national provisions, such as *Distrigas* and *E.ON Ruhrgas,* should have entailed a *quasi*-automatic *per se* prohibition. To the opposite, efficiencies and insights from the traditional competition economics of foreclosure such as the analysis of the cumulative market coverage are clearly taken into account in these cases on abuses of a dominant position. We can now safely state that dominant energy firms can implement LTC if the economic and legal contexts allow and that there is no market share threshold beyond which a contractual practice, save hard-core restraints, becomes *per se* illegal.

Most importantly for legal certainty, we can notice that the reasoning and the market share thresholds used under Art 82 in these decisions are clearly similar to the methodology which would have been applied under Art 81 EC and are in line with the VBER and the GVR. Indeed in *Distrigas*, this is primarily the cumulative effect of the network of contracts concluded by the firm which grounds the infringement of Art 82 EC. Historically, the doctrine of cumulative effect on foreclosure has been a cornerstone of the modernization of Art 81 EC and has been regularly endorsed by Community Courts.[90] It was first treated in the Art 81 EC cases *Brasserie de Haecht* (1967),[91] *Delimitis* (1991)[92] and more recently *Langnese-Iglo* (1995),[93] *Schöller* (1995),[94] *Neste* (2000)[95] or *Van den Burgh Foods* (2003).[96] This is a well-established tool of competition analysis which *in fine* helps firms themselves analyze if their portfolios of LTC infringe EC Competition law.

[90] Verouden, "Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis", 71 *Antitrust Law Journal* (2003), 525.
[91] Case 23/67, *Brasserie De Haecht v Wilkin*, [1967] ECR 407.
[92] Case C-234/89, *Stergios Delimitis v Henninger Bräu*, [1991] ECR I-935.
[93] Case T-7/93, *Langnese-Iglo GmbH v Commission*, [1995] ECR II-1533.
[94] Case T-9/93, *Scholler Lebensmittel GmbH & Co KG v Commission,* [1995] ECR II-1610.
[95] Case C-214/99, *Neste Markkinointi Oy v Yötuuli Ky and Others*, [2000] ECR I-11121.
[96] Case T-65/98, *Van den Bergh Foods Ltd v Commission*, [2003] ECR II-4653, para.82-83.

One can also take two examples from the field of remedies. The first regards termination rights of existing contracts granted to buyers, which one can find in *E.ON Rurhgas* and *Distrigas*. In *Distrigas*, existing contracts with energy intensive industries (resellers excluded) enjoyed unilateral termination rights. This is a classical remedy in EC completion policy and the fact that LTC with indefinite durations and clear termination rights are less restrictive than LTC concluded for several years has once again been recalled in the recent Dutch case *Heineken Nederland* and *Neste*.[97] Second, one can notice that the criteria used to define the duration of commitments becomes in line with what happens in other sectors. Indeed in *Distrigas*, the fact that the commitments will only apply as long as the firm has a market share exceeding 40% and the share of its closest competitors is no more than 20% mirrors a similar approach adopted in the recent *Coca-Cola* case,[98] where the commitments only applied if the share of Coca-Cola's closest competitor was less than half that of Coca-Cola.

At last, traditional market share thresholds under Art 81 EC such as the 30% for automatic exemption defined in the VBER became a benchmark for applying remedies in *Distrigas*. Indeed, the Commission imposed that 65-70% of the firm's customers come back to the market every year as long as Distrigas' market shares still exceed (a very ambitious) 40%, in line with the dominance threshold in other sectors. Another example is the one year duration which renders any exclusive purchase obligation acceptable under Art 81 EC[99] and has become an explicit target under Art 82 EC as shown above.

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 Art 81(3), all show that a unified approach among competition provisions of the EC Treaty is emerging.

