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“Legal Uncertainty and Competition Policy in Deregulated Network
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Legal Uncertainty and Competition Policy in Deregulated Network Industries: The Case of Long term Vertical Contracts in the EU Electricity Markets

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Abstract—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.

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I. INTRODUCTION

Competition authorities face a considerable challenge with the liberalization of network industries. The shift of regulatory regimes towards market-based competition in these sectors largely implied, if not a retreat, at least a redefinition of the role of the state and its tools for action. In fast-evolving market settings, competition authorities must now find coping strategies to fight anti-competitive practices while ensuring a fair degree of legal certainty to market players, without always being able to firmly rely on past case law, experience or economic theory. This is not an easy task, particularly in energy, where the opening-up of markets opened new doors for sophisticated market abuse while the specifics of the sector

remain strong and the antitrust objectives often contradictory in practice as other considerations such as security of supply are to be taken into account.

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,² 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 LTC³ 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 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.

² e.g. stranded power purchase agreements (thereafter PPA) in Hungary or Poland, legacy rights on interconnectors.

³ DG Competition report on energy sector inquiry, SEC(2006) 1724, 10 January 2007, at 232-244 and 283-294.

This article proposes to explore the implications of the legal uncertainty which derives from the strategy implemented by the European Commission to cope with the policy trade-offs raised by LTC in this sector. Section II 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 III will then depict the methodology which emerged from recent proceedings in gas and oil. Section IV will show why this methodology will be applied in electricity and what its consequences could be for efficiency in future competition enforcement. Important insights will then be drawn on the way competition authorities may react in the face of the radical uncertainties arising from the liberalization of network industries.

II. 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),⁴ tolling agreements (e.g. Centrica's contract with Intergen for an 860 MW gas-fired power plant) and diverse PPA with energy 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 have diverse effects on consumer surplus, investment, risk management, entry and spot prices.⁷ Particularly relevant for

4 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. On VPP, see below at Section IV for a discussion.

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 pooled their electricity purchases with different contractual and financial arrangements. 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). One can also note that most vertical contracts with energy intensive users include horizontal restrictions of competition and the associated risk of collusion.

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 jointmarketing, 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 is 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 Rapport EDF-IDEI, Contrat de Long Terme, Concurrence et Efficacité, Decembre 2007.

electricity are clauses regarding exclusive dealing,⁸ duration and use restrictions, exclusive distribution and destination clauses remaining today more relevant for gas.⁹ 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 final consumers, LTC

in electricity need to be carefully regulated by competition authorities so as not to hamper the best allocation of risks among market players while limiting legal uncertainty. I briefly show in this section why LTC are so crucial in electricity as well as the trade-offs raised from a competition policy point of view, and why legal uncertainty has increased recently in the market place.

A. The Basic Competition Economics of LTC in the Electricity Sector and its Ambiguities

Whereas vertical restraints generally tend to be viewed more leniently than horizontal restraints from a competition policy viewpoint, this is not the case in energy where the disintegration of vertical market relationships has been the key policy item since the first liberalization directive. However, long-term vertical contracts are a logical answer for market players facing spot prices volatility, non-storability and the

⁸ Exclusive supply clauses encompass exclusive purchase and exclusive distribution obligations. Exclusive supply clauses are called 'exclusive dealing' in EC competition law. We will use them interchangeably.

⁹ We note here that exclusive purchase clauses are much more common than exclusive distribution clauses in electricity. 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 H., Cultrera C., Schnichels D., "The Territorial Restrictions Case in the Gas Sector: a State of Play", Competition Policy Newsletter, n°1 2004, pp 48-51; Cultrera C., "Les Décisions GDF, la Commission est Formelle: les Clauses de Restrictions Territoriales dans les Contrats de gaz violent l'Article 81" 2005, n°1, Competition Policy Newsletter, p.45-48; Wåktare E., "Territorial restrictions and profit sharing mechanisms in the gas sector: the Algerian Case" n°3, 2007, Competition Policy Newsletter pp.19-21, and Talus K., "Long-term Gas Agreements and Security of Supply – Between Law and Politics", European Law Review, 2007, 32(4), pp. 535-548. The only important exclusive supply cases in electricity since liberalization have been the remedy on CNR in Case M.1853 EdF/EnBW (at 29-30, 91-92; see also European Commission press release IP/01/175 of 07.02.2001), and the stranded PPA 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. 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 Directive 96/92 EC (OJ 1996 L 27/20-29); the Commission Communication on the Methodology for analysing State Aid linked to stranded costs, available on the website of the European Commission; Hancher L., State Aid, in at 656-680 and the analysis of Eilmansberger, Jaeger and Thyri in Compatibility of the Hungarian System of Long-term Capacity and Power Purchase Agreements with EU Energy and Competition Law, Expert Opinion, 2004.

unbundling imposed.¹⁰ When we add the concentrated market structure, inelastic demand and high investment costs, LTC seem to become an unavoidable contractual structure, at least as a complement to spot market contracting. The basic rationale for LTC in electricity is hedging price and quantity risks over a certain period of time, so duration is crucial. However, 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, which might be particularly detrimental in the context of slowly liberalizing energy markets. In Gas Natural/Endesa¹¹ for instance, the Commission 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.

