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*Committed to reform?  
Pragmatic antitrust enforcement in electricity markets*

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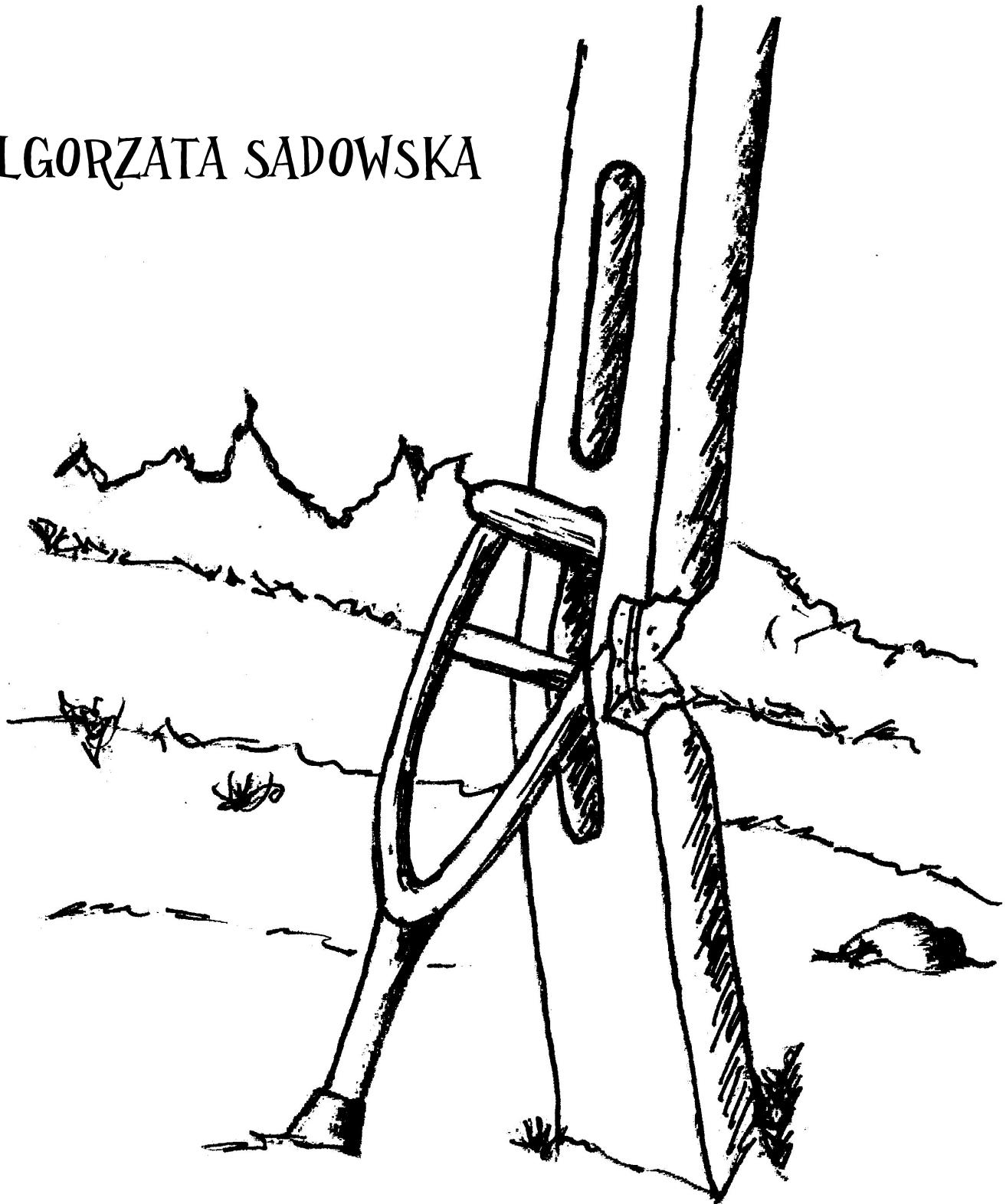
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COMMITTED TO REFORM?

PRAGMATIC ANTITRUST ENFORCEMENT  
IN ELECTRICITY MARKETS

MALGORZATA SADOWSKA



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# 1. INTRODUCTION<sup>2</sup>

I like very much what Joseph Kelliher, former chairman of the U.S. Federal Energy Regulatory Commission, once said about the U.S. wholesale power markets. He said: ‘Our goal is perfect competition, textbook competition, competition that is so beautiful it would make an economist weep.<sup>3</sup> Electricity markets in Europe might be different from those in the U.S. in many respects, but the goals of regulators on both sides of the Atlantic are shared. More than two decades have passed since the European Commission (“the Commission”) decided to open up national energy markets to competition and gradually integrate them, to create Europe-wide markets for electricity and gas.<sup>4</sup><sup>5</sup> The levels of competition reached in these markets may have made economists weep, but not necessarily with tears of joy yet.<sup>6</sup> Nevertheless, the EU electricity sector has undergone major changes over recent years. The Commission has extensively intervened in the market structure and market rules, and continues to do so in order to meet the ambitious political target for completing the internal energy market by 2014.<sup>7</sup>

## 1.1. PROBLEM DEFINITION

***This thesis concerns the instrumental use of commitment decisions to facilitate the completion of the European internal electricity market.***

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<sup>2</sup> My sincere thanks to Massimo Motta, Klaus Heine, Leigh Hancher, Hans Vedder and Roger Van den Bergh for their helpful comments and suggestions on the early draft of this thesis.

<sup>3</sup> J. T. KELLIHER, ‘Quest for Security: Strategies for a New Energy Future’, speech at CERAWEK Conference, *States of US Competitive Wholesale Power Markets*, 11-15.02.2008, Houston, Texas.

<sup>4</sup> See European Commission, *The internal energy market*, Commission working document, COM (88) 238 final, Brussels, 02.05.1988.

<sup>5</sup> By ‘energy markets’ are meant electricity and gas markets. Gas markets are beyond the scope of this research, but the term ‘energy markets’ is nevertheless sometimes used throughout this thesis, especially when reference is made to the EU energy policy and the objective of completing the internal energy market, as both markets are high on the Commission’s regulatory agenda and subject to similar reforms at the EU level.

<sup>6</sup> European Commission, *Making the internal energy market work*, Communication from the Commission, COM(2012) 663 final, Brussels, 15.11.2012, available at <[http://ec.europa.eu/energy/gas\\_electricity/internal\\_market\\_en.htm](http://ec.europa.eu/energy/gas_electricity/internal_market_en.htm)> accessed 20.05.2013.

<sup>7</sup> This target was set by the European Energy Council on 04.02.2011. See European Council, *Conclusions on energy*, Brussels, 04.02.2011, available at <[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/trans/119253.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/trans/119253.pdf)> accessed 20.05.2013.

European policy can shape markets in many ways, two most evident being EU regulation and competition enforcement.<sup>8</sup> The interplay between these two instruments has been much discussed in the context of different sectors, and still attracts a lot of scholarly attention, both from academics and practitioners.<sup>9</sup> One of the major concerns in this debate is the instrumental use of competition rules. It has been observed that competition enforcement in Europe is triggered not only as a response to an anticompetitive harm occurring in the market, but that it sometimes becomes a powerful tool in the Commission's hands to pursue regulatory rather than purely competition goals. This is particularly true in case of formerly state-owned monopolies. Since their liberalisation, these industries have become an interface between a new type of sector-specific regulation and newly applied competition rules. As a result, the two regimes converged to some degree. On the one hand, sector-specific regulation aims now to facilitate competition in the newly created markets and often protects them from monopolistic practices.<sup>10</sup> On the other hand, competition law in these sectors is sometimes applied beyond its proper limits in order to meet the objectives of sector-specific regulation.<sup>11</sup> The latter phenomenon, i.e. instrumentalised

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<sup>8</sup> In this thesis ‘antitrust law’ is viewed as a subsection of ‘competition law’. By antitrust enforcement is meant prohibition of cartels and abuses of dominant position (Article 101 and 102 TFEU). Competition enforcement encompasses antitrust enforcement and also includes merger control, state aid rules and supervision of undertakings with special and exclusive rights.

<sup>9</sup> For instance, see third panel discussion at the CRA Annual Conference – Economic developments in European competition policy, Brussels, 05.12.2012, entitled: ‘Competition vs regulation for abusive conduct: back to the future?’.

<sup>10</sup> For an overview of regulatory measures in the electricity markets, see section 1.2.3 below.

<sup>11</sup> The competition versus regulation debate usually relates to industries where some sort of sector-specific regulation is already present or at least appears desirable because the markets have (A) natural monopoly or (B) network monopoly characteristics. (A)-type markets are e.g. telecommunications, electricity, gas, railway and postal services. (B)-type markets are prone to monopolisation due to the presence of network effects (e.g. new technologies). Application of competition policy as regulation has been a well-known phenomenon in the U.S antitrust enforcement. Back in 1979, Justice Breyer expressly called antitrust enforcement a form of government regulation, an alternative (to ‘classical’ regulation) regulatory tool to deal with market failures. See S. BREYER, ‘Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform’ (1979) 92 *Harvard Law Review* 3, 547-609, p. 578. See also three short articles included in the 1995 Fall Issue of *Antitrust* dedicated to consent decrees (U.S. equivalent of commitment decisions) – ‘Consent Decrees: Antitrust Enforcers as Regulators?’, 10 *Antitrust* 1; H. FIRST, ‘Is Antitrust “Law”?’, 9-12, discusses the influence of politics on the U.S. antitrust law and its shift to bureaucratic regulatory “culture”. A. D. MELAMED, ‘Antitrust: The New Regulation’, 13-15, observes that consent decrees (the U.S. equivalent of commitment decisions) ‘enabled the government officials to address issues that are politically or economically important, but legally ambiguous’, i.e. remedies imposed by a consent decree went beyond what could have been achieved by litigating the case. M. L. WEINER, ‘Antitrust and the Rise of the Regulatory Consent Decree’, 4-8, argues that through consent decrees agencies seek to recast behaviour in accordance with their policy objectives. On the same topic see also M. FURSE, ‘The Decision to Commit: Some Pointers from the US’ (2004) 25 *European Competition Law Review* 1, 5-10. J. R. ATWOOD, ‘Observations on Negotiating Government Antitrust Settlements in the United States’,

competition enforcement,<sup>12</sup> might have a substantial impact both on competition policy and regulation, and ultimately on markets to which they apply, and is thus worth considering closely. This thesis fits well into this debate, because it deals with the use of commitment decisions to facilitate the completion of the internal market for electricity.<sup>13</sup>

---

in B. HAWK (ed.) *2005 Annual Proceedings of the Fordham Competition Law Institute, International Antitrust Law and Policy*, Juris Publishing, New York 2006. For a more recent contribution on the Supreme Court's decisions in *Trinko* and *Credit Suisse* cases, see H. SHELANSKI, 'The Case for Rebalancing Antitrust and Regulation (2011) 109 *Michigan Law Review*, 683-732.

In Europe, much has been written on the role of competition policy in the liberalisation of the telecommunications sector. Commission extensively applied competition rules to this sector during the 1990s and, as observed by the commentators at that time, these targeted antitrust actions significantly contributed to the liberalisation of the telecommunications markets. For an extensive discussion on the use of competition rules as a regulatory driver in the telecommunications sector and the legitimacy of such use see P. LAROUCHE, *Competition Law and Regulation in European Telecommunications*, Hart Publishing, Oxford 2000, pp. 321-358. See also H. UNGERER, 'Use of EC Competition Rules in the Liberalisation of the European Union's Telecommunications Sector. Assessment of Past Experience and Conclusions for Use in other Utility Sectors', COMP/C/2/HU/rdu, Brussels, 06.05.2001, available at <[http://ec.europa.eu/competition/speeches/text/sp2001\\_009\\_en.pdf](http://ec.europa.eu/competition/speeches/text/sp2001_009_en.pdf)> accessed 20.05.2013. L. GARZANITI, *Telecommunications, Broadcasting and the Internet: EU Competition Law and Regulation*, 2<sup>nd</sup> ed., Sweet & Maxwell, London 2003, pp. 537-551. S. VANNINI, 'Competition and Regulation in Network Industries: Not an Easy Balance to Strike. Comments on Koski and Kretschmer' (2004) *Journal of Industry, Competition and Trade. Bank Papers*, 49-65. D. GERADIN and R. O'DONOGHUE, 'The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector' (2005) 1 *Journal of Competition Law and Economics* 2, 355-425. P. LAROUCHE, 'Contrasting legal solutions and the comparability of EU and US experiences' (2006) Tilburg University, TILEC Discussion Paper 2006-028. N. ECONOMIDES, 'Competition Policy in Network Industries: An Introduction' in D. JANSEN (ed.) *The New Economy and Beyond: Past, Present and Future*, Edward Elgar, Northampton 2006, 96-121. P.A. BUGUES, 'Competition Policy vs Sector-Specific Regulation in Network Industries – The EU Experience', paper submitted to UNCTAD's Seventh Session of the Intergovernmental Group of Experts on Competition Law and Policy, Geneva, 30.10-02.11.2006, available at <[http://unctad.org/sections/wcmu/docs/c2clp\\_ige7p14\\_en.pdf](http://unctad.org/sections/wcmu/docs/c2clp_ige7p14_en.pdf)> accessed 20.05.2013. A. DE STREEL, 'The Relationship between Competition Law and Sector Specific Regulation: The case of electronic communications' (2008) XLVII *Reflets et perspectives de la vie économique* 1, 55-72. G. MONTI, 'Managing the Intersection of Utilities Regulation and EC Competition Law' (2008) 4 *The Competition Law Review* 2, 123-145. J. TEMPLE LANG, 'European Competition Policy and Regulation: Differences, Overlaps and Constraints' in F. LÉVÈQUE and H. SHELANSKY (eds.) *Antitrust and Regulation in the EU and US: Legal and Economic Perspective*, Edward Elgar, Northampton 2010. P. IBÁÑEZ COLOMO, 'On the Application of Competition Law as Regulation: Elements for a Theory' in P. EECKHOUT and T. TRIDIMAS (eds.) *Yearbook of European Law*, Oxford University Press, Oxford 2010, pp. 261-306. L. ORTIZ BLANCO and A. LAMADRID DE PABLO, 'EU Competition Law Enforcement: Elements for a Discussion on Effectiveness and Uniformity' in B. HAWK (ed.) *International Antitrust Law & Policy: 2011 Annual Proceedings of the Fordham Competition Law Institute*, Juris Publishing, Huntington, N.Y. 2012, pp. 80-82 and roundtable discussion, pp. 137-138.

<sup>12</sup> This phenomenon is sometimes labelled 'regulatory antitrust'. See G. MONTI, *supra* n. 11, p. 138.