The recent decisions analyzed above, and essentially *Distrigas,* show that the reform of Art 82 EC is well under way and it would not be unrealistic to assert that the European Commission is using the deregulation of network industries to complete the modernization of EC Competition law. This trend is confirmed by the opinion of Advocate General Damasco Ruiz-Jarabo Colomer in Case C-468/06 presented the 1st of April 2008, where he encourages the European Court of Justice to clearly state that a *per se* approach is not applied any more in Art 82 cases, 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. In the future, energy companies should thus less and less face discrepancies between enforcement under Art 81 and 82 EC, and between enforcement in energy and other sectors, which shows that the legal uncertainty currently perceived in the market place is largely overstated.[100]

[97] In *Kalibraxe/EDF*, the need to clarify termination right is also recalled.
[98] Case COMP/39.116 . *Coca-Cola*.
[99] para.141 GVR.
[100] This effect, which was predicted in the EAGC report and Rey, "On the right test for exclusive dealing", in Ehlermann and Marquis (eds.), *European Competition Law Annual 2007: A Reformed Approach to Article 82 EC* (2008), is evidenced here.

Proposition 3: The quick alignment of antitrust enforcement in energy also demonstrates the limits of the application of the "more-economic" approach in deregulated network industries

The rationale of the more economic approach in EC competition policy 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 can find in the Sector Enquiry. True, applying some analytical devices such as the cumulative effect doctrine does bring some relevant insights for competition enforcement in energy. Indeed, seeking consistency in enforcement across sectors is a legitimate goal of competition policy.

However, it seems that the application of the new methodology also expresses a path dependency in competition enforcement and the difficulties the Commission currently faces in energy. 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, as purported for instance in the EAGCP report, but from a methodology which the Commission knows, can easily apply and *in fine* be anticipated. The only specificity introduced by the European Commission was the flexibility granted to the dominant firm when applying remedies. This has to be recognized but the Commission could have gone further. Remedies could for instance be gradually decreasing in strength before the dominance threshold, which would be the proof that a proportionality test is really applied under Art 82 EC and that remedies should evolve with a firm going from a "super-dominant"[101] to a dominant position.

As a result, the new methodology as applied in recent decisions in energy is closer to an improved *per se* rule than a true unstructured *rule of reason*. Given the limited information at hand on the specific competition dynamics of market building in these sectors and the limited practical insights to be drawn from energy economics, it is not sure that this coping strategy is really sub-optimal from an efficiency point of view. In addition, from a more procedural point of view, we cannot but notice than a limited level of discretion is more suitable to a decentralized application of EC competition law. However, the more-economic approach finds here its limits and providing guidance through cases as the Commission is doing at the moment certainly does not fulfill the objective of legal certainty. Retaining that way some flexibility for future competition enforcement is understandable, but this comes at an unknown cost.

4.2. The new methodology of the European commission in energy : unfinished business ?

This paper aims in this final section to highlight certain theoretical and practical problems which the Commission will face when enforcing competition rules in the near future.

[101] 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.

LTC and spot market development: the black box. First, one cannot but notice that the main issue debated by economists when it comes to LTC in electricity is neither taken account of nor debated whatsoever in any decision of the Commission.[102] The impact of LTC on spot market deepening is a complicated issue though. On the one hand, there is a negative effect in the sense that LTC would dry out spot markets, which increases price volatility and incentivizes players to contract bilaterally. This lack of liquidity on spot markets is what the Commission aims to fix. However on the other hand, LTC are a good mitigation device, for certain market structures and types of competition,[103] when firms may either abuse their market power by strategically withholding capacities or tacitly colluding.[104] These conclusions come from recent economic analyses which depart from the traditional assessment of market structure using e.g HHI index to use instead oligopoly models. As a result, some authors even propose to impose a tax on market players who do not contract long term a substantial part of their supply.[105]

The Commission implicitly recognizes the need of different contract durations when imposing remedies, but always for sake of production planning, and not for a smooth development of spot markets. By choosing to tackle the lack of liquidity rather than potential abuses of market power, the Commission seems to take a legitimate course of action as more than 95% of electricity in the EU remains contracted bilaterally. However, the Sector Enquiry[106] acknowledges recurrent problems of abuse of a dominant position on European spot markets. As a result, even if these analysis still tends to rely on fairly strong assumptions, the Commission should not ignore the questions raised by recent advances in economic theory.