As in any other sector, the main competition concern associated with long term vertical contracts 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. Tied consumers will not be able either 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.

¹² 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. Moreover, much theoretical ambiguities remain around the impact of long-term supply contracts on spot market deepening,¹³ a cornerstone of competition policy in European energy markets.¹⁴ 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

¹⁰ See Art 10 and 15 of Directive 2003/54/EC of the European Parliament and

of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC. 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 Commission Competition Report 2000 and European Commission press release IP/00/297 of 27.03.2000.

12 P. Aghion, and P. Bolton, "Contract as Barrier to Entry", *American Economic Review*, Vol. 77, pp. 388-401, 1987.

13 M. Bonasina, A. Creti and F. Manca (2007), "Im-perfectly Competitive Contract Markets for Electricity", Working Paper.

14 DG Competition report on energy sector inquiry, see above note 3.

If a significant part of electricity flows are contracted on a longterm bilateral basis, spot market development is limited and price volatility increases, which undermines entry and incentivize market players towards vertical (re)integration or long-term contracting (feed-back effect). However, theoretical arguments¹⁵ 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.¹⁶

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 in specific contexts,¹⁷ which results in both higher profits and lower prices, and facilitate entry when sufficiently long.¹⁸ 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 investment in nuclear or coal power stations which might not be financed otherwise.¹⁹

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 price volatility, such potential contractors can only go slowly upward the learning curve in this sector, which may

limit opportunities for long term contracting.²⁰ This is particularly visible for producer/retailer relationships as retailers face risk of free-riding by final consumers which are tied for much shorter periods.²¹ 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 B. Allaz and JL Vila, "Cournot Competition, Forward Markets and Efficiency", *Journal of Economic Theory*, Vol. 59, pp. 1-16, 1993.

16 As long as LTC are not indexed on spot prices.

17 L. Onofri, "Electricity market restructuring and energy contracts: a critical note on the EU Commission's NEA Decision", *European Journal of Law and Economics*, vol. 20, pp. 71-85, 2005.

18 Newbery, D. (1998). "Competition, Contracts and Entry in the Electricity Spot Market." *RAND Journal of Economics*. 29, 726-749.

19 Finon and Perez, above note 2.

20 Vasquez, C., M. Rivier and I.J. Pérez-Arriaga (2002), "A market approach to long-term security of supply", *IEEE Transactions on Power Systems*, Vol. 17, No. 2, pp.349-357.

21 Neuhoff, K., L. de Vries, "Insufficient incentives for investment in electricity generations", *Utilities Policy* 12 (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. Antitrust authorities thus cannot rely on well established economic foundations when enforcing competition law in this industry whereas industrial organization theory is usually more mature and thus helpful in other sectors. As we saw, a blind enforcement of competition law in electricity may create incentives to further vertical (re)integration and hamper the best allocation of risks which would go counter the objectives of the European Union in terms of market building and investment. In the face of such difficulties, it may thus be tempting to disregard sector specifics and use well-known methodologies previously applied in other contexts. However, if the reception of new insights from energy economics in competition analysis could be a source of concerns in itself given their ambiguities, we will see that the legal uncertainty currently perceived in the market place originates somewhere else.

B. The Sources of Legal Uncertainty: Modernization of EC Competition Law and the New Market Context in Energy
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. The first source of legal uncertainty comes from the limited number of decisions on LTC in electricity since the opening-up of markets. Apart from Synergen which relates as much to gas as to electricity, relevant cases in this sector essentially concern long-term reservation rights on interconnectors signed before liberalization. Most cases concerning LTC in energy have taken place in gas and oil, which at first glance would not provide obvious guidance. Cases in electricity prior to liberalization are interesting but characterized by a clear lack of methodology leading to inconsistencies and decisions based on fairly weak grounds (e.g. loosely defined security of supply) which are unlikely to be accepted today on the same terms.²²

Furthermore, since the early 2000's, DG Competition has publicly voiced strong concerns over risks of anti-competitive effects inherent in electricity and gas LTC²³ whereas long durations had been repeatedly accepted in the former period. For instance, a duration of 15 years had been accepted in *Electricidade de Portugal/Pego*,²⁴ *Isab Energy*, *Sarlux*, *Rosen* or *Api Energia* and 25 years in *Transgas/Turbogas*. The legal uncertainty created by the lack of precedents has therefore been amplified by the split between the current state of Commission thinking and its past decisional practice.

²² e.g. the formation of selling and purchasing consortia contracting on a long-term basis (5 years renewable) was accepted in *Jahrhundertvertrag* to allow the development of local energy sources (coal) for the sake of "national security"; a market partitioning clause was accepted in *Scottish Nuclear*.

²³ DG Competition report on energy sector inquiry, SEC(2006) 1724, 10 January 2007, at 232-244 and 283-294.