<sup>13</sup> EU legislative reforms encompass electricity and gas markets. This thesis studies the application of competition rules to the electricity sector only.

## 1.2. CONTEXT

*The purpose of this section is to explain the connection between commitment decisions, electricity sector and the objective of completing internal electricity market.*

### 1.2.1. *What are commitment decisions?*

Recital 13 of Regulation 1/2003<sup>14</sup> reads:

*Where, in the course of proceedings which might lead to an agreement or practice being prohibited, undertakings offer the Commission commitments such as to meet its concerns, the Commission should be able to adopt decisions which make those commitments binding on the undertakings concerned. Commitment decisions should find that there are no longer grounds for action by the Commission without concluding whether or not there has been or still is an infringement. Commitment decisions are without prejudice to the powers of competition authorities and courts of the Member States to make such a finding and decide upon the case. Commitment decisions are not appropriate in cases where the Commission intends to impose a fine.*

The option to close antitrust cases in this way is formally provided by Article 9 of Regulation 1/2003 which reads:

*(1) Where the Commission intends to adopt a decision requiring that an infringement be brought to an end and the undertakings concerned offer commitments to meet the concerns expressed to them by the Commission in its preliminary assessment, the Commission may by decision make those commitments binding on the undertakings. Such a decision may be adopted for a specified period and shall conclude that there are no longer grounds for action by the Commission.*

---

<sup>14</sup> Council Regulation (EC) No 1/2003 of 16.12.2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L 1/1.

(2) The Commission may, upon request or on its own initiative, reopen the proceedings:

- (a) where there has been a material change in any of the facts on which the decision was based;
- (b) where the undertakings concerned act contrary to their commitments; or
- (c) where the decision was based on incomplete, incorrect or misleading information provided by the parties.

When the Commission has concerns that a dominant undertaking engages in anticompetitive conduct<sup>15</sup> and decides to open an antitrust investigation under Article 102 TFEU, it faces the following procedural routes.<sup>16</sup> Firstly, it may decide that there are no grounds for action and close the case accordingly. Secondly, the investigation might show that the concerns are sufficiently serious to warrant further proceedings and the adoption of an infringement decision under Article 7. This is a standard infringement procedure whereby the Commission prohibits anticompetitive conduct in question and can impose a fine and/or remedies which can be behavioural or structural in nature. In order to do so, the Commission needs first to establish a breach of competition rules, i.e. that the undertaking is in fact dominant and that it abused its dominant position on the market. Lastly, as provided for in Article 9, if the

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<sup>15</sup> The same considerations apply to a situation when two (or more) undertakings enter into an anticompetitive agreement or concerted practice in violation of Article 101 TFEU. However, these types of infringements will not be discussed here. Even though commitment decisions are adopted in Article 101 cases as well, Article 102 constituted the legal basis of most energy-related cases, and they are the focus of this thesis.

<sup>16</sup> Initiation of proceedings pursuant to Article 11(6) of Regulation (EC) No 1/2003, *supra* n. 14. See also Commission notice on the best practices for the conduct of proceedings concerning Articles 101 and 102 TFEU [2011] OJ C 308/6, at point 2.3 and 2.13. The Commission can also act outside this procedural framework and settle a case by reaching an informal deal with an undertaking. In fact, such informal agreements (settlements) are common practice. See, for instance, the Commission's settlement with IBM, European Commission, XIV<sup>th</sup> Report on Competition Policy, 1984, paras. 94-95. Other examples include: *La Poste/SWIFT + GUF* (Case No IV/36.120), European Commission, XXVII<sup>th</sup> Report on Competition Policy, 1997, par. 68, *Wood Pulp* (here the settlement with the Commission involved only reductions in fines in exchange for promises from companies which were parties to a cartel, see joint cases C-89, 104, 114, 116, 117 & 125-129/85, *A. Ahlström Osakeyhtiö et al. v. Commission (Wood Pulp)* [1993] ECR I-1307), Digital Equipment (IP/97/857 of 08.10.1997), Marathon (IP/04/573 of 30.04.2004) and Interbrew (IP/04/574 of 30.04.2004). For a list of further examples, see R. WHISH, *Competition Law*, 5<sup>th</sup> ed., Oxford University Press, Oxford 2005, p. 210, or J. TEMPLE LANG, 'Commitment decisions under Regulation 1/2003 - legal aspects of a new kind of competition decision' (2003) 24 *European Competition Law Review*, pp. 347-356, at note 12. The notion of a 'settlement' is usually given a broad meaning in competition literature. It captures both formal (e.g. commitment decisions or U.S. consent decrees) as well as informal (i.e. reached outside the existing procedures) deals between a competition authority and the investigated undertakings (see *infra* n. 38). In this thesis the term 'settlement' is not used in the context of Article 9 commitment decisions in order to avoid confusion with these other types of settlement mechanisms.

anticompetitive concerns are serious and the Commission intents to pursue the proceedings and adopt an infringement decision, it does not have to go down the Article 7 route, if the undertaking is willing to negotiate and offer voluntary commitments addressing these concerns. As long as the Commission finds these commitments sufficient, it makes them binding upon undertaking in a *commitment decision*. Otherwise, it negotiates with the undertaking in order to reach a deal that is acceptable for both parties. In case negotiations over commitments fail, the Commission can always follow the standard infringement procedure, i.e. establish a breach of competition rules and adopt an Article 7 decision.<sup>17</sup>

#### 1.2.1.1. Potential benefits of commitment procedure and the incentives to engage in negotiations

Unlike a prohibition decision, a commitment decision does not establish an infringement of competition rules, which makes Article 9 procedure much quicker and simpler, thus attractive both for the Commission and for the undertakings alike. Negotiations over commitments might take some time,<sup>18</sup> but the Commission avoids an even more time-consuming and very often complex exercise of finding an abuse which would warrant an infringement decision and the imposition of remedies. Thus, Article 9 option enhances administrative efficiency and effectiveness of competition enforcement, because it allows the Commission to streamline its procedures in less important cases and focus on more serious anticompetitive practices.<sup>19</sup> Formal findings of Article 102 abuses usually undergo harsh public scrutiny, which further explains why the Commission might be inclined to use Article 9, especially in less straightforward cases.<sup>20</sup> Given their consensual nature, commitment decisions are

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<sup>17</sup> The Commission may also close the case for other reasons. Examples are provided by D. WAELBROECK, ‘The Development of a new “settlement culture” in competition cases. What is left to the Courts?’ in C. GHEUR and N. PETIT (eds.), *Alternative Enforcement Techniques in EC Competition Law*, Bruylant, Brussels 2009, 221-260, p. 225 at note 9.

<sup>18</sup> The *Microsoft* case (see Table 1) involved several rounds of negotiations over commitments before the Commission agreed to the proposed package.

<sup>19</sup> European Commission, *Report on the functioning of Regulation 1/2003*, Communication from the Commission, COM(2009) 206 final, Brussels, 29.04.2009, para. 13.

<sup>20</sup> D. GERARD, ‘Breaking the EU Antitrust Enforcement Deadlock: Re-Empowering the Courts?’ (2011), 36 *European Law Review*, 457-479, p. 464.

never appealed by the undertakings submitting commitments, so the Commission faces little risk of litigating the case in court.<sup>21</sup> Moreover, commitment decisions, if challenged at all, are only subject to a limited judicial review.<sup>22</sup> This is because, according to the European Court of Justice (ECJ), the Commission enjoys a substantial margin of discretion in making commitments binding or rejecting them, which the Courts do not wish to encroach upon.<sup>23</sup> Last but not least, commitments are not subject to the strict proportionality test applied to remedies imposed under Article 7, which in practice means that commitments may go beyond what is considered appropriate and necessary to remedy an anticompetitive problem.<sup>24</sup> In sum, negotiated process coupled with the Commission's discretion may produce more customised and innovative solutions than a fully contested proceeding under Article 7. Negotiations over commitments bring together the Commission's expertise in competition law compliance and the undertaking's sector-specific knowledge. Thus, the undertaking can make sure that its commitments demonstrate an economically viable and workable solution, whereas the Commission provides a clear set of competition guidelines for the undertaking's future business conduct. From this perspective, negotiated outcomes might prove to be useful in complex and novel cases, where *unilaterally* devising effective remedies under Article 7 would be not only costly, but generally problematic

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<sup>21</sup> Affected third parties and Member States might have some interest in challenging commitment decisions. However, only two commitment decisions have been appealed by third parties so far, and only one of them, the *ALROSA + de Beers* decision, has been reviewed by the European Courts (case T-170/06, *Alrosa v. Commission* [2007] ECR II-2601 and case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949). Two appeals following the *REPSOL* decision have been rejected on procedural grounds (cases T-274/06, *Estaser El Maren*, SL v. *Commission* [2007] ECR II-143 and T-45/08, *Transportes Evaristo Molina v. Commission* [2008] ECR II-265 (Orders of the General Court of 25.10.2007 and 14.11.2008 respectively). An appeal against the order in case T-45/08 is pending before the ECJ (case C-36/09 P, appeal brought on 28.01.2009, OJ C 82, 04.04.2009, 16-17). See *infra* Table 1 for cases.

<sup>22</sup> Judicial review of commitment decisions is confined to examining whether the Commission's assessment was manifestly incorrect (case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, par. 42). To the contrary, infringement decisions are (at least in theory) subject to full and unqualified review in law and in fact. In practice this is often not the case. Complex technical appraisals (usually economic assessments) carried out by the Commission are also subject to limited judicial review under the 'manifest error of assessment' standard. In practice, this excludes most Article 102 cases from full judicial review. For a recent account criticising the proliferation of the 'manifest error of assessment' standard see I.S. FORRESTER, 'A Bush in Need of Pruning: the Luxuriant Growth of "Light Judicial Review"' in C.-D. EHLMERMAN and M. MARQUIS (eds.) *European Competition Law Annual 2009: Evaluation of Evidence and its Judicial Review in Competition Cases*, Hart Publishing, Oxford 2011, available at <http://www.eui.eu/Documents/RSCAS/Research/Competition/2009/2009-COMPETITION-Forrester.pdf> accessed 20.05.2013, and also D. GERARD, *supra* n. 20. For the *Alrosa* case and its implications see *infra* n. 237.

<sup>23</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 90.

<sup>24</sup> See *infra* section 1.5.2.1 for discussion.

given the Courts' rather conservative stance on remedies.<sup>25</sup> Similarly, certain types of agreements (e.g. airline alliances) might be particularly suitable for an Article 9 decision, because the Commission can accept tailor-made commitments without trumping largely desirable and pro-competitive effects of these agreements.<sup>26</sup> The same reasoning lies behind a number of commitment cases involving intellectual property rights, which are indispensable to provide incentives to innovate, but which, at the same time, restrict competition.<sup>27</sup> In some cases, however, Article 9 might not be the Commission's preferred option. This is usually the case of blatant infringements of competition rules by 'object' (e.g. collusive practices) where sufficient punishment and deterrence effects can be achieved only by an infringement decision and imposition of fines. But there might be other cases, where, according to the Commission, potential benefits of finding an infringement (for instance, setting a clear precedence) outweigh efficiencies of commitment procedure.

An undertaking makes a cost benefit analysis too. It weighs the benefits of the commitment procedure (avoiding costly and possibly long proceedings with an unpredictable outcome, clear and immediate guidance on how to run its business in compliance with competition rules, control over the remedy package, insight into the

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<sup>25</sup> As Temple Lang forecasted in 2003, '[c]ommitments, duly negotiated, will probably be the way in which the Commission develops its so far rather unimaginative practice in relation to remedies.' J. TEMPLE LANG (2003), *supra* n. 16, p. 354. See also J. TEMPLE LANG, 'Commitment Decisions under Regulation 1/2003' in C. GHEUR and N. PETIT (eds.) *Alternative enforcement techniques in EC competition law: Settlements, commitments and other novel instruments*, Bruylants, Brussels 2009, 121-144, p. 142. See also F. WAGNER-VON PAPP, 'Best and even better practices in commitment procedures after *Alrosa*: The dangers of abandoning the "Struggle for Competition Law"' (2012) 49 *Common Market Law Review* 3, 929-970, pp. 965-966, suggesting that allowing the Commission to have more freedom in devising proactive remedies under Article 7 would make the standard infringement procedure more attractive.

<sup>26</sup> However, see critical comments by J. TEMPLE LANG (2009), *supra* n. 25, pp. 126-129, on the Commission's approach in the *AuA/SAS*, *SkyTeam* and *CISAC* cases. For a more supporting view on the Commission's commitment policy in airline sector see K. KOSTOPOULOS, 'Commitment Decisions: The New Kind of Settlement in European Competition Law. Application in Air Transport' (2009) 34 *Air and Space Law* 1, 13-19, pp. 16-17, who advocates the use of Article 9 in cases of airline alliances, because certain types of commitments like the release of slots to competitors, sharing with them frequent flyer programmes, or entering into interline or intermodal agreements might have substantial pro-competitive effects on the market. In the same line, S. RAB, D. MONNOYEUR and A. SUKHTANKAR, 'Commitments in EU Competition Cases. Article 9 of Regulation 1/2003, its application and the challenges ahead' (2010) 1 *Journal of European Competition Law & Practice* 3, 171-188, p. 177.

<sup>27</sup> E.g. agreements between collecting societies or joint selling of media rights for football matches. In this respect commitment decisions replace exemption decisions with conditions, which the Commission used to adopt in cases of such agreements under Regulation 17/62 (Council Regulation No 17 (EEC): First Regulation implementing Articles 85 and 86 of the Treaty [1962] OJ 013, 21.02.1962, 204-211, abolished by Regulation 1/2003, *supra* n. 14). See *infra* n. 48.

Commission's approach to investigation and its reasoning) and the absence of infringement (no fine<sup>28</sup>, reduced risk of follow-on private actions<sup>29</sup>, no negative publicity and the subsequent stigma of being in a dominant position) against the probability of winning the case in appeal. If the Commission has strong evidence indicating abusive conduct and the scope for contesting liability is limited, the undertaking might be willing to offer voluntary commitments. In more complex cases, where the Commission's theory of harm is less compelling, an undertaking might prefer to take the risk and litigate the case rather than offer commitments under Article 9. In practice, various other factors may influence this simple logic. For instance, even though an undertaking believes its conduct was legitimate and has a strong case, it might nevertheless prefer to keep a 'clean' record and a good relationship with the Commission and not to engage in contested proceedings.<sup>30</sup> It might also prefer to voluntarily offer certain commitments which do not materially affect its business than face the risk of fines or remedies imposed by the Commission. Further, it might have other strategic interests in offering certain commitments.<sup>31</sup>

It should be noted that the Commission used to make deals with the investigated undertakings and close antitrust cases in exchange of certain promises also before the

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<sup>28</sup> Recital 13 of Regulation 1/2003, *supra* n. 14, states that commitment decisions are not appropriate in cases in which the Commission intends to adopt a fine. Despite its misleading formulation, the aim of this provision is to exclude cases of competition law violations 'by object' (mostly cartels) and not all cases where fines are considered. See Commission notice on best practices, *supra* n. 16, para. 116: 'Commitment decisions are not appropriate in cases where the Commission considers that the nature of the infringement calls for the imposition of a fine. Consequently, the Commission does not apply the Article 9 procedure to secret cartels that fall under the Notice on immunity from fines and reduction of fines in cartel cases.' In practice, it has been observed that the Commission used to accept commitments in cases in which it would normally impose a fine under Article 7. For references, see *infra*, n. 207. See also comments by D. GERARD, *supra* n. 20, p. 459, who observes that the increase in antitrust fines 'together with the typical aversion of businesses to uncertainty, have rendered the temptation to offer commitments instead of litigating cases almost irresistible, to the point of becoming the norm.'