Remedies in energy and entry in generation. A second potential problem lies in the way the Commission analyzes market fundamentals and the resulting opportunities for entry in generation. The purpose of the methodology is to better analyze the competitive situation on a given market and then impose remedies to remove barriers to entry. The Commission bets that the long-term benefits of competition will offset the short-term costs incurred by individual players and thus increase social welfare aggregated over several periods of time. The whole methodology must therefore be based on a robust understanding of the pattern of entry. From that perspective, the almost systematic imposition of VPP (or gas release) is, it is submitted, a source of concern.[107]

[102] As Buschnell 2007 states: « *The competitive implications of the ability of firms to trade in transparent forward markets has received considerable attention in the academic literature. Their implications have not had much implication on policy however*."

[103]Allaz and Vila 1993, note ?; Mahenc, P., & Salanie, F. (2004). « Softening Competition Through Forward Trading. » Journal of Economic *Theory, 116*, 282–293., Bushnell J., 2007, Oligopoly Equilibria in Electricity Contract Markets. *J Regul Econ (*2007) 32:225–245. Anderson E and X. Hu, Forward contracts and market power in an electricity market, *International Journal of Industrial Organization* 26 (2008) 679–694.

[104] Green, R. J., & Le Coq, C. (2006). The length of contracts and collusion. CSEM Working Paper WP-154, University of California Energy Institute.

[105] Willem B., Market Power Mitigation by Contracts, 2006 Working Paper.

[106] DG Competition report on energy sector inquiry, supra note 2.

[107] VPP have for instance been implemented as remedy in *EDF/EnBW, Nuon/Reliant Energy, Synergen, Direct Energy*. More surprisingly, it has also been imposed by the Bundeskartellamt to RWE in the context of a proceeding concerning abusive pass-on of CO2 certificates to consumers. The auction concerns 46 millions MW of both base-load electricity from lignite power station and pick load electricity from a new hard coal power station. On this, see Bundeskartellamt press release of 27.09.2007.

VPP are primarily intended to remedy horizontal concentration at the generation level and increase liquidity on the wholesale market. They force dominant firms to make capacity options available for a pre-determined time horizon, which amounts to a virtual divestiture of capacity. As such, VPP are a way to tackle concentrated market structures in merger and antitrust proceedings when physical asset divestiture is not feasible.[108] VPP are thus hybrid remedies, between structural and behavioral, which should facilitate entry by cancelling the need to invest in generation. In the Commission view indeed, VPP is part of a two-stage strategy where a first wave of entry in retail must create new outlets which will attract entry in production by independent power producer or at least enable resellers to build a sufficiently stable customer base to subsequently integrate backward. As any LTC, VPP might have mitigation effects on abuse of market power by dominant firms in the spot market but there are few studies quantifying these effects on firms' strategic bidding and equilibrium prices.[109]

As a result, there is to date no convincing evidence of positive effect of VPP on competition.[110] This can be explained by the fact that the efficiency of VPP will depend on many factors such as auction design,[111] contract durations or the investment climate, which have not been systemically analyzed, neither theoretically nor empirically.[112] Indeed, the main effect of VPP might well be to deter investment in new capacity, which goes counter the objective of long-term generation adequacy. In balancing the contradictory incentives for entry in retail and production, the length of the VPP is thus important and implementing VPP for periods longer than the period of decision and construction of a new power station does not seem necessary.[113] In addition, the proceedings themselves as well as the monitoring of remedies over many years are not costless. If long-term VPP or gas releases are imposed, or if competition authorities must monitor portfolios of contracts over a long period of time, competition authorities will be durably involved in the day-to-day monitoring of deregulated network industries, taking up a *quasi-ex ante* regulatory role for which they might not be prepared.[114]

Remaining uncertainties concerning the antitrust treatment of LTC involving energy intensive users. Strong uncertainties remain concerning the different collective buying schemes for energy intensive users[115] which might be found at all levels of the supply chain in both gas and electricity.[116] Energy intensive users, who once lobbied for the opening up of markets, pretend now to be squeezed between rising energy costs and the impossibility of passing them on downstream due to the stark international competition. This has pressured certain Member States like Spain and France to act on that question and fight the risk of delocalization.