²⁴ Case No IV/34.598 – *Electricidade de Portugal/Pego Project*, OJ C265/3, 1993.

This lack of legal certainty has not been softened by the ongoing modernization of EC Competition law,²⁵ which culminated with the enactment of Regulation 1/2003²⁶ and a revised Merger Regulation.²⁷ Antitrust is a key policy tools to overcome the current shortcomings of energy liberalization in Europe²⁸ and the new context of EC competition law raises several problems for legal certainty which deserve to be highlighted. First, 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.²⁹ Applying a sort of rule of reason is already a challenge for competition authorities 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, may be intractable in practice for competition authorities and is most likely to undermine legal certainty. Second, 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 between Art 81 and 82 EC when enforcing EC competition rules in LTC cases.³⁰ 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 they involve dominant firms, unless the agreement contains the so-called ‘hard-core’ restraints.³¹ 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. Indeed, the reform of Art 82 EC is recent and still going forward.³² This has fostered legal uncertainty

25 See the White Paper on modernization of the rules implementing Articles 85 and 86 of the EC Treaty [1999] OJ C132/1, [1999] 5 CMLR 208.

26 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.

27 Regulation 139/2004, [2004], OJ L24/1.

28 Cameron p.280.

29 The modernization of EC Competition law has already been widely commented. For a legal account see Ehlermann, C-D. 2000. *The Modernization of EC Antitrust Policy: a Legal and Cultural Revolution*. *Common Market Law Review*, 37. For an economic account see

30 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 PJ, “The Defense of “Objective Justification in the Application of Article 82 EC”, *World Competition* 28(4), 2005, at 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 in *Compatibility of the Hungarian System of Long-term Capacity and Power Purchase Agreements with EU Energy and Competition Law*, Expert Opinion, 2004.

31 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.

32 See on this the very influential EAGCP report « *An Economic Approach to Article 82* » of July 2005; DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, December 2005; Lowe P., *DG Competition’s Review of the Policy on Abuse of Dominance*, in B.E. Hawk, ed., *International Antitrust and Policy: Annual Proceedings of the Fordham Corporate Law Institute 2003*, Juris Publishing, New York, 2004, at 163.

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.³³ In particular, procompetitive 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.³⁴ 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 energy³⁵ and both the Vertical Block Exemption Regulation (VBER)³⁶ and Guidelines on Vertical restraints³⁷ (GVR) provide, it is submitted, sufficient guidance for LTC involving non dominant firms.³⁸ In fact, legal uncertainty is now concentrated

33 Sher, *The last of the Steam-powered Trains: Modernizing Art 82*, 2004, ECLR, 244; Jones and Sufrin p.17; Slot at 462; Bellamy and Child, *European Community Law of Competition*, London 2001, at 42. Ridyard, "Exclusive pricing and price discrimination abuses under Article 82- an economic analysis" 23 ECLR (2002), 286, at 290-291. For a contrasting view, see Eilmansberger 2005 at 138. Sinclair D., "Abuse of Dominance at a Crossroads: Potential Effect, Object and Appreciability under Article 82 EC, 2004, ECLR 491.

34 See E. Rousseva, *supra* note 50. Vickers J, *Abuse of Market Power*, Speech to the 31st conference of the European Association for Research in Industrial Economics, Berlin. Sher, *The last of the Steam-powered Trains: Modernizing Art 82*, 2004, ECLR, 243. Kallagher and Sher, "Rebate Revisited: Anti-Competitive Effects and Exclusionary Abuse under Art 82", 2004, ECLR. Loewenthal PJ, "The Defence of "Objective Justification in the Application of Article 82 EC", *World Competition* 28(4): 455:477, 2005. For a contrasting view on the need to completely revamp Art 82 EC, see Eilmansberger T, "How to Distinguish Good from Bad Competition under Article 82 EC: in Search of Clearer and More Coherent Standards for Anti-Competitive Abuses", *Common Market Law Review*, 42(1), p.129, 2005.

35 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).

36 Regulation 2790/1999 on the Application of Art 81(3) to categories of vertical agreement and concerted practices, O.J. 1999, L 336/21. The VBER was enacted in 1999 following the Green Paper (European Commission, *Green Paper on Vertical Restraints in EC Competition Policy*. COM (96) 721 final, 22 January 1997). The objective was primarily to reduce the regulatory burden on the Commission by abolishing the old notification system.

37 Commission Notice on Guidelines on Vertical Restraints [2000] OJ C291/1.

38 For recent cases in the gas retail segment, see 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).

39 Other relevant cases from national competition authorities will also be used when relevant. The remedies will be touched upon in the different paragraphs and discussed in Section IV.

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 EC Treaty rules on competition. This is all the more detrimental to market players in a context of fast evolution 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 is most likely to face from the next four or five years onwards, the legal uncertainty currently perceived in the market place becomes a major issue.