<sup>29</sup> F. WAGNER-VON PAPP, *supra* n. 25, at note 73, argues that even though damages actions do not pose a substantial threat in non-cartel cases for the time being in Europe but that the companies might also fear private actions seeking injunctive relief in the wake of an infringement decision.

<sup>30</sup> For similar arguments see F. WAGNER-VON PAPP, *supra* n. 25, p. 948.

<sup>31</sup> J. TEMPLE LANG (2009), *supra* n. 25, p. 134, discusses a scenario, where a dominant undertaking offers commitments not to discriminate on price or not to offer selective price reductions, which ultimately might be an excuse for not competing on price or for not offering selective discounts. As the author observes, 'a commitment that at first sight might seem to constrain only the interests of the dominant enterprise might in reality harm the interests of its customers.' The *E.ON* case discussed in chapter 3 is another illustrating example where the investigated undertaking might have strategic interests in offering certain commitments.

adoption of Regulation 1/2003.<sup>32</sup> However, settlements of this type were not enforceable, because they were reached outside the legal framework. All the Commission could do in cases of breach of such an informal deal was to reopen the case and follow the standard infringement route. Also the undertakings had no legal guarantee that the Commission's investigation was definitely over.<sup>33</sup> The novelty of Article 9 consists thus in making commitments binding and enforceable upon undertakings by a formal decision. On the one hand, the Commission can ensure compliance with the offered commitments. Namely, in case of a breach of a commitment, the Commission may not only reopen proceedings<sup>34</sup> (and maybe eventually adopt an infringement decision) but also impose heavy fines and periodic penalties, the same that it could impose pursuant to an infringement decision, but even without having to prove an infringement.<sup>35</sup> On the other hand, undertakings can be sure that the Commission formally closed its investigation.<sup>36</sup> <sup>37</sup> In sum, Article 9 commitment decisions combine the flexibility of a negotiated solution with legal certainty of a formal decision.<sup>38</sup>

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<sup>32</sup> For an overview of the Commission's settlement practice and criticism it provoked see I. VAN BAEL, 'The Antitrust Settlement Practice of the EC Commission' (1986) 23 *Common Market Law Review* 1, 61-90, or D. WAELBROECK, 'New Forms of Settlement of Antitrust Cases and Procedural Safeguards: Is Regulation 17 Falling Into Abeyance?' (1986) 11 *European Law Review*, 268-280. For examples of the Commission's settlements see *supra* n. 16.

<sup>33</sup> However, settlements may still give rise to legitimate expectations. See e.g. E. GIPPINI-FOURNIER, 'The Modernisation of European Competition Law: First Experiences with Regulation 1/2003' in H. KOECK and M. KAROLLUS (eds.) *The Modernisation of European Competition Law*, FIDE Congress, Linz 2008, or W.P.J. WILS, 'Settlement of EU Antitrust Investigations: Commitment Decisions under Article 9 of Regulation No. 1/2003' (2006) 29 *World Competition* 3, 345-366, p. 347.

<sup>34</sup> Article 9(2)(b) of Regulation 1/2003, *supra* n. 14.

<sup>35</sup> Article 23(2)(c) of Regulation 1/2003, *supra* n. 14, gives the Commission power to impose fines up to 10% of the undertaking's worldwide turnover for a breach of commitments. Further, on the basis of 24(1)(c) of Regulation 1/2003 the Commission can impose periodic penalties in order to ensure that the undertakings comply with the commitments.

<sup>36</sup> A commitment decision states that there are no longer grounds for action on the part of the Commission. Moreover, the Commission can reopen proceedings only in three exceptional cases listed in Article 9 (2).

<sup>37</sup> The existence of Article 9 does not prevent the Commission from entering into settlements outside the legal framework. In fact, the Commission has settled a few cases informally since Regulation 1/2003 entered into force.

<sup>38</sup> Commitment decisions can be seen as a part of a more general tendency in the EU competition enforcement to move away from litigation towards consensus-generating processes and negotiated solutions, just as the simultaneous use of settlements outside the legal framework or leniency programme in cartel cases.<sup>38</sup> As Commissioner Almunia said at the 2011 conference in St. Gallen, '[o]ne trend that is emerging from a growing number of antitrust cases is our search for effective — and sometimes structural — commitments when they would more efficiently prevent competition concerns in the longer term.' (SPEECH/11/243 of 08.04.2011). This shift towards 'negotiated solutions', or – as Denis Waelbroeck calls it – the emergence of a 'settlement culture' in the EU antitrust enforcement, has been pointed out and analysed by several commentators. See L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 73. D. WAELBROECK (2009), *supra* n. 17, pp.

### *1.2.2. Making the link with electricity markets*

Article 9 entered into force on 1 May 2004 as a provision of Regulation 1/2003<sup>39</sup> and has been widely discussed from the outset.<sup>40</sup> The novelty of Article 9 and its concise wording quickly raised a number of questions, both of material and procedural nature.<sup>41</sup> It seems that the Commission deliberately did not provide much guidance on the application of Article 9, but even emphasised that ‘the conditions for its use are flexible,’<sup>42</sup> leaving some discretion as to when and how use Article 9 in its future enforcement practice.<sup>43</sup>

And in fact, the Commission’s use of Article 9 has caused some controversy. Almost a decade has now passed since the adoption of Regulation 1/2003 and one can easily observe that commitment decisions have become an increasingly important tool in the EU competition law enforcement.<sup>44</sup> Contrary to the expectations that Article 9 would be used sparingly,<sup>45</sup> it actually became a common way of closing EU antitrust investigations.<sup>46</sup>

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221-260. D. GERARD, *supra* n. 20, pp. 457 and 465. F. WAGNER-VON PAPP, *supra* n. 25, p. 929 at note 1. See also D. WAELBROECK, ‘Le développement en droit européen de la concurrence des solutions négociées (engagements, clémence, non-contestation des faits et transactions): que va-t-il rester aux juges?’ (2008) GCLC (Global Competition Law Centre) Working Paper 01/08.

<sup>39</sup> *Supra* n. 14. Regulation 1/2003 is often called ‘the Modernisation Regulation’, as it introduced substantial changes to the EU competition enforcement.

<sup>40</sup> For references including recent accounts see *infra* n. 122.

<sup>41</sup> See *infra* n. 125.

<sup>42</sup> MEMO/04/217 of 17.09.2004.

<sup>43</sup> The Commission initially expected that commitment decisions would be adopted rather in exceptional cases, which might explain why Article 9 guidelines were low on its priority list in the early years of Regulation 1/2003. In fact, it took the Commission as much as 7 years to provide more guidance in that regard. See Commission notice on best practices, *supra* n. 16, paras. 115-133. See also recently adopted by the Commission, *Antitrust: Manual of Procedures*, Internal DG Competition working document on procedures for the application of Articles 101 and 102 TFEU, March 2012, available at [http://ec.europa.eu/competition/antitrust/information\\_en.html](http://ec.europa.eu/competition/antitrust/information_en.html) accessed 20.05.2013, chapter 16 on Commitment Decisions (pp. 177-188). Further, see comments of Davies during the ‘Settlements of Government Civil Proceedings and Private Actions Roundtable’ in B. HAWK (ed.) *International Antitrust Law and Policy: Fordham Corporate Law 2005*, Juris Publishing, New York 2006, pp. 352-353.

<sup>44</sup> S. RAB, D. MONNOYEUR and A SUKHANKAR, *supra* n. 26, p. 185.

<sup>45</sup> See e.g. M. FURSE, *supra* n. 11, 5 and 10. J. TEMPLE LANG, ‘Commitment Decisions and Settlements with Antitrust Authorities and Private Parties under European Antitrust Law’ and also comments made by Ducore during the ‘Settlements of Government Civil Proceedings and Private Actions Roundtable’, in B. HAWK (ed.) *International Antitrust Law and Policy: Fordham Corporate Law 2005*, Juris Publishing, New York 2006, 265-324, p. 270. R. WHISH, ‘Commitment Decisions Under Article 9 of the EC Modernisation Regulation: Some Unanswered Questions’ in M. JOHANSSON, N. WAHL and U. BERNITZ (eds.) *Liber Amicorum in Honour of*

Table 1 provides an overview of all antitrust cases closed by commitment decision over the course of eight years, between 2004 and 2012. Since the entry into force of Article 9, the Commission has adopted 30 commitment decisions. In contrast, only 17 prohibition decisions have been adopted in this period, out of which only 3 over the last 4 years.<sup>47</sup> A closer look at the targeted sectors allows for the following conclusions. First of all, the second half of the 2000s was marked by an increased antitrust intervention in the energy sector following the 2005 energy sector inquiry (discussed in section 1.2.3.2). As a result, energy-related cases constitute 1/3 of the Commission's overall commitment practice (cases highlighted in red), half of which in the electricity sector.<sup>48</sup> Second, whereas the Commission adopted commitment decisions both in cases of anticompetitive agreements (Article 101 TFEU<sup>49</sup>) as well as

*Sven Norberg: A European for All Seasons*, Bruylant, Brussels 2006, p. 564. E. GIPPINI-FOURNIER, *supra* n. 33, p. 43.

<sup>46</sup> For a discussion on the optimal use of commitment decisions see *infra* section 1.5.1.1.

<sup>47</sup> Table 1 does not report prohibition decisions, as well as the few cases which have been still settled informally. Four commitment decisions listed in this table have been adopted in one case regarding major car manufacturers (cases 8-11). Also the two decisions on wholesale and balancing markets (12 and 13) were adopted in one investigation against E.ON. In 4 open antitrust investigations commitments have already been offered. This calculation excludes cartels, because they always involve fines and commitment decisions are not appropriate in such cases (see Recital 13 of Regulation 1/2003, n. 14 above). For a list of settlements post-2004, see S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 174, Table 1.

<sup>48</sup> Another visible trend is a substantial number of cases involving intellectual property rights (17 cases marked with a star, see Table 1). This latter trend might be explained by the particular nature of IP rights. Where allegedly anticompetitive behaviour often demonstrates pro-competitive effects, negotiating a tailor-made commitment package might reflect a more balanced approach than a prohibition decision. In particular, this is the case of agreements of collecting societies (*Cannes Agreement*) and joint selling of media rights for popular sport events (*Deutsche Bundesliga* and *Premier League*). E.g. in all these cases agreements were ultimately approved, just subject to certain conditions. Further, many of these cases needed fast procedures and quickly implemented remedies, as they involved high-tech industries. Lengthy infringement proceedings (often protracted by an appeal) would not keep pace with these dynamic and constantly changing markets, so commitment decisions might have been more practical. See J. TEMPLE LANG (2006), *supra* n. 45, p. 292-293, S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 179, as well as comments by Bruno Lasserre in L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 133 (roundtable discussion). Whish also suggests that the first commitment cases were a way of dealing with a backlog of troublesome cases left by Regulation 17/62, *supra* n. 27 (e.g. cases concerning media and music rights). See R. WHISH (2006), *supra* n. 45, 564. In the same line G.S. GEORGIEV, 'Contagious Efficiency: The Growing Reliance on U.S.-Style Antitrust Settlements in EU Law' (2007) *Utah Law Review* 4, 971-1037, 1002. For a more detailed overview of these cases see H. SCHWEITZER, 'Commitment Decisions under Article 9 of Regulation 1/2003: The Developing EC Practice and Case Law' in C.-D. EHLMERMAN and M. MARQUIS (eds.) *European Competition Law Annual 2009: Antitrust Settlements under EC Competition Law*, Hart Publishing, Oxford and Portland 2010, available online as EUI (European University Institute) Working Paper LAW 2008/22, pp. 5-10 of the working paper. For a similar practice developing at the national level see H. SCHWEITZER, 'Commitment Decisions in the EU and in the Member States: Functions and risks of a new instrument of competition law enforcement within a federal enforcement regime' (2012) *e-Competitions Bulletin* (Special Issue on Commitment Decisions, August 2012), preliminary draft available online at <http://ssrn.com/abstract=2101630> accessed 20.05.2013, at notes 60-64 and the accompanying text.

<sup>49</sup> Treaty on the Functioning of the European Union. Further referred to as the 'Treaty'.

abuses of dominance (Article 102 TFEU), energy-related commitments were accepted predominantly in abuse of dominance cases.<sup>50</sup>

Table 1. Overview of antitrust cases closed by commitment decision between 2004 and 2012.

No	CASE	CASE REFERENCE	SECTOR	YEAR	LEGAL BASIS
1	<i>Deutsche Bundesliga*</i>	COMP/37.214	TV, broadcasting	2005	101
2	<i>Coca-Cola</i>	COMP/39.116	soft drinks	2005	102
3	<i>ALROSA/de Beers group</i>	COMP/38.381	mining	2006	102
4	<i>Premier League*</i>	COMP/38.173	TV, broadcasting	2006	101
5	<i>REPSOL</i>	COMP/38.348	fuels	2006	101
6	<i>Cannes Agreement*</i>	COMP/38.681	recorded media	2006	101
7	<i>Distrigaz</i>	COMP/37.966	energy (gas)	2007	102
8	<i>Daimler Chrysler*</i>	COMP/39.140	motor vehicles	2007	101
9	<i>Fiat*</i>	COMP/39.141	motor vehicles	2007	101
10	<i>Toyota Motor Europe*</i>	COMP/39.142	motor vehicles	2007	101
11	<i>Opel / GM*</i>	COMP/39.143	motor vehicles	2007	101
12	<i>E.ON – wholesale market</i>	COMP/39.388	energy (electricity)	2008	102
13	<i>E.ON – balancing market</i>	COMP/39.389	energy (electricity)	2008	102
14	<i>RWE gas foreclosure</i>	COMP/39.402	energy (gas)	2009	102
15	<i>IACS – Ship Classification*</i>	COMP/39.416	ship classification	2009	102
16	<i>GDF foreclosure</i>	COMP/39.316	energy (gas)	2009	102
17	<i>RAMBUS*</i>	COMP/38.636	computers	2009	102
18	<i>Microsoft*</i>	COMP/39.530	computers	2009	102
19	<i>Long term el. contracts (F)</i>	COMP/39.386	energy (electricity)	2010	102
20	<i>Swedish Interconnectors</i>	COMP/39.351	energy (electricity)	2010	102
21	<i>E.ON gas foreclosure</i>	COMP/39.317	energy (gas)	2010	102
22	<i>BA/AA/IB</i>	COMP/39.596	airline	2010	101
23	<i>ENI</i>	COMP/39.315	energy (gas)	2010	102
24	<i>Visa (MIF)</i>	COMP/39.398	financial services	2010	101
25	<i>Standard and Poor's</i>	COMP/39.592	financial services	2011	102
26	<i>IBM Maintenance Service*</i>	COMP/39.692	computers	2011	102

<sup>50</sup> A relatively high number of 102 cases among commitment cases is remarkable, given that Article 101 investigations usually prevail in the EU competition enforcement, whereas Article 102 cases are less common. Moreover, as D. GERARD, *supra* n. 20, p. 464, notices, most Article 102 cases are now closed under Article 9. He explains that the Commission might prefer to accept commitments in Article 102 cases just to avoid public scrutiny of formal findings of abuses.