[108] Competition authorities traditionally favor physical divestitures as it limits subsequent monitoring costs.

[109] For an attempt, see Boisseleau and Giesbertz, "Assessing Regulatory Measures in Electricity Markets: The Case of VPP in the Netherlands", 29th IAEE International Conference, 2006, Potsdam, Germany, conference proceedings.

[110] Boisseleau and Giesbertz, supra note 110.

[111] In most cases, VPP define base and peak load rights with different durations granted through an ascending clock auction.

[112] Boisseleau and Giesbertz, supra note 110.

[113] As decided by the French Competition Council in *Direct Energy*, see also Lévêque, "Le Conseil de la Concurrence au secours des opérateurs alternatives de l'électricité", *Revue Lamy de la Concurrence*, (2008).

[114] Leveque 2008, supra note 114.

[115] See DG Competition report on energy sector inquiry, supra note 2, 204-205.

[116] This could also concern joint buying of technical equipments for construction services, e.g. C4 gas joint venture set up by Fluxys, GDF International and Transco, O.J. 2002, C 166/8.

Prior to liberalization, in *Jahrundertvertrag*, the Commission had cleared joint coal sales and purchasing consortia based on Art 65(2) ECSC Treaty but the exemption reasoning is unlikely to be replicated today. In the new context, these schemes give rise to significant competition problems which are not all answered by applying the new methodology. Given that no Block Exemption Regulation applies and assuming that the *de-minimis* thresholds are exceeded, these schemes will be assessed under Art 81 EC,[117] Art 82 EC if a dominant supplier participates, or State Aids if a government or a public firm is involved. To get the exemption under Art 81(3) EC, this is the fulfillment of Art 81(3)(b) which will constitute the biggest hurdle. Indeed, cost efficiencies will not be hard to trace back to the buying scheme and the Commission will probably accept that they will benefit *in fine* final consumers. Under Art 81(3)(b), the agreement in question must not give to the firm "*the opportunity of eliminating competition in respect of a substantial part of the products in question*." This is where the new methodology brings relevant insights, especially on the cumulative market coverage and the interaction of duration and the percentage of the customer demand tied from a competition perspective. However, it is far from clear what the Commission position is on the likely collusive aspects inherent in such schemes and how it would assess competition effects on markets upstream and downstream of the joint purchasing consortium.

In addition, the opinion issued by the French Competition Council on Exeltium[118] in 2005 may cast doubt as to the definition of the relevant market. Indeed, the Council took as relevant only the market for eligible customers who effectively switched. In addition, to assess horizontal competition aspects at the supplier level, it estimated that the supply of 15-20 years LTC by EDF would not distort competition as alternative suppliers with production capacities in France were not willing to commit for such a long period and importers would be most unlikely to compete with EDF given the current restrictions on interconnections. As a result and following the Council reasoning, due to the specific pattern of consumption of energy intensive users, a criteria taken into account in *Distrigas* and *E.ON Ruhrgas*, LTC with such purchasing consortium would constitute a different relevant market where the long duration would not be a problem or at least would be counterbalanced by efficiency gains.

This opinion is all the more striking since it is fairly recent and seems to go counter the late practice of the Commission. The only recent guidance we have concerning duration for LTC with energy intensive users comes from the *Distrigas* case where a 5 years duration is accepted, with termination rights.[119] In the context of purchasing consortia, giving unilateral termination rights to the members could be a way to balance benefits from more predictability and cheaper prices against costs from not being able to opt out of the deal to benefit from a better offer. However, the *Distrigas* decision might not be replicable in this context as cost efficiencies arising from these buying schemes might be much more important than for traditional LTC. Indeed in Exeltium, the supplier does not contract directly with buyers but with a highly leveraged project financed special purpose vehicle (debt/equity ratio around 90/10) which enables the buyers to finance off balance-sheet their electricity purchase. In view of this, it is hard to anticipate which direction the Commission will take.