III. DIGGING DEEPER INTO THE NEW COMMISSION METHODOLOGY

Under exclusive dealing, 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. More legal certainty would 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. Indeed, 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 preliberalization 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 underlying rationale of this new methodology is 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 Distringas methodology with relevant insights from Synergen, Gas Natural/Endesa, Repsol, and E.ON Ruhrgas, 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.³⁹ This paper will then show in section IV why this methodology is most likely to be applied in future proceedings in electricity, the far reaching consequences in terms of legal certainty and efficiency it will have and the conclusions we may draw on the coping strategies competition authorities implement in the face of the radical uncertainties raised by the liberalization of network industries.

When assessing individual cases in energy, the Commission will now focus on interactions among several key elements once the 30% threshold⁴⁰ 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.⁴¹

A) 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.⁴² This conclusion has been confirmed in Distringas.

⁴⁰ 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, OJ 2000 C118/3.

⁴¹ This broadly follows the Commission's typology in MEMO/07/407, 11.10.2007 and in the Sector Enquiry, p.235.

42 M. Fernandez Salas, “Long-term Supply agreements in the context of gas market liberalization: Commission closes investigation of Gas Natural”, Competition Policy Newsletter, vol.2, pp.55-58, 2000.

When assessing market characteristics, the Commission will primarily look at potential entry in supply and demand, and its real impact on competition. Indeed, in Synergen, the Commission states that the future entry of Viridian which will develop a 340MW power plant will 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 clarifies 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.⁴³ Here the Commission states 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.

B) The Market Position of the Dominant Supplier or Group of 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 concerns.”⁴⁴ As a general rule, the higher the market share of the dominant supplier, the sooner the cumulative market coverage of its LTC will be deemed to create foreclosure.⁴⁵ This 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.⁴⁶ 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.⁴⁷ Of course, 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.⁴⁸ In energy, sole or joint dominance is in most cases self-evident. Except in the old Almelo case,⁴⁹ the Commission has not yet dealt with collective dominance in an anti-competitive long-term supply contract case.

43 Art. 1(a) of the VBER and para. 26-27 of the GVR.

44 European Commission, MEMO/07/407, 11.10.2007.

45 para.149 GVR.

46 para.148 GVR and Case T-65/98 Van den Bergh Foods, ECR 2003.

47 Kjolbye L. in: Jones C. (ed), EU Energy Law Volume II: EU Competition Law and Energy Markets, 2nd ed., Claeys and Casteels, 2007.

48 para.107 GVR.

49 Case C-393/82, Almelo, ECR 1994.

C) 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,⁵⁰ 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.⁵¹ 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.⁵² 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"⁵³ (confirmed in Gas Natural/Endesa). In addition, reduction clauses,⁵⁴ the so-called 'English clauses'⁵⁵ and fidelity rebates granted by

50 In Gas Natural/Endesa, 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 producer 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 could raise antitrust issues.

51 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.

52 Nyssens and Schnichels, *supra* note 24.

53 European Commission, *supra* note 62.

54 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, Commission Competition Report 2002 at 196). These clauses thus have similar market portioning 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.

55 '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 M. and C. Waddams Price, "Introducing Competition and Deregulating the British Domestic Markets: a Legal and Economic Discussion", J.B.L. 2007, May, 244-268.

dominant firms on remaining volumes are also most likely to infringe competition rules, as has been shown in German cases.⁵⁶

D) 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.⁵⁷ 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.⁵⁸ I also note that the Commission considers contracts with tacit renewal clauses or no last delivery date as

contracts of indefinite duration (confirmed in E.ON Ruhrgas). In line with the more economic approach, 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%.⁵⁹ Competition authorities will thus play with the two factors. Where 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 (HNG) and Naturgas Midt-Nord (MN), and shortened the duration by 2 years to have it terminated by January 2007 as well as cancelling the exclusive supply clause with a prohibition of such clause in future contracts if they were to renegotiate the agreement. For a new entrant in retail, a duration of 5 years is most likely to be

⁵⁶ Lohmann H., *The German Path to Natural Gas Liberalisation*, 2006, NG 14, Oxford Institute for Energy studies.

⁵⁷ Aghion and Bolton, note 14.

⁵⁸ Art 5(a) VBER and para.141 GVR.

⁵⁹ 80% is a classical threshold in EC Competition Law as the VBER considers any obligation to buy more than 80% of its purchase from the same supplier as non-compete obligation.

accepted.⁶⁰ 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 is accepted for contracts with established resellers (from 25-40 years originally) but the market shares of the dominant firm only reached 30% to 50% which hardly exceeds the dominance threshold (40%). One also notice 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 need and can claim for some degree of long term security in fuel supply.

Concerning new investments in capacities and interconnectors, the Commission has clearly showed its support to long-term contracting. 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.