27	<i>SIEMENS / AREVA</i>	COMP/39.736	energy (electricity)	2012	101 & 102
28	<i>Rio Tinto Alcan*</i>	COMP/39.230	aluminium	2012	102
29	<i>Thomson Reuters*</i>	COMP/39.654	financial services	2012	102
30	<i>Ebooks*</i>	COMP/39.847	sale of e-books	2012	101
31	<i>CEZ &amp; others</i>	COMP/39.727	energy (electricity)	open <sup>1</sup>	102
32	<i>AC/LH/UA/</i>	COMP/39.595	airline	open <sup>2</sup>	101
33	<i>SABAM (Belgium)*</i>	COMP/39.151	recorded media	- <sup>3</sup>	101
34	<i>BUMA (Netherlands)*</i>	COMP/39.152	recorded media	- <sup>3</sup>	101
35	<i>CISAC Agreement*</i>	COMP/38.698	recorded media	- <sup>4</sup>	101
36	<i>AuA/SAS</i>	COMP/37.749	airline	- <sup>5</sup>	101
37	<i>SKYTEAM</i>	COMP/37.984	airline	- <sup>6</sup>	101

\* Cases involving intellectual property issues.

<sup>1</sup> Commitments offered and Market Test Notice issued on 10.07.2012.

<sup>2</sup> Commitments offered on 21.12.2012.

<sup>3</sup> Commitments offered on 25.04.2005 (BUMA) and 10.05.2005 (SABAM), Market Test Notice issued on 03.08.2005. No formal Article 9 decision.

<sup>4</sup> Some of the Societies offered commitments. The Commission did not accept them and issued an infringement decision on 16.07.2008. Several societies appealed to the EGC, appeals are pending (see cases T-398/08, OJ C 285, 08.11.2008, p. 53, T-401/08, OJ C 313, 06.12.2008, p. 38, and T-422/08, OJ C 327, 20.12.2008, pp. 31–32).

<sup>5</sup> Commitments offered on 12.07.2005, Market Test Notice issued on 22.09.2005, closure of proceedings on 13.03.2008.

<sup>6</sup> Commitments offered on 19.10.2007, closure of proceedings on 26.01.2012.

Source: Own table based on the Commission's record of cases between 1.05.2004 (Regulation 1/2003 entered into force) and 1.01.2013, available at <http://ec.europa.eu/competition/antitrust/cases/index.html> accessed 20.05.2013.

In order to better illustrate this trend, Table 2 lists all antitrust investigations launched between 2004 and 2012 in the energy sector. At present,<sup>51</sup> antitrust enforcement in the energy sector amounts to 20 investigations and 14 in the electricity sector only. 13 investigations have been closed, and only three of them did not follow the commitment route (highlighted in blue).

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<sup>51</sup> At the time of writing this chapter (01.2013).

Table 2. Energy antitrust investigations 2004 – 2012.

No	CASE	CASE REFERENCE	YEAR	LEGAL BASIS	DECISION
1	<i>Distrigaz</i>	COMP/37.966	2007	102	commitments
2	<i>German el. wholesale market*</i>	COMP/39.388	2008	102	commitments
3	<i>German el. balancing market*</i>	COMP/39.389	2008	102	commitments
4	<i>RWE gas foreclosure</i>	COMP/39.402	2009	102	commitments
5	<i>E.ON / GDF*</i>	COMP/39.401	2009	101	infringement
6	<i>GDF foreclosure</i>	COMP/39.316	2009	102	commitments
7	<i>French long term contracts*</i>	COMP/39.386	2010	102	commitments
8	<i>Swedish Interconnectors*</i>	COMP/39.351	2010	102	commitments
9	<i>E.ON gas foreclosure</i>	COMP/39.317	2010	102	commitments
10	<i>ENI</i>	COMP/39.315	2010	102	commitments
11	<i>SIEMENS / AREVA*</i>	COMP/B-1/39.736	2012	101, 102	commitments
12	<i>Belgian long term contracts*</i>	COMP/39.387	2011	102	no decision
13	<i>Greek lignite*</i>	COMP/38.700	open <sup>1</sup>	106(1), 102	infringement
14	<i>French el. wholesale market*</i>	COMP/39.442	open <sup>2</sup>	102	-
15	<i>CEZ &amp; others*</i>	COMP/39.727	open <sup>3</sup>	102	-
16	<i>Deutsche Bahn II*</i>	COMP/39.731	open <sup>4</sup>	102	-
17	<i>Upstream gas suppliers in CEE</i>	COMP/39.816	open <sup>5</sup>	101, 102	-
18	<i>Power exchanges*</i>	COMP/39.952	open <sup>6</sup>	101	-
19	<i>BEH Electricity</i>	COMP/39.767	open <sup>7</sup>	102	-
20	<i>OPCOM / Romanian PX</i>	COMP/39.984	open <sup>8</sup>	102	-

\* Electricity-related cases.

<sup>1</sup> The case was re-opened in 2011. The 2008 decision found an infringement of Article 106 (1) TFEU read in combination with Article 102 TFEU. In order to comply with this decision, Greece proposed measures which were subsequently made binding by the Commission in 2009. Following changes in Greek national energy policy, the Greek government proposed an alternative set of measures in 2011. These new measures are currently market tested. For a more detailed discussion of this case, see section 1.4.

<sup>2</sup> Inspections on 11.03.2009.

<sup>3</sup> Commitments offered and Market Test Notice issued on 10.07.2012.

<sup>4</sup> Opening of proceedings on 13.06.2012.

<sup>5</sup> Opening of proceedings on 04.09.2012.

<sup>6</sup> Inspections on 07.02.2012.

<sup>7</sup> Opening of proceedings on 04.12.2012.

<sup>8</sup> Opening of proceedings on 06.12.2012.

Source: Own table based on the Commission's record of cases between 1.05.2004 (Regulation 1/2003 entered into force) and 1.01.2013, available at [http://ec.europa.eu/competition/sectors/energy/cases\\_en.html](http://ec.europa.eu/competition/sectors/energy/cases_en.html) accessed 20.05.2013.

The first one concerned a market-sharing agreement between E.ON and GDF Suez regarding the MEGAL pipeline. According to Recital 13 of Regulation 1/2003 (cited above) and the Commission's memorandum of 2004 commitments are not appropriate in cases where the Commission intends to impose a fine.<sup>52</sup> This suggests that hard-

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<sup>52</sup> MEMO/04/217 of 17.09.2004. See also R. WHISH (2006), *supra* n. 45, 558.

core restrictions to competition (like E.ON/GDF market-sharing cartel) require a finding of an infringement followed by a punishment and thus warrant an infringement decision.<sup>53</sup> The second one involves an investigation into alleged vertical foreclosure of the Belgian electricity market by Electrabel, where the Commission, having investigated the case, decided not to pursue it. The third investigation is not a regular antitrust case, but an action against Greece under Article 106 TFEU in connection with Article 102 TFEU. The Commission accused the Greek state of breaching competition rules by securing privileged access to lignite to PPC, its state-owned electricity supplier. Following an appeal from PPC, the General Court annulled the Commission's decision in 2012 and the case is currently pending before the ECJ. The *Greek lignite* case is discussed in more details in section 1.4 below.

The remaining 10 energy antitrust investigations are abuse of dominance cases closed under Article 9. This shows that (1) commitment decisions have been the most common way of closing antitrust cases in the energy sector and (2) antitrust enforcement in energy boils down to abuse of dominance cases. One could speculate about the reasons for this trend. In particular, a high number of Article 102 cases (the second observation) might be explained by the structure of the European deregulated energy markets, in which former legal monopolists remained dominant players in open market conditions and concerns that they might be abusing their dominance are legitimate. Article 102-based concerns might in turn explain the inclination towards commitment decisions in the energy cases (the first observation). The concept of abuse of dominance is far from clear-cut,<sup>54</sup> which makes an outcome of a fully contested Article 102 case difficult to predict. The prospect of going through drawn-

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<sup>53</sup> The Commission imposed heavy fines on E.ON and GDF totalling 1,106 billion EUR (553 million EUR each). These were the first fines imposed by the Commission for an antitrust infringement in the energy sector and the second highest fine ever imposed by the Commission. See IP/09/1099 of 08.07.2009 and J. BATTISTA, A. GEE and U. VON KOPPENFELS, ‘Commission imposes heavy fine on two major European gas companies for operating a market-sharing agreement (2009) *Competition Policy Newsletter* 3, 38-40. Both undertakings appealed to the General Court which eventually reduced the fine for each undertaking to 320 million EUR due to the Commission's errors regarding the duration of the infringement. See case T-360/09, *E.ON Ruhrgas and E.ON AG v. Commission* [2012] n.y.r., and case T-370/09, *GDF Suez SA v. Commission* [2012] n.y.r. (GC judgments of 29.06.2012).

<sup>54</sup> See J. TEMPLE LANG (2006), *supra* n. 45, 272, at note 17. On unresolved issues regarding pricing abuses see discussion by J. TEMPLE LANG and R. O'DONOOGHUE, ‘Defining Legitimate Competition: How to Clarify Pricing Abuses under Article 82 EC’ (2002) 26 *Fordham International Law Journal*, 83-162.

out proceedings and dwelling over complex abuse of dominance issues might prompt both parties into Article 9 negotiations.<sup>55</sup> On the one hand, the possibility of closing a case by accepting commitments might encourage the Commission to come up with abuse of dominance concerns, as it will not be required to prove them at a later stage in order to establish an infringement of Article 102. On the other hand, year-long proceedings and outcome uncertainty might also explain why undertakings are not venturing into litigation but are willing to offer commitments instead. What further increases incentives to offer commitments in Article 102 cases on the part of the undertakings are little chances of a successful appeal. If they eventually decide to challenge the Commission's decision (which would substantially protract the case and involve additional litigation costs), the European Courts refuse to review Article 102 decisions on substantial grounds as these usually involve 'complex technical appraisals'.<sup>56</sup> As a result, the Commission hasn't lost any Article 102 case in court yet.<sup>57</sup> Further, those Article 101 cases which involve collusive practices (infringement 'by object') usually necessitate a fine and this excludes Article 9 from the outset.<sup>58</sup> For Article 102 abuses it might be more important to make an (allegedly) dominant undertaking aware of what it can and cannot do in order to comply with competition rules. And this can be reached with a commitment decision. But this is not the end of the story. As argued in this thesis, a relatively high number of Article 102 actions against energy incumbents primarily relates to the Commission's objective to create an internal market for electricity. The following paragraphs take a closer look at this link.

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<sup>55</sup> Also prior to Regulation 1/2003 most significant antitrust settlements involved abuse of dominance concerns. See J. TEMPLE LANG (2003), *supra* n. 16, p. 353, J. TEMPLE LANG (2006), *supra* n. 45, p. 292, at note 36, G.S. GEORGIEV, *supra* n. 48, 996, or H. SCHWEITZER (2010), *supra* n. 48, p. 9 of the working paper. S. RAB, D. MONNOYEUR and A SUKHTANKAR, *supra* n. 26, p.178.

<sup>56</sup> Commission decisions resulting from 'complex technical appraisals' are subject to limited judicial review. See e.g. case T-201/04, *Microsoft v. Commission* [2007] ECR II-3601, para. 88.

<sup>57</sup> Appeals of Article 102 decisions were successful only on secondary procedural issues. L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, pp. 76-77. D. GERARD, *supra* n. 20, p. 465.

<sup>58</sup> *Supra* n. 28. For references see *infra* n. 207.

### *1.2.3. What's at stake? – Internal market for electricity*

In the recent communication on the internal energy market the Commission points out the key role of competition rules in ensuring a level playing field and signals that it will continue to actively enforce competition rules in the energy markets.<sup>59</sup> This is not a new message. The Commission has been plainspoken from the outset about its plans to enforce competition rules in the energy sector and the underlying reason: fostering liberalisation and integration of electricity and gas markets.<sup>60</sup> Promoting market integration has always been one of the main goals driving the EU competition policy, reflected by the 50 years of EU competition enforcement and recognised by the European courts.<sup>61</sup> Moreover, competition rules have recently proved to be an apt tool in liberalising telecommunications sector<sup>62</sup> and it was believed that harnessing them again to foster the completion of the internal energy market would deliver positive results as well.

Without taking an *a priori* view on whether it is legitimate to use competition rules for this purpose or not, the following paragraphs briefly outline the major steps in the liberalisation and integration of electricity markets, highlighting the involvement of competition law, and more specifically commitment decisions, in this process.

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<sup>59</sup> European Commission, *Making the internal energy market work*, supra n. 6, p. 8.

<sup>60</sup> N. KROES, ‘More competitive energy markets: building on the findings of the sector inquiry to shape the right policy solutions’, SPEECH/07/547 of 19.09.2007, European Energy Institute, Brussels.

<sup>61</sup> EU competition policy is guided not only by economic but also political and social goals, like promoting market integration, economic freedom, ensuring fair market access and level playing field, protecting small enterprises and other policy considerations. Promoting (and then protecting) internal market was the Commission’s primary concern especially in the early days of the EU integration. The first three decades of competition enforcement were dominated by cases involving restrictions to cross-border trade, which reflected the Commission’s enforcement priorities. See the flagship cases 56/64 & 58/64, *Établissements Consten SARL & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, 27/76, *United Brands v. Commission* [1978] ECR 207 and C- 33/94 P, *Tetra Pak v. Commission* [1994] ECR II- 5951. However, even now, despite the recent shift towards economic efficiency and consumer welfare, other non-economic goals are still present in the EU competition enforcement, albeit less pronounced. For a comprehensive debate on the EU competition policy objectives, see M. MOTTA, *Competition Policy. Theory and Practice*, Cambridge University Press, Cambridge 2004, pp. 17-30. A. JONES and B. SUFRIN, *EC Competition Law*, 2<sup>nd</sup> ed., Oxford University Press (OUP), Oxford 2004, pp. 3-18. R. WHISH (2005), supra n. 16, pp. 17-23.