[117] Vertical and horizontal issues will be assessed under the relevant guidelines as well as under the Notice on Art 81(3).
[118] See Opinion n°05-A-23 of 5.12.2005 from the French Competition Council.
[119] In *E.ON Ruhrgas*, LTC with energy intensive users are unaffected by the prohibition.

Furthermore, if a dominant firms supplies the consortia below its total costs to drive competitors out of the market, it can be caught by the Commission under Art 82 EC for predatory pricing, or at least for price discrimination. In a case where the supplier is a public firm, as EDF in France in the case of Exeltium, then the Commission could proceed under State Aid if prices are deemed not to reflect market conditions, which will be highly complicated to demonstrate given the limited duration (around 3 years) on European forward markets and the strong uncertainties on prices in the next 15 to 20 years due to fuel supply costs, costs of CO2 emissions and demand evolution. State Aid could also lie in the preferential fiscal regimes granted to intensive users, for instance in Spain (G4 Tariff) and foreseen in France (SOFIBASE). Finally, as pointed out by the French Competition Council, the most intractable problem from a competition point of view could lie in the discriminatory conditions for access to the buying scheme. Additionally, single market concerns exist with these schemes as intra-European competition might be hampered by the cost advantage derived from the different technology portfolios of EU member states, if foreign firms cannot participate due to interconnections restraints or political pressure.

Linked to the problem just described is the position of the Commission regarding the renewed interest for nuclear power in several European countries, especially the UK and recently Italy. In the *Scottish Nuclear* case,[120] almost 20 years ago, Scottish Nuclear was allowed to sign a 15 years supply contract with Scottish Power and Hydro-Electric. The Commission at that time explicitly recognized the need of long-term dispatch and planning for reaching the scale economies of that technology, even if it hindered price competition between the downstream duopolists.[121] It would be interesting to know whether this jurisprudence is still relevant today and whether such LTC would be acceptable for supply to a single downstream company or consortium, and on what basis.

Price restraints and the location of regulatory powers in energy LTC cases. Apart from resale price maintenance in *Repsol* and to some extent price discrimination in *Gas Natural/Endesa*, the Commission has so far never dealt with price issues in LTC cases. Community and national competition authorities have however some experience in the context of abuse of market power on spot markets[122] and discriminatory access to essential facilities. This has changed recently with the important *Direct Energy* case dealt with by the French Competition Authority in late 2007. Direct Energy is a new entrant in French retailing with no production capacity. Due to the overwhelming dominant position of EDF, restraints on interconnectors and a limited spot market, there was no alternative to bilaterally contract with EDF for a substantial part of its base load demand. Direct Energy and EDF thus signed in December 2005 a 5 year contract at a price fairly comparable to that of forward contracts with the longest maturity on Powernext at that time. Following this contract, Direct Energy remained unable to compete with the French incumbent retail subsidiary. It thus decided to sue EDF for an infringement of Art 82 EC mainly on three grounds: price discrimination (between Direct Energy and the

[120] Scottish Nuclear decision of 6 July 1991, O.J. 1991, L 178/31.
[121] This LTC was deemed to facilitate transition to a market-based industry in the UK and ultimately to benefit consumers.
[122] See for recent cases *Viesgo Generacion* where the Spanish Competition Authority found that ENEL had charged abusive prices on the spot market (Tribunal de Defesa de la Competencia, Report 2006) or *Iberdrola Castellon* where the Spanish Competition Authority found that Iberdrola had manipulated wholesale prices.

EDF retail subsidiary), margin squeeze abuse and discriminatory access to nuclear base load capacities.