E) 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 *Distrigas*, the Commission considered that no competition concerns would arise if the contracts that lasted for more than a year would cover less than 20% of the market. This assessment took into account the existence of a duration limitation of 5 years, which would avoid that customers who would be particularly likely to switch supplier could be tied for a very long period of time, which in itself would give rise to competition concerns. In *E.ON Ruhrgas*, the *Bundeskartellamt* estimated that the firm contributed significantly to cumulative

⁶⁰ 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 *Décision n°07-MC-04* du 28 juin 2007 relative à une demande de mesures conservatoires de la société *Direct Energie* et *Décision n°07-D-43* du 10 décembre 2007 relative à des pratiques mises en oeuvre par *Electricité de France*, available on the website of the French Competition Council at <http://www.conseil-concurrence.fr>

foreclosure with 75% market shares in its supply area, within a national market where 80% of demand was supplied long term. Interestingly, as opposed to the *Bundeskartellamt* and its rather form-based approach in *E.ON Ruhrgas*, the Commission in the *Distrigas* case includes flexibility parameters for the

dominant firm itself. Distrigas is allowed to adjust its portfolio of contracts to its own needs as long as it complies with durations and the 65-70% target. The firm retains by this a fair level of flexibility. Indeed, Distrigas can 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 commitments allow Distrigas to tie under LTC a certain fixed volume of gas that represents less than 20% of the market concerned. 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. This marks the alignment of energy markets with traditional markets in the Commission's view.

F) Efficiencies

As described in Section II, even if a LTC contributes to an overall effect of closing off the market to potential market entrants, the Commission will assess whether it generates efficiencies that outweigh the negative effects, as long as hardcore restraints are not included. 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 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.⁶¹ Setting up new power plants is beneficial because it will help ensure long-term generation adequacy and perhaps fuel mix diversity.⁶² 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

61 para.44, Commission Guidelines on the application of Article 81(3) of the Treaty, OJ C101/97 of 27.04.2004; confirmed in in Synergen and Distrigas.
62 Finon and Perez, note 2.

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. Promoters of new interconnectors have been granted either exclusive rights of indefinite duration on the full capacity (Scotland-England interconnector) or a 25 years exemption from third party access (Viking Cable),⁶³ with use-it or lose-it principle though. Similarly, on the UK-Belgium gas pipeline,⁶⁴ 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,⁶⁵ Norway-Denmark and Denmark-Germany interconnectors following VEBA/VIAG⁶⁶). The antitrust tolerance towards risky infrastructure investment seems impossible to justify for existing amortized infrastructure. Foreclosure effects of new long-term reservations on existing capacity, which will hardly ever be directly linked with new investment in that infrastructure, cannot be counter-balanced by arguments related to the need for investment. The same applies to current prolongation of historic contracts beyond their originally foreseen end date, even if this possibility was foreseen in the historic transport contract.

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. 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.⁶⁷ In addition, the Synergen and Gas Natural/Endesa cases 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.

63 Viking Cable, settlement in COMP/E-3/37.291 and Notice pursuant to Art 19(3) of Regulation 17, OJ C247/11 of 05.09.2001.

64 UK/Belgium interconnector, informal settlement, IP/02/401 of 13.03.2002.

65 UK/France Interconnector, informal settlement, IP/01/341 of 12.03.2001.

66 Case M.1673 VEBA/VIAG.

67 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.

One notes here that if long-term generation adequacy is clearly a critical goal of the Commission,⁶⁸ the vague concept of ‘security of supply’ is approached with much skepticism. 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).⁶⁹ Today, only long-term gas import contracts are sure to be accepted on the basis of a ‘security of supply’ argument.

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.⁷⁰ As a general rule, 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 competition restriction. 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, I think that a neutral effect on final consumers will 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 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).

IV. COMPETITION ENFORCEMENT IN ELECTRICITY: LEGAL UNCERTAINTY VS EFFICIENCY IN THE AFTERMATH OF DISTRIGAS

This paper shows in this section that the methodology depicted above has recently upgraded legal certainty more than

68 As evidenced by the new directive on security of supply, Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment, OJ L 33/22, 04.02.2006.

69 L. 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 Commission Competition Report 1997 p.150 and European Commission press release IP/97/351 of 25.04.1997).

70 Hildebrand D, *supra* note 14, at 84-88.

market players and commentators tend to usually think. However, it will argue that this principally expresses the difficulties which the Commission currently faces when enforcing competition law in energy and that its coping strategy may raise serious concerns for future proceedings in this sector.

A. The New Methodology and Legal Uncertainty in Electricity

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 Dstrigaz and the gas markets in Belgium.”⁷¹ 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 probably for future enforcement in electricity, three elements tend to show that the proceedings analyzed above paved the way for enforcement in electricity and that legal certainty in electricity has also been upgraded. First, 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. Second, the recent energy decisions analyzed above show that the frontiers

between Art 81 and Art 82 EC become blurred, which limits the possibilities of inconsistent enforcement of EC competition law. Third, these decisions show that competition enforcement in energy quickly converges with enforcement in other sectors, which facilitates firms' anticipations of Commission's decisions. These elements bring new lights on the strategies of competition authorities in deregulated network industries.