<sup>62</sup> Supra n. 11.

Nowadays it is not possible to discuss EU energy policy without mentioning climate change issues. The European Union shifts to a low-carbon economy.<sup>63</sup> This transition is going to have an unprecedented impact on the energy sector and requires a well-functioning, competitive and fully integrated electricity and gas markets across Europe. At the meeting of the European Council last year, the EU leaders called thus for urgent completion of the internal energy market, a process which started already in the mid 1990s.<sup>64</sup>

Electricity markets in Europe used to be regulated. Each European country usually had one vertically integrated and state-owned company which enjoyed monopoly rights for electricity supply across the country (electricity incumbent). In simple terms, creating the internal market for electricity involves two major processes. The first one is **market liberalisation**,<sup>65</sup> by which monopoly rights awarded to electricity incumbents are abolished and markets open up to (national) competition. The second one is **market integration**, by which differences in national market designs are eliminated, which facilitates cross-border trade in electricity and cross-border competition can take place. These two processes often run in parallel. However, cross-border trade cannot take place if national markets are not deregulated, so market integration is to some extent preconditioned by market liberalisation. Market integration also requires substantial investments in interconnectors<sup>66</sup> in order to provide sufficient transmission capacity to accommodate cross-border electricity flows.

Liberalisation and integration of electricity and gas markets have been gradually implemented across Europe primarily by a centrally driven programme of reforms at

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<sup>63</sup> European Commission, *Energy Roadmap 2050*, Communication from the Commission, COM/2011/0885 final, Brussels, 15.12.2011.

<sup>64</sup> Supra n. 7

<sup>65</sup> This thesis refers to market liberalisation in the broad sense, which comprises both deregulation (market liberalisation in the narrow sense) as well as all regulatory measures which are intended to inject more competition in the market.

<sup>66</sup> Cross-border electricity transmission lines.

the EU level.<sup>67</sup> The following paragraphs briefly describe the main steps of this process and what has been achieved so far. A fully-fledged discussion of these reforms is beyond the scope of this thesis.<sup>68</sup> Rather, the following summary provides necessary context for the subsequent chapters. Inasmuch as this thesis focuses on electricity, the measures discussed here apply to electricity markets only.

#### 1.2.3.1. Early legislative reforms – the 1<sup>st</sup> and the 2<sup>nd</sup> Energy Package

The 1997 Electricity Directive brought about important structural and regulatory changes and as such constituted the first big step in a long and difficult process of liberalisation and integration of national electricity markets.<sup>69</sup> First of all, legal monopolies were abolished in order to allow new market entry in generation and supply segments. Construction of new generation capacity was made possible through standard licensing or tendering procedures. Markets were supposed to open to competition gradually and the directives set minimum targets for that as well. First were the large consumers to choose their supplier.<sup>70</sup> Transmission and distribution services remained regulated, but all competitors were given free and fair access to networks by means of a ‘regulated’ or ‘negotiated’ Third Party Access (TPA). Given that grids were owned by vertically integrated energy companies, directives provided for minimum unbundling requirements (separation of accounts and ‘Chinese walls’).

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<sup>67</sup> Whereas some Member States started to open up their energy markets to competition before it was required by the EU legislation (e.g. the UK and the Nordic countries), the liberalisation process in Europe would be much slower without a coordinated liberalisation and integration policy at the EU level. See T. JAMASB and M. POLLITT, ‘Electricity Market Liberalisation and Integration in the European Union’ (2006) CESifo DICE Report 2/2006.

<sup>68</sup> For a comprehensive discussion of the EU energy reforms see e.g. C. JONES, *EU Energy Law: The Internal Energy Market – Volume 1*, 2<sup>nd</sup> ed., Claeys & Casteels, Leuven 2006. P.D. CAMERON, *Competition in Energy Markets: Law and Regulation in the European Union*, Oxford University Press, Oxford 2007. A more detailed summary is provided by F. DE LA PEÑA FERNÁNDEZ-GARNELO, ‘Has Merger Control Made a Contribution Towards the Liberalisation of the Gas and Electricity Markets in the EU?’(2012) doctoral thesis 0234750/02, King’s College London, 2012, 104-115.

<sup>69</sup> Directive 96/92/EC of the European Parliament and of the Council of 19.12.1996 concerning common rules for the internal market in electricity [1997] OJ L 27/1. Before that, minor harmonisation at the EU level took place in 1990 regarding transparency of electricity prices and electricity transit. See Council Directive 90/377 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users [1990] OJ L 185/16 and Council Directive 90/547 on the transit of electricity through transmission grids [1990] OJ L 313/33.

<sup>70</sup> For a detailed discussion on the first Electricity Directive, see M. MARQUIS, *Introducing Free Markets & Competition to the Electricity Sector in Europe*, Wisdom House, Leeds 2001, p. 76.

Further, Member States were required to appoint independent transmission system operators in charge of operation, maintenance and development of transmission grids. Similarly, newly designated distribution system operators were responsible for distribution networks.

This first step towards electricity liberalisation proved insufficient. Despite market opening in generation and supply, competition did not happen in these segments. Markets were still highly concentrated. A wave of energy mergers in the aftermath of liberalisation resulted in even higher concentration rates and further discouraged new entry.<sup>71</sup> Unbundling requirements imposed on vertically integrated incumbents weren't strong enough to prevent discriminatory behaviour. Further, the first Directive allowed for national competition, but it was criticised for failing to address cross-border trade in electricity.<sup>72</sup> More far-reaching market reforms seemed essential to allow for more competition and create conditions for market integration. The 2<sup>nd</sup> Energy Package was adopted in 2003 and included a new Electricity Directive and a Regulation on cross-border trade in electricity.<sup>73</sup> This 2<sup>nd</sup> Electricity Directive brought about full market opening by 2007. Also, it reinforced the existing provisions with respect to network unbundling (legal, managerial) and network access ('regulated' TPA only). The Directive strengthened the role of regulatory oversight. Member States were required to establish a regulatory body with substantial powers and independent from the electricity business.<sup>74</sup> Among others, these national regulators were supposed to monitor interconnector capacity and ensure a non-discriminatory

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<sup>71</sup> These mergers were strongly supported by governments which aimed to promote their 'national champions'. See A. G. SOARES, "National Champions" Rhetoric in European Law. Or many faces of protectionism' (2008) 31 *World Competition: Law and Economics Review* 3, pp. 353-368.

<sup>72</sup> See B. EBERLEIN, 'Regulation by Cooperation: The "Third Way" in Making Rules for the Internal Energy Market' in P. D. CAMERON (ed.), *Legal Aspects of EU Energy Regulation. Implementing the New Directives on Electricity and Gas Across Europe*, Oxford University Press, Oxford 2005, p. 64. G. MONTI, *EC Competition Law*, Cambridge University Press, Cambridge 2007, p. 462.

<sup>73</sup> Directive 2003/54/EC of the European Parliament and of the Council of 26.07.2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC [2003] OJ L 176/37. Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26.06.2003 on conditions for access to the network for cross-border exchanges in electricity [2003] OJ L 176/1.

<sup>74</sup> Article 23 of Directive 2003/54/EC, *supra* n. 73. The provision refers to the regulators' independence from the interests of the industry, but does not speak about their independence from the government.

access to the networks.<sup>75</sup> Cross-border electricity exchange was for the first time addressed in a separate and directly applicable Regulation in a more comprehensive way (Cross-border Regulation).<sup>76</sup>

### 1.2.3.2. The use of competition toolbox – energy sector inquiry and the follow-up actions

While the implementation of the 2<sup>nd</sup> Energy Package advanced slowly and in fits and starts in the face of national protectionism, Regulation 1/2003 opened up new possibilities to use antitrust enforcement in order to support or sometimes even substitute efforts made on the regulatory and political fronts. Electricity liberalisation required good knowledge of the markets, quick actions and major structural changes. The new antitrust provisions, which empowered the Commission to carry out sector inquiries,<sup>77</sup> adopt commitment decisions and impose structural remedies, created a toolbox of particular value to implement the Commission's conception of the competitive electricity markets.

In 2005 it became obvious that the second wave of reforms had not removed the key obstacles to competition: high market concentration and the presence of vertically integrated firms. Electricity wholesale prices not only did not drop, as expected, but even started to rise slowly. The lack of progress and dissatisfaction of energy-

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<sup>75</sup> TSOs were required to submit network access tariffs (or at least their calculation methods) to national regulators for authorisation.

<sup>76</sup> Regulation 1228/2003, *supra* n. 73, was the outcome of discussions undertaken within the Florence Electricity Regulatory Forum. Established in 1998, the Florence Forum is a platform to discuss the creation and development of the internal electricity market. Participants include governments of the Member States, national regulators, the Commission and, most importantly, market participants: TSOs, traders, consumers, grid users and power exchanges. For more information on the Florence Forum see e.g. C. MUSIALSKI, 'The ENTSO's Under the Third Energy Package' in B. DELVAUX, M. HUNT and K. TALUS (eds.), *EU Energy Law and Policy Issues*, ELRF Collection 3, Intersentia 2011, p 37.

<sup>77</sup> Sector inquiries were carried out also before the 2004 reform, on the basis of Article 12 of Regulation 17/62, *supra* n. 27 (e.g. the 1999 telecommunications sector inquiry or the 2004 inquiry into sports rights to Internet and 3G mobile operators). However, despite the similar wording of the two articles, the Commission launched sector inquiries under the old provision only occasionally. This might be explained by the fact, that the previous system of notifications and exemptions provided the Commission with constant flow of market information and also left it less time and resources to seek such information on its own initiative. See more on this and generally on the role of sector inquiries in the EU competition law G. OLSEN and B. ROY, 'The New World of Proactive EC Antitrust Enforcement? Sector Inquiries by the European Commission' (2007) 21 *Antitrust* 3, 82-88, 82.

intensive consumers prompted the Commission to make use of competition policy instruments and launch a **sector inquiry** into the functioning of the electricity and gas markets.<sup>78</sup>

A sector inquiry is a comprehensive fact-finding exercise, an extensive investigation usually into a particular industry<sup>79</sup> which raises competition concerns and is therefore of potential interest for competition enforcement. The Commission's powers to conduct sector inquiries are set forth in Regulation 1/2003, the same which regulates commitment procedure. According to Article 17, the Commission may open an inquiry into a sector in which 'the trend of trade between Member States, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the common market.' The provision appears very broad in scope when it comes to indicating which industries may be subject to an inquiry and what might be the reasons for it. It basically allows the Commission to take action on the basis of a vaguely defined 'restriction' or 'distortion' of competition.<sup>80</sup> If the sector inquiry confirms anticompetitive concerns, the Commission may then follow up with individual antitrust actions under Article 101 and 102 TFEU. Sector inquiries can be therefore considered a 'curtain-raiser' of competition enforcement preparing the ground for individual antitrust proceedings.<sup>81</sup>

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<sup>78</sup> European Commission, *Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors*, Communication from the Commission, COM(2006)851 final, Brussels 10.01.2007, as well as European Commission, *DG Competition report on energy sector inquiry*, SEC(2006)1724, Brussels, 10.01.2007 (in the following 'Final Report'). Documents are available at <http://ec.europa.eu/competition/sectors/energy/inquiry/index.html> accessed 20.05.2013.

<sup>79</sup> The Commission may also investigate in this way a certain type of agreements across various sectors (see Art. 17 Regulation 1/2003, *supra* n. 14) In practice, however, inquiries targeting a particular sector of economy have been more common so far.

<sup>80</sup> See A. VAN HAASTEREN and G.S. GEORGIEV, 'Commission launches inquiries into the energy and financial service sectors' (2005) 3 *Competition Policy Newsletter*, Autumn Issue, 51-53, p. 51: 'Essentially, the Commission can open a sector inquiry if it has concerns that competition may not be working as well as it should but the reasons for that are unclear.' In comparison to this, launching an individual investigation would require a more specific reason, e.g. a suspicion that an infringement of competition rules has occurred. See N. PETIT and M. RATO, 'From Hard to Soft Enforcement of EC Competition Law – A Bestiary of "Sunshine" Enforcement Instruments' in C. GHEUR and N. PETIT (eds.) *Alternative enforcement techniques in EC competition law: Settlements, commitments and other novel instruments*, Bruylants, Brussels 2009, p. 200.

<sup>81</sup> In this line G. OLSEN and B. ROY, *supra* n. 77, 83. For a different view, see N. PETIT and M. RATO, *supra* n. 80, pp. 200-201.

Highly concentrated electricity and gas markets with barriers to entry and rising wholesale prices made a good candidate for a sectoral screening.<sup>82</sup> In early 2005 the Commission announced a more pro-active application of competition rules in the energy sector and underlined its role in shaping European competitive markets.<sup>83</sup> The energy sector inquiry was opened a few months later, and the Commission for the first time mentioned the use of competition rules to foster energy market liberalisation and integration, as a complementary instrument to reforms taking place on the EU regulatory front.<sup>84</sup> The inquiry took two years. In 2007 the Commission issued a report summarising its findings (Final Report). The main conclusion was that the process of market liberalisation has not delivered expected results and European electricity and gas markets are not functioning as they should. The Final Report pointed at several competition problems which mostly stemmed from concentrated market structure, vertical integration and the lack of cross-border market integration and competition.<sup>85</sup>

Energy sector inquiry had an important informative function. The Commission collected a vast amount of market data, analysed it, identified problem areas which required remedy actions and in some cases even suggested concrete remedies to address them.<sup>86</sup> This gave effect to a wave of individual antitrust investigations against electricity and gas incumbents which marked the second half of the 2000s (listed in Table 2 above). The investigations targeted problems identified in the sector inquiry (i.e. market concentration, vertical integration, lack of cross-border integration) and clearly built on its findings to a great extent, and sometimes even did not go much beyond them.<sup>87</sup> As pointed out before, almost all follow-up cases have been closed under Article 9 and in many cases companies offered substantial

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<sup>82</sup> MEMO/05/203 of 13.06.2005

<sup>83</sup> European Commission, *Working together for growth and jobs, a new start for the Lisbon strategy*, Communication of the Commission, COM(2005) 24 final, Brussels, 02.02.2005, pp. 8 and 18.