The tremendous difficulties of the Council in this case remind the difficulties the competition authorities face as soon as price issues are involved.[123] Concerning the margin squeeze aspect of the case, the Council recognized that Direct Energy was squeezed out between the EDF retail tariffs and the high and unstable prices to be found on wholesale markets where EDF was dominant. The Council could only conclude on a presumption of margin squeeze. On the remaining two issues, the Council is much less clear. On the price discrimination aspect, the Council simply stated that it could not conclude due to missing evidence and that further analysis was required as the competitive 'benchmark' price was highly difficult to determine in energy. Even if the Council deemed that access to nuclear capacities was not discriminatory, he acknowledged the need to organize access for alternative suppliers. As a remedy, the Council imposed a VPP to EDF.

The Council thus revived the debate which took place in the telecommunication sector about whether or not to regulate *ex ante* access to upstream products and whether this is an acceptable second best. This also raised the debate about the suitability of competition authorities in dealing with price restraints in general and whether regulatory authorities should not be given jurisdictional power on this issue, especially to avoid deterrent effects on entry in generation.[124] However, since the ECJ upheld the 10th of April 2008 the Commission decision on *Deutsche Telekom*[125] and confirmed the legality of its methodology, this is unlikely to be the case.

Procedural issues of the new methodology. At last, the end of *ex ante* notification has added a layer of uncertainty and potential problems for efficiency in enforcement in a sector where *ex post* monitoring might not be optimal. Indeed, *ex post* monitoring is likely to be the optimal audit regime only when the competition authority's probability of error is low.[126] At least relatively to enforcement in unregulated sectors, it is unlikely to be the case in a deregulated network industry.

5. Conclusion

Due to their ambiguous effects on competition, investment and welfare, long-term vertical contracts will remain a key issue of competition enforcement in the EU electricity markets for many years to come. Even if some uncertainty remains, this paper has showed that a clear methodology emerged from recent decisions in other energy industries and that this methodology is most likely to be applied in electricity.

[123] Another recent case concerning difficulties to prove anti-competitive pricing in energy, though not in electricity, is *Austrian Airlines/OMV* where the Austrian Federal Competition Authority could not assert with the necessary degree of certainty that OMV was charging excessive prices and thus referred the case to the Cartel Court (Bundeswettbewerbsbehörde, Report 2006-2007).

[124] For a discussion in the context of the telecommunication sector, see Geradin and O'Donoghue, "The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications sector", 1(2) *Journal of Competition Law and Economics* (2005), at 355-425. Fletcher and Jardine discuss the pros and cons of price regulation by competition authorities for exploitative conduct in Fletcher and Jardine, "Towards an Appropriate Policy for Excessive Pricing", in Ehlermann and Marquis (eds.), supra note 100.

[125] Case T-271/03, *Deutsch Telecom v Commission*, 10 April 2008, not yet published.

[126] Loss et al, "European competition policy modernization: From Notifications to legal exception", 52 *European Economic Review* (2008), 77–98.

The strong legal uncertainty currently perceived in the market place is largely overstated but the European Commission would be well advised to clearly and publicly state its strategy given the negative externalities it may create in energy markets and *in fine* the society as a whole.

The analysis of the parallel development of EC competition law and energy markets liberalization raised interesting insights on antitrust enforcement in deregulated network industries. In face of a radically new context, the European Commission largely disregarded sector specifics and simply replicated competition analysis it had devised in other sectors, especially beer and ice-cream. This cannot only be explained by the implicit antitrust objective of fostering consistency across sectors of the economy but rather expresses the difficulties competition authorities tend to face with the liberalization of network industries. In electricity, the pattern of entry in generation and the impact of LTC on spot markets remain little known and this is precisely where the new methodology implemented by the Commission will display its most important shortcomings. While the Commission states in the explanatory memorandum attached to the Third Energy Package presented in January 2008 that it will provide soon guidance on LTC, this paper shows that many dimensions might not be addressed.