1) Legal uncertainty in electricity and remedies in energy 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, the maximum duration of about three 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 VPP, it is interesting to note that the Commission broadly imposed the same durations in electricity, which tends to show that it take similar views on market players' needs across energy sectors. Indeed, in the 2000 EDF/EnBW merger proceeding,⁷² EDF is 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 submarine interconnector, 100% of the capacity must be freed, this time on the basis of 3 years bilateral contracts (1500MW divided in 50MW blocks) and

⁷¹ See European Commission press release MEMO/07/313, 26 July 2007.

⁷² Case M.1853 EDF/EnBW.

concurrently annual (50MW in 1MW blocks) and daily (150MW in 1MW blocks) auctions. In 2002, in Synergen, the original plan submitted to the Commission foresees that the dominant incumbent ECB will hold 30% 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 imposes a 600 MW VPP, including 200MW from the Synergen power plant (so for half of eligible consumer demand). The 600MW will have to be sold on the basis of three years bilateral contracts, and subsequently through auctions in case bilateral contracting does 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.

2) The blurring of Art 81 and Art 82 EC: The consequences for legal uncertainty in energy and the modernization of EC competition law

A good part of legal uncertainty came from the fact that dominance could be analyzed under Art 81 and/or Art 82 EC. An interesting conclusion of this paper is that the frontiers between analysis of both anti-competitive agreement and abuse of dominance in energy LTC cases become blurred, which upgrades legal certainty.

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. Indeed, under old Art 82 EC case law, exclusive dealing was almost illegal per se if accompanied by fidelity rebates⁷³ as it would increase switching costs, reinforce the supplier dominant position and foreclose competitors,⁷⁴ and this often without sufficient demonstration of foreclosure or analysis of potential entry.⁷⁵ This was in sharp contrast with the evolution of analysis under Art 81 EC described above and the focus on efficiencies both under Art 81(3) EC and merger control.

To the opposite, efficiencies and insights from the traditional competition economics of foreclosure such as the cumulative market coverage doctrine are clearly taken into account in the recent line of cases. The reasoning and the market share

⁷³ See for instance Case 85/76, *Hoffmann-La Roche & Co AG v. Commission*, [1979] ECR 461 at 89, 120; Joined Cases 40-48, 50, 54-56, 111, 113 and 114/73, *Coöperatieve Vereniging "Suiker Unie" UA and others v. Commission*, [1975] ECR 1663 at 111 and *Michelin* (2003) at 54.

⁷⁴ *Rousseva*

⁷⁵ Case T-203/01 *Michelin v. Commission* of 30.09.2003 at para. 293; Case T-219/99 *British Airways v. Commission*, of 17.12.2003 para. 239 or 293?. *BPP Industries* at 69.

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. For instance, 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 EC⁷⁶ 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 five 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. Furthermore, the recent cases analyzed above, and essentially Distrigas, show that the reform of Art 82 EC is well under way.⁷⁷ This conclusion is confirmed in the opinion of Advocate General Damasco Ruiz-Jarabo Colomer in Case C-468/06 presented the 1st of April 2008 where he engages 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.

3) Legal uncertainty in energy and the coping strategies of European competition authorities in deregulated network industries

Most analytical devices and remedies such as the cumulative effect coverage doctrine and contract termination rights, which have been integrated in recent decisions in energy, are not new to EC competition policy and can be traced back to key decisions in the long process of modernization of vertical restraints analysis. This reduces legal uncertainty as market players can now predict the way the Commission will analyze their LTC from a competition point of view and what sort of remedies it will impose.

⁷⁶ para.141 GVR.

⁷⁷ However, we could argue that there is still some way to go when looking at remedies in Distrigas which are not 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 remedy should evolve with a firm going from a "superdominant" (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) to a dominant position.

One of the main innovations of recent decisions in energy is the use of the cumulative market doctrine. As shown in Section III, the cumulative effect doctrine is a way to analyze if an agreement, which taken isolated would not fall within the scope of Art 81 EC, nevertheless has an appreciable effect on competition when assessed in its legal and economic context, especially when it is part of a network of parallel agreements concluded by one or several dominant suppliers. 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 vertical restraint analysis and has been regularly endorsed by Community Courts.⁷⁸ It was first treated in the Art 81 EC cases *Brasserie de Haecht* (1967),⁷⁹ *Delimitis* (1991)⁸⁰ and more recently *Langnese-Iglo* (1995),⁸¹ *Schöller* (1995),⁸² *Neste* (2000)⁸³ or *Van den Burgh Foods* (2003).⁸⁴ This is a well-established tool of competition analysis which will be used in future energy proceedings and help firms analyze themselves the potential anti-competitive effects of their portfolios of LTC.

One can also take two examples from the field of remedies. The first is termination rights of existing contracts granted to buyers, which one can find in *E.ON Rurhgas* and *Distrigas*. In *Distrigas* for instance, existing contracts with energy intensive industries (resellers excluded) enjoyed unilateral termination rights. This is a classical remedy in EC competition policy and the fact that LTC with indefinite durations and clear termination rights are less restrictive than LTC concluded for several years as recalled in the recent Dutch case *Heineken Nederland* and *Neste*.⁸⁵ Second, one can notice that the criteria used to define the duration of commitments become 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,⁸⁶ where the commitments only applied if the share of *Coca-Cola's* closest competitor was less than half that of *Coca-Cola*.