<sup>84</sup> Press release IP/05/716 of 13.06.2005.

<sup>85</sup> See Final Report, *supra* n. 78, para. 4. See also N. KROES, ‘Introductory remarks on Final Report of Energy Sector Competition Inquiry’, SPEECH/07/4, Press Conference, Brussels, 10.01.2007.

<sup>86</sup> For instance, the Final Report recommended ownership unbundling to address conflict of interests resulting from vertical integration. This was later reflected by commitments of E.ON, RWE and ENI to divest their transmission networks under Article 9. See Final Report, *supra* n. 78, paras. 53-55. See also P. IBANEZ COLOMO, *supra* n. 11, pp. 286-287.

<sup>87</sup> The E.ON case, discussed in chapter 3, is here an illustrative example.

structural commitments to address the Commission's concerns. In sum, following the energy sector inquiry, commitment decisions have become the standard of the Commission's antitrust enforcement in the energy sector.

Remarkably, in addition to investigations at the European level, energy firms have come under increasing scrutiny from the National Competition Authorities (NCAs) and National Regulatory Authorities (NRAs) over their market practices. Prompt by the Commission's active competition enforcement in the energy sector, NCAs open antitrust investigations based on their own sector inquiries or market studies carried out by national energy regulators. These national cases often focus on areas identified in the Commission's energy sector inquiry and its antitrust investigations.<sup>88</sup> While competition enforcement at the national level is not the focus of this thesis, section 3.7 (Annex 2 to chapter 3) illustrates how NCAs in Spain, Denmark, Germany, the UK, Italy and Belgium investigated their electricity wholesale markets looking for evidence of capacity withholding and/or excessive bidding, four of them shortly after the Commission's energy sector inquiry and its decision in the *E.ON* case.

#### 1.2.3.3. Where do we stand now? – The 3<sup>rd</sup> Energy Package

Antitrust actions target individual undertakings, so they can only provide one-off tailor-made remedies to more straightforward anticompetitive practices. They cannot replace a comprehensive regulatory solution where the underlying problem is the market structure itself. Despite the Commission's enhanced competition enforcement,<sup>89</sup> major developments in the electricity sector were to come through regulatory reforms. In 2007 the Commission came up with new legislative proposals.

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<sup>88</sup> For an interesting overview of NCAs' Article 102 decisions in the energy sector adopted between 01.2010 and 09.2012 see M. ABEL and P. WILLIS, 'National Article 102 cases in the energy sector' (2011) presented at the IBC Legal's 6<sup>th</sup> Annual Competition Law in the Energy Sector conference, 29.11.2011, Brussels.

<sup>89</sup> This thesis focuses on antitrust actions and does not consider other competition law instruments which can have a similar function with respect to the energy markets (state aid rules and merger control). For an in-depth study on the role of EU merger control in liberalisation of energy markets in Europe see the doctoral thesis of F. DE LA PEÑA FERNÁNDEZ-GARNELO, *supra* n. 68.

Electricity markets were subject to the 3<sup>rd</sup> Electricity Directive<sup>90</sup> and a revised Cross-border Regulation.<sup>91</sup> This so-called 3<sup>rd</sup> Energy Package was adopted in 2009 and also included corresponding acts regulating gas markets and a new Regulation establishing an Agency for Cooperation of Energy Regulators (ACER) responsible for cross-border issues.<sup>92</sup>

With the 3<sup>rd</sup> Energy Package the Commission attempted to address the major shortcomings identified in the sector inquiry. Firstly, the 3<sup>rd</sup> Electricity Directive introduced a higher degree of network unbundling in order to eliminate once and for all the conflict of interest resulting from vertical integration. However, the Commission's initial proposal imposing full ownership unbundling has met with strong opposition in several Member States and has been watered down in the Council. As a result, Member States could have opted for three less intrusive unbundling regimes, each of which allowed electricity incumbents to retain the ownership of their networks, provided that they either hand over their technical and commercial operation to independent bodies designated by Member States<sup>93</sup> or comply with a more detailed set of rules on 'Chinese walls', compliance monitoring and regulatory supervision which would guarantee their autonomous operation.<sup>94</sup> Secondly, the 3<sup>rd</sup> Package focused on increasing cross-border trade in electricity and fostering market integration. To this aim the newly created ACER complements and coordinates the work of national regulatory authorities and monitors the functioning of electricity markets. It also coordinates regional and cross-regional initiatives promoting market integration and can take binding decisions regarding access conditions and operational security of cross-border infrastructure. Further, the new Cross-border Regulation strengthened cooperation between national network operators by creating the European Network of Transmission System Operators for

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<sup>90</sup> Directive 2009/72/EC of the European Parliament and of the Council of 13.07.2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55.

<sup>91</sup> Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13.07.2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15.

<sup>92</sup> Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13.07.2009 establishing an Agency for the Cooperation of Energy Regulators [2009] OJ L 211/1.

<sup>93</sup> Independent System Operator (ISO model).

<sup>94</sup> Independent Transmission Operator (ITO and ITO+ models).

Electricity (ENTSO-E). Under this umbrella association network operators have been assigned important EU-wide planning and operations tasks in order to provide for new cross-border infrastructure (EU-wide network development plans) and gradually integrate different regulatory regimes governing national transmission grids (development of network codes).

#### 1.2.3.4. Actions for non-compliance

Member States are under an obligation to transpose EU laws into their respective legal systems.<sup>95</sup> If they fail to do that, the Commission has powers under Article 258 TFEU to take procedural steps in order to enforce their compliance, and if necessary, bring them to the ECJ (action for non-compliance). The Commission monitors all the implementing measures taken by Member States following the 2<sup>nd</sup> and the 3<sup>rd</sup> Energy Packages and has already launched a number of Article 258 actions against Member States which have not yet transposed the Packages or have failed to do it correctly. According to the Commission's update from October 2012, 7 infringement cases are still pending on 2<sup>nd</sup> Energy Package and 13 cases on the 3<sup>rd</sup> Energy Package.<sup>96</sup>

Non-compliance has a broad meaning and includes any failure by a Member State to fulfil its obligations under EU law, whether it is done by the government itself or by any state agency,<sup>97</sup> and whether it is action, e.g. adoption of measures incompatible with EU law or omission, e.g. non-implementation of EU law within the prescribed time limit.

Action for non-compliance consists of two phases. The first phase is administrative

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<sup>95</sup> Article 4(3) TEU and the European Courts' settled case law dating back to case 6/64, *Flaminio Costa v. ENEL* [1964] ECR 585.

<sup>96</sup> The list of on-going infringement cases for non-transposition of the provisions of the 2<sup>nd</sup> and the 3<sup>rd</sup> Energy Package is provided in the European Commission's *Energy Markets in the European Union in 2011*, Commission Staff Working Document, SWD(2012) 368 final, Brussels, 15.11.2012, accompanying the document European Commission, *Making the internal energy market work*, supra n. 6, and available at [http://ec.europa.eu/energy/gas\\_electricity/doc/20121217\\_energy\\_market\\_2011\\_lr\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/doc/20121217_energy_market_2011_lr_en.pdf) accessed 20.05.2013, Part IV.

<sup>97</sup> Executive, legislative or judicial, even if it is a constitutionally independent institution. See case 77/69, *Commission v Belgium* [1970] ECR 237.

and involves direct negotiations between the Commission and the Member State (infringement proceedings).<sup>98</sup> At this stage the Commission closely examines the case in order to examine the nature and extent of the suspected breach of EU law. The investigated Member State, on its part, has a possibility to clarify the situation, which constitutes an important guarantee of its right of defence. But most importantly, it is given an opportunity to bring the alleged infringement voluntarily to an end. In this sense, the infringement proceedings are comparable to commitment procedure under Article 9. If no amicable settlement is reached during the administrative phase, the Commission may then decide to enter the second, litigation phase by referring the case to the ECJ.

#### 1.2.3.5. On the home straight?

Out of the three EU packages of energy reforms, the 3<sup>rd</sup> and last one is viewed as the major step towards the completion of the internal market.<sup>99</sup> However, the 2014 deadline set by the Council is tight and the Commission is going to step up its efforts to ‘make the internal market work’.<sup>100</sup> It is expected that the Commission will not cease to pursue Article 258 TFEU infringement proceedings in order to tackle delays in transposition of the EU energy law into national legal systems.<sup>101</sup> Further, more attention will be paid to developing and implementing complementary legislation and technical rules stemming from the 3<sup>rd</sup> Energy Package.<sup>102</sup> According to the

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<sup>98</sup> This initial, administrative phase consists of several formal stages and is preceded by a fact-finding stage, whereby the Commission closely examines the problem in order to establish a breach of EU law and may also engage in informal negotiations with the investigated Member State. If the case is to answer, it sends out a *letter of formal notice*, requesting the investigated Member State to submit its observations regarding the alleged breach of an obligation under the Treaty within a specified time period. If the Commission finds not satisfactory the explanations provided by a Member State, it may deliver a *reasoned opinion*, which among others informs the Member State about the measures the Commission considers necessary to bring the alleged infringement to an end. Member State may then agree to take measures proposed by the Commission, but it must be given sufficient time to do implement them. At this point the administrative phase is exhausted, and if the Member State still does not comply with the reasoned opinion, the Commission may decide to enter the second phase by taking proceedings before the ECJ.

<sup>99</sup> See, for instance, the speech of EU Commissioner for Energy G. OETTINGER, ‘The completion of the EU internal energy market “Getting to 2014”’, SPEECH/11/614 of 29.09.2011, DG Energy Internal Market Conference, Brussels.

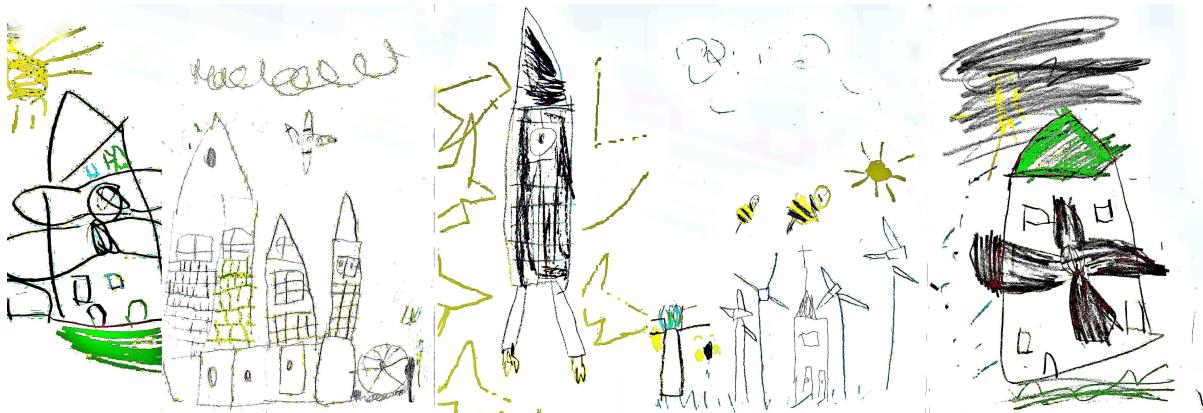
<sup>100</sup> European Commission, *Making the internal energy market work*, supra n. 6.

<sup>101</sup> *Ibid.*, para. 3.1.1.

<sup>102</sup> For instance, implementation of REMIT - the EU Regulation No 1227/2011 of the European Parliament and of the Council of 25.10.2011 on wholesale energy market integrity and transparency [2011] OJ L 326/1 (for

Commission, these activities on the regulatory front will be complemented by an active enforcement of competition rules.<sup>103</sup>

Figure 1. Well-functioning and competitive electricity markets according to my nephews and my sister.



Source: Made by Nicolas (5 and a half), Maks (almost 4) and Ania (looks 25) on 27<sup>th</sup> April 2013 in Maaseik, Belgium.

### 1.3. ENERGY POLICY AND COMPETITION POLICY: DEFINITIONS

The previous section shows that it might be sometimes difficult to distinguish between competition policy and energy policy in the context of the Commission's efforts to create a well-functioning and competitive internal market for electricity. This section attempts to define what is considered here to be 'EU competition policy' and 'EU energy policy', to identify their common denominator and to determine where the dividing line between the two policies should be drawn.

Even though the EU competence to regulate some energy-related areas dates back to the creation of the European Coal and Steel Community in 1951, it is only since the adoption of the Lisbon Treaty in 2007 that one can truly speak about a common and

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more information, see infra text accompanying n. 424-429), development of guidelines for trans-European energy infrastructure (European Commission, Proposal for a Regulation of the European Parliament and of the Council on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC, COM/2011/658 final – 2011/0300 (COD), Brussels, 19.10.2011), development and adoption of network codes.

<sup>103</sup> European Commission, *Making the internal energy market work*, supra n. 6, para. 3.1.2.

comprehensive EU energy policy.<sup>104</sup> The Union's competence to regulate energy matters has been explicitly recognised in Article 194 TFEU which constitutes a new chapter on energy. As set forth therein, the EU energy policy is to (1) ensure the functioning of the energy market, (2) ensure security of energy supply in the Union, (3) promote energy efficiency and energy saving and the development of new and renewable forms of energy and (4) promote the interconnection of energy networks. The four guiding objectives of EU energy policy address various challenges facing Europe in relation to energy such as climate change, growing energy demand, increasing import dependency, maintaining operational security of the network in view of increasing reliance on intermittent energy sources and progressing market integration.

While recognising that EU energy policy deals with a wide spectrum of challenges, this thesis narrows it down to the Commission's goal of creating the EU internal market for electricity. As a consequence, EU energy policy is discussed here only in the context of electricity sector. Moreover, some of the energy objectives listed in Article 194 TFEU are emphasised whereas others are ignored. Energy goals which receive here a lot of attention are (1) ensuring the functioning of the energy market, which is referred to as **market liberalisation**, and (4) promoting network interconnection, labelled here **market integration**.<sup>105</sup>

EU competition policy aims to ensure free and fair competition in the European internal market. The underlying idea is that undistorted competition benefits European consumers, because it results in lower prices, higher quality and a broader range of goods. In order to protect competition within the EU, the Commission is active in five main areas: (1) prohibition of cartels and abuses of a dominant position capable of affecting competition in the common market, (2) preventive control of mergers with an EU dimension as they can result in restriction of competition, (3) supervision of aid

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<sup>104</sup> Prior to the Lisbon reform, EU used to adopt measures in relation to energy based on its other e.g. internal market provisions, rules on trans-European networks, competition and environmental protection, and eventually Article 352 TFEU (ex Article 308 TEC) permitting the EU to decide in areas not specifically covered by the Treaties. However, there was no explicit EU competence to legislate on energy issues.