Facing traditional competition issues in a completely new and fast-evolving market setting, the Commission thus tends to apply methodologies and remedies similar to those used in other sectors. As a result, this paper argues that the (not so) new methodology depicted above is likely to be here to stay

and that the alignment of enforcement in energy with traditional competition policy is well advanced. Competition

78 V. Verouden, “Vertical Agreements and Article 81(1) EC: The Evolving Role of Economic Analysis”, 71, *Antitrust Law Journal*, vol. 71, p. 525.

79 Case 23/67 *Brasserie De Haecht v Wilkin* [1967] ECR 407.

80 Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR I-935.

81 Case T-7/93 *Langnese-Iglo GmbH v Commission* [1995] ECR II-1533.

82 Case T-9/93 *Scholler Lebensmittel GmbH & Co KG v Commission* [1995] ECR II-1610.

83 Case C-214/99, *Neste Markkinointi Oy v Yötuuli Ky and Others*, [2000] ECR I-11121.

84 Case T-65/98 [2003] ECR II-4653, para.82-83.

85 In *Kalibraxe/EDF*, the need to clarify termination right is also recalled.

86 Case COMP/39.116 . *Coca-Cola*.

policy toward long-term vertical contracts in electricity therefore becomes more predictable and firms have now more robust guidelines to make their portfolio of contracts comply with EC competition rules.

B. Legal Uncertainty vs Efficiency in Competition

Enforcement: Caveats and Remaining Uncertainties in the Methodology

The rationale of the more economic approach in EC competition policy is to better capture industry specifics and as such, there is no reason to believe that energy at this stage of the liberalization process must be analyzed as the beer or icecream 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. However, this paper argues 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 but from a methodology which the Commission knows and can apply. As a result, certain problems brought up by the new methodology need to be highlighted.

1) Efficiency in competition enforcement and economic theory

At first one can notice that the main issue debated by economists when it comes to LTC in electricity is neither taken account of nor debated in any decision of the Commission. The impact of LTC on spot market deepening is a complicated issue. 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,⁸⁷ when firms may either abuse their market power by strategically withholding capacities or tacitly collude.⁸⁸ 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.⁸⁹

⁸⁷Allaz 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.

⁸⁸ Green, R. J., & Le Coq, C. (2006). The length of contracts and collusion. CSEM Working Paper WP-154, University of California Energy Institute.

⁸⁹ Willem B., Market Power Mitigation by Contracts, 2006 Working Paper.

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 acknowledges recurrent problems of abuse of a dominant position on European spot markets. As a result, even if recent economic analyzes still tend to rely on fairly strong assumptions, the Commission should not ignore the questions raised by recent advances in economic theory.⁹⁰

2) Remedies in energy and entry in generation

A second 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.⁹¹

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.⁹² 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 from dominant firms in the spot market but there are few studies

⁹⁰ 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.»

⁹¹ 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.

⁹² Competition authorities traditionally favor physical divestitures as it limits subsequent regulatory costs.

quantifying these effects on firms' strategic bidding and equilibrium prices.⁹³

As a result, there is to date no convincing evidence of positive effect of VPP on competition.⁹⁴ This can be explained by the fact that the efficiency of VPP will depend on many factors such as auction design,⁹⁵ contract durations or the investment climate, which have not been systemically analyzed, neither theoretically nor empirically.⁹⁶ 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.⁹⁷ 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 network industries, taking up a quasi-regulatory role for which they might not be prepared.⁹⁸

3) The new methodology and the case of energy intensive users

Strong uncertainties remain concerning the different collective buying schemes for energy intensive users⁹⁹ which might be found at all levels of the supply chain in both gas and electricity.¹⁰⁰ 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 stark international competition. This has pressured certain Member States like Spain and France to act on that question and fight the risk of delocalization. These schemes give rise to significant competition problems which are not all answered by applying the new methodology.¹⁰¹ Given that no Block Exemption Regulation applies and assuming that the de-minimis thresholds are

⁹³ For an attempt, see *Assessing Regulatory Measures in Electricity Markets: The Case of VPP in the Netherlands*, by Boisseleau and Giesbertz.

⁹⁴ Boisseleau and Giesbertz, *Assessing Regulatory Measures in Electricity Markets: The Case of VPP in the Netherlands*, Working Paper.

⁹⁵ In most cases, VPP define base and peak load rights with different durations granted through an ascending clock auction.

⁹⁶ Boisseleau and Giesbertz. Note 108.

⁹⁷ As decided by the French Competition Council in *Direct Energy*, see Lévêque F., “Le Conseil de la Concurrence au secours des opérateurs alternatives de l’électricité”, *Revue Lamy de la Concurrence*, avril 2008.

⁹⁸ Leveque 2008, op cit.