<sup>105</sup> See supra section 1.2.3 for definitions.

granted by Member States which may also distort competition by giving certain undertakings or certain goods a competitive advantage, (4) efforts to open markets up to competition (market liberalisation) and (5) cooperation with national competition authorities in Member States in order to ensure effective and consistent application of competition rules.<sup>106</sup>

Again, this thesis does not deal with all these aspects of EU competition policy, but only looks at the supportive role of Article 102 TFEU in achieving the EU internal electricity market (areas (1) and (4)). The energy sector inquiry and antitrust investigations which then followed (section 1.2.3.2 above) make a good example of competition policy' involvement for the completion of the EU internal market for electricity, a goal shared with EU energy policy, and even more generally, with EU internal market policy.

It follows from the above that the completion of the EU internal market for electricity lies at the intersection of energy policy and competition policy. Transformation of electricity industry with monopolistic structures gives rise to a number of competition problems which can be then addressed by enforcing competition rules. In that sense, EU competition policy supports EU energy policy, and vice versa, and both of them play an important role in completing the EU internal electricity market. However, even though the goal is shared, each policy uses different instruments to achieve it. In that sense they should be seen as complements rather than substitutes. Whereas energy policy abolishes legal monopolies and develops a new regulatory framework for the functioning of the internal electricity market, it is for the competition policy to remove factual obstacles to its functioning. Put differently, energy policy creates conditions for competition to take place, and competition policy prevents private arrangements or practices which would *de facto* hamper the emerging competition. This is exactly where the dividing line between the two policies should fall.

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<sup>106</sup> European Commission, [http://ec.europa.eu/competition/consumers/what\\_en.html](http://ec.europa.eu/competition/consumers/what_en.html) accessed 20.05.2013.

This thesis looks at instances where this dividing line between competition policy and energy policy gets blurred. This is the case where EU energy policy does not bring the expected results in terms of market liberalisation and integration, and the Commission reaches for competition policy to achieve the same ‘regulatory’ result. Next chapters attempt to demonstrate what happens when competition enforcement stops to be seen as complementary to energy policy measures, but starts to be a replacement for them.

#### 1.4. DEALING WITH GAP CASES: SOME COMMENTS ON THE *GREEK LIGNITE* CASE

The attempt of the previous section was to distinguish between the application of EU competition policy and EU energy policy in the European electricity markets. Whereas energy policy targets state monopolies at the regulatory level, competition policy deals with factual barriers to competition. In particular, Article 102 TFEU applies to the conduct of undertakings and in most cases its enforcement ignores the presence of the state, assuming that undertakings act independently from the state and are fully responsible for their conduct in the market. Antitrust investigations studied in this thesis result in bilateral agreements between the Commission and the investigated undertaking, leaving governments out of the picture. However, and despite advancements in deregulation, the European electricity sector remained subject to heavy state intervention, albeit of a different nature.<sup>107</sup> The presence of state measures regulating the industry gives rise to less clear-cut cases where barriers to competition are either created or supported by the state itself. Anticompetitive state measures are addressed at the EU level by means of (1) supervision of state aid, (2) provisions concerning public undertakings (Article 106 TFEU).<sup>108</sup> This is an area of EU competition policy which gets very close to EU energy policy, because it often deals with state measures supporting ‘national champions’ and protecting state monopolies.

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<sup>107</sup> See comments of VEDDER H., ‘Competition in the EU energy sector – an overview of developments in 2009 and 2010’ in M. ROGGENKAMP and U. HAMMER (eds.), *European Energy Law Report VIII*, Intersentia 2011, p. 16.

<sup>108</sup> Apart from enforcing competition rules, the Commission can also challenge anticompetitive state measures by initiating infringement proceedings under Article 258 TFEU (*supra* section 1.2.3.4) or in the context of the duty of loyal cooperation set forth in Article 4 (3) TEU.

Whereas these provisions are beyond the scope of this thesis, as a way of example, the following paragraphs discuss the Commission's decision in the *Greek lignite* case, where the Greek state measures were found in breach of antitrust rules in connection with Article 106 (1) TFEU.

Article 106(1) TFEU prohibits Member States adopting or maintaining in force, in the case of public undertakings and the undertakings to which they grant special or exclusive rights, measures contrary to the rules contained in the Treaty, in particular competition rules.<sup>109</sup> Thus, Article 106 (1) TFEU provides a legal basis for the Commission's action only when used in combination with other provisions of the Treaty. In the *Greek lignite* case, the Commission applied Article 106 (1) TFEU in connection with Article 102 TFEU, prohibiting undertakings abusing a dominant position on the market in so far as this affects cross-border trade.

#### 1.4.1.1. *The case*

Lignite is a type of soft brown coal and its low extraction costs make it the cheapest fuel for electricity generation in Greece. A half of lignite reserve in Greece remains in the hand of the Public Power Corporation (PPC), the Greek electricity incumbent, to which the Greek state assigned exclusive rights to mine lignite. PPC also operates all lignite-fired power plants in Greece. No mining rights have been allocated with respect to the other half of lignite deposits and they remain unexplored.

PPC was created back in the 1950s as a state-owned utility enjoying monopoly for production, transmission and supply of electricity. Already at that time, PPC was granted exclusive rights to exploit Greek lignite reserves. Once the electricity market in Greece was liberalised in 2001, PPC turned into a limited liability company. However, the state retained full control over PPC as its majority shareholder with more than 51 % of the voting shares. The measures adopted by the Greek government

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<sup>109</sup> Subject to Article 106 (2) TFEU.

which first granted and then maintained privileged access to lignite in favour of PPC, remained in force.<sup>110</sup>

Upon a complaint filed in 2003, the Commission investigated this case and adopted a decision in 2008 concluding that Greece infringed Article 106 (1) TFEU in conjunction with Article 102 TFEU. Namely, the state measures in question created an inequality of opportunities between market players as regards access to primary fuels for electricity generation permitting PPC to maintain or strengthen its dominant position on the wholesale electricity market by excluding or hindering any new entry to the market.<sup>111</sup> According to the Commission, the infringement had lasted at least since the Greek electricity market was formally liberalised in 2001. In its decision, the Commission called on Greece to take steps in order to end the infringement.<sup>112</sup>

PPC appealed to the General Court claiming, among others, that the Commission failed to establish the existence of an actual or potential abuse of a dominant position on the markets concerned, which was necessary in order to apply Article 106 (1)

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<sup>110</sup> The measures in question were adopted by the Greek State between 1959 and 1994 and include Article 22 (1) of the Legislative Decree No 4029/1959 of 12.11.1959 and 13.11.1959 (FEK A' 250), Article 3 (3) of the Law No 134/1975 of 23.08/1975 and 29.08.1975 (FEK A' 180), as well as Decisions by the Minister of Industry, Energy and Technology published in the Official Journal of the Hellenic Republic, volume B, issue No 282, of 3.03.1976, volume B, issue No 596, of 24.08.1988 and volume B, issue No 633, of 22.08.1994.

<sup>111</sup> *Ibid.*, Article 1. The Commission identified two separate markets, one for the supply of lignite (upstream market), and one for electricity production (downstream market). According to the Commission, PPC holds approx. 97% share in the market for lignite supply and more than 85% share in the market for electricity production – the result of awarding PPC exclusive mining rights over lignite deposits. See Commission Decision of 05.03.2008 on the granting or maintaining in force by the Hellenic Republic of rights in favour of Public Power Corporation S.A. for extraction of lignite, C(2008) 824 final, paras. 108-109 and 174.

<sup>112</sup> Greece proposed a number of measures ensuring that PPC's competitors get access to about 40% of all Greek lignite deposits, mostly by allocating new exploitation rights for yet unexplored lignite deposits. The Commission made these measures binding in 2009 (Commission Decision of 04.08.2009 establishing the specific measures to correct the anti-competitive effects of the infringement identified in the Commission Decision of 05.03.2008 on the granting or maintaining in force by the Hellenic Republic of rights in favour of Public Power Corporation S.A. for extraction of lignite, C(2009) 6244 final). In 2011, however, Greece asked the Commission to review the commitments due to changes in its energy policy which do not support opening new lignite mines. As an alternative measure to comply with the 2008 decision, Greece proposed to give to competitors of PPC access to 40% of lignite-fired generation through drawing rights in existing lignite-fired power plants of PPC. Furthermore, participants will be offered participation in future power plant projects using currently available lignite. See *Description of alternative measures to be adopted by the Hellenic Republic for the further liberalisation of the Greek wholesale electricity generation market, including lignite-fired generation* of 13.01.2011, available at [http://ec.europa.eu/competition/antitrust/cases/dec\\_docs/38700/38700\\_716\\_14.pdf](http://ec.europa.eu/competition/antitrust/cases/dec_docs/38700/38700_716_14.pdf) accessed 20.05.2013. At the time of writing this chapter (01.2013), no decision has been adopted regarding the new measures yet. See press release IP/11/34 of 14.01.2011.

TFEU in connection with Article 102 TFEU.<sup>113</sup> The Greek State intervened in this case in support of PPC. In 2012 General Court ruled in favour of PPC and Greece, setting aside the Commission's 2008 decision.<sup>114</sup>

The General Court explained that in the case of a combined application of Articles 106 (1) TFEU and 102 TFEU, the contested state measure must infringe Article 102. In other words, the Commission has to identify the specific (actual or potential) abuse of a dominant position by an undertaking to which the state measure in question led, or at least could lead. The Court found that the Commission failed to establish that granting PPC privileged access to lignite was capable of creating a situation in which, by the mere exercise of its exploitation rights, PPC could have been able to commit an abuse of a dominant position on the market for electricity generation or was led to commit such an abuse.<sup>115</sup> According to the Court, the Commission misinterpreted the existing case law on the combined application of Articles 106 (1) TFEU and 102 TFEU where state measures resulted in an 'inequality of opportunities' between undertakings.<sup>116</sup> In that respect, the mere finding that PPC continues to maintain a dominant position on the wholesale electricity market by virtue of the advantage conferred upon it by privileged access to lignite and that that situation creates an inequality of opportunities between market players, is not sufficient to find an infringement of Article 106 (1) TFEU in combination with Article 102 TFEU.

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<sup>113</sup> Case T-169/08, Action brought on 13.04.2008 — *DEI v Commission* [2008] OJ C 183/24. The 2009 decision was also challenged (Case T-421/09, Action brought on 19.10.2009 — *DEI v. Commission* [2010] OJ C 11/28).

<sup>114</sup> Case T-168/08 (and Case T-421/09) *Dimosia Epicheirisi Ilektrismou AE (DEI) v. Commission* [2012] not yet reported. Judgment of the General Court of 20.09.2012.

<sup>115</sup> *Ibid.*, para. 92. By reference to its case law, the Court stressed that a Member State infringes Article 106 (1) TFEU in combination with Article 102 TFEU if the undertaking in question is led, by the mere exercise of the exclusive or special rights conferred upon it, to abuse its dominant position or where those rights are capable of creating a situation in which that undertaking is led to commit such an abuse. As then observed by the Court, it does not follow from these cases that the mere fact that the undertaking finds itself in an advantageous situation in comparison with its competitors, by reason of a state measure, in itself constitutes an abuse of a dominant position. See *ibid.*, paras. 95-103, and the cases discussed therein: Case C-163/96, *Raso and Others* [1998] ECR I-533; para. 27, Case C-41/90, *Höfner and Elser* [1991] ECR I-1979, para. 29; Case C-179/90, *Merci convenzionali porto di Genova* [1991] ECR I-5889, para. 17; Case C-55/96, *Job Centre* [1997] ECR I-7119, para. 31; and Case C-49/07, *MOTOE* [2008] ECR I-4863, paras. 50-51.

<sup>116</sup> As for the case law cited by the Commission in support of its findings, the Court argued that the Commission had relied on expressions used by the Court with no regard to the factual context of those cases. See *ibid.*, paras. 104-118.

Following the Commission's appeal, the *Greek lignite* case is currently<sup>117</sup> pending before the ECJ.<sup>118</sup>

#### 1.4.1.2. Discussion

Commissioner Kroes' statement from 2008 reflects a strong political flavour of the *Greek lignite* decision: 'Customers are denied the benefits of competition in the electricity sector when one operator controls virtually all access to Greek lignite reserves [...]. Greece should act decisively to establish a level playing field by ensuring within the framework of its national lignite policy, that competitors have access to substantial volumes of lignite.'<sup>119</sup> In 2003 it was clear that the 2<sup>nd</sup> Energy Package in Greece has not delivered the expected results. A wholesale electricity market was created but, with PPC enjoying privileged access to the cheapest fuel source, competition in electricity supply could not take place. It was in the state's interest to protect PPC, the Greek 'national champion'.

Unlike Article 9 cases studied in this thesis, the *Greek lignite* case is not a standard abuse of dominance investigation against an undertaking subsequently closed by commitments. Yet it can be seen as another attempt of instrumentalisation of competition rules, this time to create more competition in the Greek electricity market. In this case the Commission found an infringement of Article 102 TFEU in connection with Article 106 (1) TFEU, without identifying any specific abuse of a dominant position that PPC committed or could have committed by virtue of state measures in question. In fact, the existing case law on the combined application of these provisions is far from clear and leaves some room for interpretation.<sup>120</sup> According to the Commission, it is enough to show that the state measure in question

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<sup>117</sup> At the time of writing this chapter (01.2013).

<sup>118</sup> Cases C-553/12 P & C-554/12 P: Appeal brought on 30.11.2012 by the Commission against the judgment delivered by the General Court on 20.09.2012 in cases T-169/08 and T-421/09 *DEI v Commission* [2013] OJ C 32/10-11.

<sup>119</sup> Press release IP/08/386 of 05.03.2008.

<sup>120</sup> See H. VEDDER, 'A Burning Desire to Clarify (?) The Law For Public Undertakings: The Judgment in Greek Lignite (Case T-169/08)', post of 04.10.2012, *European Law Blog. News and comments on EU law*, available at <http://europeanlawblog.eu/?p=935> accessed 20.05.2013.

distorts competition by creating an ‘inequality of opportunities’ between market players. The underlying premise is that antitrust rules can be used not only to put an end to a specific (actual or potential) abusive behaviour, but also to correct less competitive market structures. This broadens the scope of application of Article 102 (in connection with Article 106 (1) TFEU), allowing the Commission to instrumentalise competition policy and capture state measures which maintain anticompetitive market structures but do not lead to any specific (actual or potential) abuse of a dominant position. In this case, the Commission concluded that PPC’s competitors would need to have access to a minimum of 40% of lignite resources in order to create a level playing field in the electricity market and called upon Greece to change its current lignite policy to ensure this access.