⁹⁹ See Sector Enquiry pp.204-205.

¹⁰⁰ 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, [2002] OJ C166/8.

¹⁰¹ 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.

exceeded, these schemes will be assessed under Art 81 EC,¹⁰² 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 might be the biggest hurdle among the four criteria recalled in Section II.¹⁰³ 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. 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 of the different configurations on markets upstream and downstream of the joint purchasing consortium. One notices here that there is generally less legal certainty concerning the assessment of buyer power than seller power, not only in energy but also in EC competition policy in general.¹⁰⁴ In addition, the opinion issued by the French Competition Council on Exeltium¹⁰⁵ 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 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.¹⁰⁶ In the context of purchasing consortia, giving termination rights could be a way to balance benefits from more predictability and cheaper prices against costs from not

¹⁰² Vertical and horizontal issues will be assessed under the relevant guidelines as well as under the Notice on Art 81(3).

¹⁰³ Avis n°05-A-23 du 5 décembre 2005 relatif à un dispositif envisagé pour permettre aux industries électro-intensives de bénéficier de conditions spécifiques de prix d’achat de l’électricité.

¹⁰⁴ See Green Paper and GVR.

¹⁰⁵ Avis n°05-A-23 du 5 décembre 2005 relatif à un dispositif envisagé pour permettre aux industries électro-intensives de bénéficier de conditions spécifiques de prix d’achat de l’électricité.

¹⁰⁶ In *E.ON Ruhrgas*, LTC with energy intensive users are unaffected by the

prohibition.

being able to opt out of the deal to benefit from a better offer. However, the Distrigas decision might not be replicable in the context of purchasing consortium 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 project financed special purpose vehicle highly leveraged (debt/equity ratio around 90/10) which enables the buyers to finance off balancesheet their electricity purchase. In view of this, it is hard to anticipate which direction the Commission will take. Furthermore, vertical price restraints might express an abuse of dominant position or a hidden State Aid if a public undertaking is involved. Indeed, if a supplier 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 prices, 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 define given the limited durations (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.¹⁰⁷ 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 schemes. 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. In the Scottish Nuclear case,¹⁰⁸ almost 20 years ago, Scottish Nuclear was allowed to sign a 15 years 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.¹⁰⁹ 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.

4) Price restraints and the location of regulatory powers in energy LTC cases

107 See on this, Fiche n°11: Problématiques Juridiques des Contrats de Long Terme, DGCCRF.

108 Scottish Nuclear decision of 6 July 1991, [1991] OJ L178/31.

109 This LTC was deemed to facilitate transition to a market-based industry in the UK and ultimately benefits consumers.

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 markets¹¹⁰ 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. 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 DE and the 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.¹¹¹ Concerning the margin squeeze aspect of the case, the Council recognized that DE was squeezed out between the EDF retail tariffs and the high and unstable prices to be found on wholesale markets. The Council concluded 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 states that it cannot conclude due to missing evidence and that further analysis is required. Even if the Council deems that access to nuclear capacities is not discriminatory, he acknowledges the need to organize access

for alternative suppliers. As a remedy, the Council imposed a VPP to EDF. However, VPP results seem highly uncertain.¹¹² The Council thus revived the debate which took place in telecom about whether or not to regulate ex ante access to upstream products and whether this is an acceptable second best. This also raises 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.¹¹³ However, since the ECJ

110 See for recent cases *Viesgo Generacion* where the Spanish Competition Authority found that ENEL had charged abusive prices on the spot market (Tribunal de Defensa de la Competencia, Report 2006) or *Iberdrola Castellon* where the Spanish Competition Authority found that Iberdrola had manipulated wholesale prices.

111 Another interesting case concerning difficulties to prove anti-competitive pricing, 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 (Bundeswettbewerbshörde, Report 2006-2007).

112 See above and Leveque 2008.

113 For a discussion in the context of the telecommunication sector, see Geradin D. and R. O'Donoghue, "The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications sector", *Journal of Competition Law and Economics* 1(2), at 355-425.

upheld the 10th of April 2008 the Commission decision on *Deutsche Telekom*, and confirmed the legality of its methodology, this is unlikely to be the case.

5) Procedural issues of the new methodology

From a more procedural point of view, we cannot but notice, following some commentators,¹¹⁴ that the more economic approach raises new challenges for national courts which, since modernization, must apply EC competition law and can clear agreements under Art 81(3) EC and Art 82 EC.¹¹⁵ Indeed, if a buyer challenges certain clauses of its LTC before national courts, the latter might not have the relevant expertise and investigation powers to assess for instance overall foreclosure effects. True, systematic recourse to experts is developing but this is a strong limit to the widening of private enforcement of competition rules in this field and arguably a remaining source of legal uncertainty.

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.¹¹⁶ At least relatively to enforcement in unregulated sectors, it is unlikely to be the case in a

deregulated network industry.

V. 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. The strong legal uncertainty currently perceived in the market place is thus 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 in 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

114 Nyssens...

115 See Loewenthal p.456.

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

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.