The General Court did not support the Commission’s approach and set aside the *Greek lignite* decision. The final outcome of this case, currently pending before the ECJ, depends on the Court’s interpretation of its case law on combined application of Articles 106 (1) TFEU and 102 TFEU. The annulment of this decision highlights the role of judicial control over the Commission’s exercise of powers. Appeals from infringement decisions are common, and when opting for this route, the Commission has to factor in risk that any ‘creative’ interpretation of competition provisions in order to broaden the scope of their application and use them for non-competition objectives will likely result in an annulment of its decisions. In that respect, commitment cases do not pose a high risk of appeal and thus provide a safer route to use competition law in pursue of other objectives, like the completion of the internal market for electricity.

If the ECJ upholds the GC ruling, setting a high standard for showing harm in electricity markets, this may only encourage commitment cases, because the Commission will find the standard for showing the infringement of competition rules too high.

## 1.5. LITERATURE REVIEW

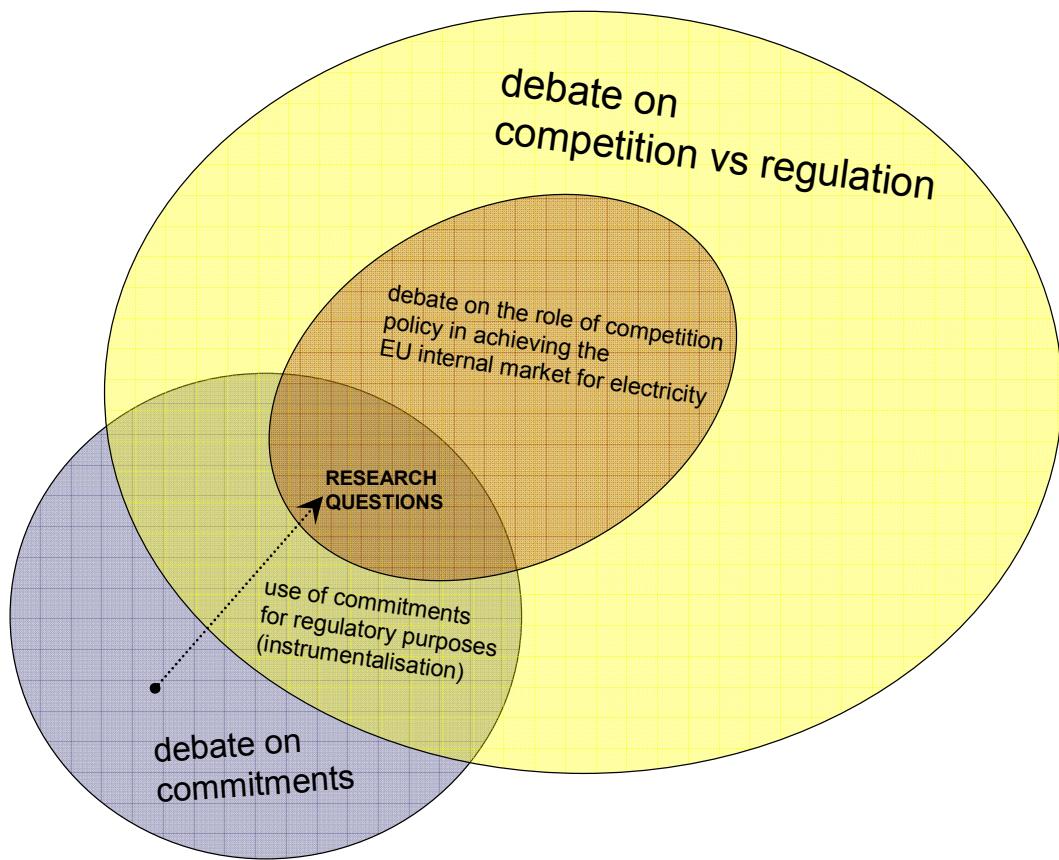
*This thesis lies at the intersection of two scholarly debates and casts some more light on a borderline area which has not been fully explored yet.*

It has been mentioned at the outset that this research falls under a wider debate on the interplay between competition policy and regulation. Yet a closer look discloses at least two more specific debates and the topic of this thesis lies somewhere at their intersection (see Figure 2). **One debate** concerns Article 9 commitments. Insofar as it tackles the use (or abuse) of commitment decisions for non-competition regulatory goals, it becomes part of the competition vs. regulation debate. This debate is not electricity-specific, but looks at the Commission's commitment practice across different sectors. Sometimes it refers to electricity markets as an example of the Commission's fierce antitrust intervention and far-reaching structural commitments. **The other debate** can be viewed as a fraction of the competition vs. regulation debate. It raises questions about the role of competition policy in achieving the internal market for electricity. This debate does not focus specifically on commitment decisions, but takes a comprehensive look at all competition law instruments which find their application in the energy sector, often helping the Commission to implement its regulatory agenda, like 'classical' antitrust enforcement (including commitment decisions), merger control, state aid rules and supervision of undertakings with special or exclusive rights.<sup>121</sup> Inasmuch as it discusses the role of Article 9, it overlaps with the first debate and enters the scope of this research.

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<sup>121</sup> E.g. the Commission has been known for negotiating particularly far-reaching (regulatory) merger remedies with energy incumbents. See K. BACHOUR, G. CONTE, P. EBERL, C. MARTINI, A. PAOLICCHI, P. REDONDO, A. VAN HAASTEREN and G. WILS, 'Gaz de France/Suez: keeping energy markets in Belgium open and contestable through far-reaching remedies' (2007) *Competition Policy Newsletter* 1, Spring Issue, pp.83-91.

Figure 2. Positioning the research topic in the context of current scholarly debates.



Source: Own illustration.

The structure of this section follows the arrow in Figure 2, that is, it leads the reader towards the center of the diagram starting from its bottom-left corner. It begins with some general insights from the commitment debate, in particular regarding the optimal use of commitment decisions, and signals concerns expressed in this debate that the introduction of Article 9 to competition enforcement may result in suboptimal outcomes. Then, it argues that suboptimal outcomes might to a great extent result from instrumentalisation, i.e. the use of commitments for regulatory purposes, and also explains how the relaxed legal framework of Article 9 may encourage instrumentalisation on the part of the Commission. Finally, it refers to the Commission's antitrust enforcement in the electricity sector and observes that there is still scope for more case-oriented research.

### 1.5.1. Debate on commitments

The debate on commitment decisions has been going on for almost a decade and the recent articles suggest that this topic has not yet been exhausted.<sup>122</sup> Generally

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<sup>122</sup> In addition to the already mentioned contributions of J. TEMPLE LANG (2003), *supra* n. 16, M. FURSE (2004), *supra* n. 11, J. TEMPLE LANG (2006), *supra* n. 45, R. WHISH (2006), *supra* n. 45, W.P.J. WILS (2006), *supra* n. 33, G.S. GEORGIEV (2007), *supra* n. 48, E. GIPPINI-FOURNIER (2008), *supra* n. 33, D. WAELBROECK (2008), *supra* n. 38, D. WAELBROECK (2009), *supra* n. 17, K. KOSTOPOULOS (2009), *supra* n. 26, J. TEMPLE LANG (2009), *supra* n. 25, H. SCHWEITZER (2010), *supra* n. 48, P. IBÁÑEZ COLOMO (2010), *supra* n. 11, S. RAB, D. MONNOYEUR and A. SUKHTANKAR (2010), *supra* n. 26, D. GERARD (2011), *supra* n. 20, L. ORTIZ BLANCO and A. LAMADRID DE PABLO (2012), *supra* n. 11. H. SCHWEITZER (2012), *supra* n. 48. F. WAGNER-VON PAPP (2012), *supra* n. 25, also in a chronological order: E.-J. MESTMÄCKER, ‘The EC Commission’s Modernization of Competition Policy: a Challenge to the Community’s Constitutional Order’ (2000) 1 *European Business Organization Law Review* 3, 401-444. M. SOUSA FERRO, ‘Committing to commitment decisions – unanswered questions on Article 9 decisions’ (2005) 26 *European Competition Law Review* 8, 451-459. C. FERNÁNDEZ ‘Commitment Decisions under EC Regulation 1/2003’ in P. LOWE and M. REYNOLDS (eds.) *Antitrust Reform in Europe – A Year in Practice*, International Bar Association, Brussels 2005. J.P. GRUBER, ‘Verpflichtungszusagen im europäischen Kartellrecht’ (2005) 7 *Europäisches Wirtschafts- und Steuerrecht*, 310-315. C.J. COOK, ‘Commitment Decisions: The Law and Practice under Article 9’ (2006) 29 *World Competition* 2, 209-228. J. DAVIES and M. DAS, ‘Private Enforcement of Commission Commitment Decisions: A Steep Climb, Not a Gentle Stroll’, 199-226, D.P. DUCORE, ‘Settlement of Competition Conduct Violations at the United States Antitrust Agencies and at the European Commission – Some Observations’, 227-242, in B. HAWK (ed.) 2005 *Annual Proceedings of the Fordham Competition Law Institute: International Antitrust Law and Policy*, Juris Publishing, New York 2006. O. ARMENGOL and A. PASCUAL, ‘Some reflections on Article 9 Commitment Decisions in the Light of the Coca-Cola Case’ (2006) 27 *European Competition Law Review* 3, 124-129. W.P.J. WILS, ‘The Use of Settlements in Public Antitrust Enforcement: Objectives and Principles’ (2008) 31 *World Competition* 3, 335-352, draft version available at <http://ssrn.com/abstract=1135627> accessed 20.05.2013. G. BRUZZONE and M. BOCCACCIO, ‘Taking Care of Modernisation After the Start-up: A View from a Member State’ (2008) 31 *World Competition* 1, 81-111, pp. 98-100. A. PERA and M. CARPAGNANO, ‘The Law and Practice of Commitment Decisions: A Comparative Analysis’ (2008) 29 *European Competition Law Review* 12, 669-685. N. PETIT, Cross-country survey of the discretion of competition authorities in the course of their enforcement activities’, Report prepared for the LIDC International Conference, Vienna, 22-25.10.2009. S. MARTINEZ LAGE and R. ALLENDESLAZAR, ‘Commitment Decisions ex Regulation 1/2003: Procedure and Effects’, and I.S. FORRESTER, ‘Creating New Rules or Closing Easy Cases? Policy consequences for public enforcement of settlements under Article 9 of Regulation 1/2003’ (available as EUI working paper at <http://www.eui.eu/Documents/RSCAS/Research/Competition/Forrester-2008.pdf> accessed 20.05.2013) as well as A.J. PADILLA and K. EDWARDS, ‘Antitrust Settlements in the EU: Private Incentives and Enforcement Policy’ in C.-D. EHLMERMAN and M. MARQUIS (eds.) *European Competition Law Annual 2008: Antitrust Settlements under EC Competition Law*, Hart Publishing, Oxford 2009. A. KLEES, ‘Das Instrument der Zusageentscheidung und der Fall “E.ON” - Ein (weiterer) Sunderfall’ (2009) 4 *Wirtschaft und Wettbewerb*, 374-382. H. VON ROSENBERG, ‘Unbundling through the back door...the case of network divestiture as a remedy in the energy sector’ (2009) 30 *European Competition Law Review*, 237-254. A. KLEES, ‘Freie Bahn für die Kommission in Kartellverfahren bei Anwendung des Art. 9 VO 1/2003’ (2010) 10 *Recht der Internationalen Wirtschaft*, 688-695. T. KÖRBER, ‘Rechtliches Gehör, Verpflichtungszusagen nach Art. 9 VO 1/2003 und die Alrosa-Entscheidung’ in W. WEIß (ed.) *Die Rechtsstellung Betroffener im modernisierten EU-Kartellverfahren*, Nomos, Baden-Baden 2010. F. CENGIZ, ‘Judicial review and the rule of law in the EU competition law regime after Alrosa’ (2011) 7 *European Competition Journal* 1, 127-153. T. EIJSBOUTS, ‘A new life for commitment decisions under Article 9 of Regulation 1/2003? The aftermath of the ECJ judgement of 29 June 2010 in case C 441/07P, Commission v. Alrosa’ in T. BAUMÉ (ed.) *Today’s multi-layered legal order: current issues and perspectives: liber amicorum in honour of Arjen W.H. Meij*, Zutphen, Paris 2011. M. KELLERBAUER, ‘Playground instead of playpen: The Court of Justice of the European Union’s Alrosa judgment on art. 9 of Regulation 1/2003’ (2011) *European Competition Law Review* 1, 1-8. M. MESSINA and J-C.A. HO, ‘Re-establishing the Orthodoxy of Commitment Decisions under Article 9 of Regulation 1/2003: Comment on Commission v Alrosa’ (2011) 36 *European Law Review* 5, 737-751. I. KAWKA, ‘Rights of an Undertaking in Proceedings Regarding Commitment Decisions under Article 9 of Regulation No. 1/2003’

speaking, most commentators view the introduction of Article 9 commitment decisions as a positive development in the EU competition enforcement, considering all the benefits of this mechanism.<sup>123</sup> However, negotiated solutions are not deeply embedded in the European legal culture,<sup>124</sup> so the concept of Article 9 and its application raises a lot of questions and generates much commentary.<sup>125</sup> In particular, the incentives of the Commission and the undertakings to engage in negotiations and settling cases are widely recognised in the literature.<sup>126</sup> In fact, these incentives are considered so strong, that almost all commentators raise concerns about the potentially *excessive* use of Article 9. At the same time, only few explain what they actually mean by the (socially) optimal use of commitment decisions and how it might be influenced by those incentives.<sup>127</sup>

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(2012) 5 *Yearbook of Antitrust and Regulatory Studies* 6, 169-192. M-T. RICHTER, ‘The Settlement Procedure: A Comparison and Impact Analysis’ (2012) 11 *European Competition Law Review*, 537-542. Accounts on national settlements equivalent to Article 9 are not reported here.

<sup>123</sup> See discussion in section 1.2.1.

<sup>124</sup> Comparing with the longstanding use of settlements in the U.S.

<sup>125</sup> Early contributions often focused on more technical questions regarding the procedural framework and legal effects of commitment decisions, but obviously could only speculate about the way the Commission was going to apply Article 9 and to what effect. At that time much discussed was the nature and scope of preliminary assessment especially in relation to the statement of objections, lack of important procedural safeguards protecting the right of defence under commitment procedure (e.g. no statement of objections required, no oral hearing, no access to file), meaning and binding effect of a commitment decision and its effect on the powers of national competition authorities and national courts regarding past (allegedly anticompetitive) conduct, position of third parties under commitment procedure, public and private enforcement of commitment decisions under national law, the possibility of appeal to the European Courts, the scope of judicial review, the impact of commitment procedure on the existing practice of (informal) settlements, the use of similar procedures by national competition authorities and the comparison of commitment decisions to the U.S.-style settlement practice based on consent decrees. Only once the Commission started to make use of its new powers, a number of practical issues have been clarified (for instance, it was initially believed that the Commission has to issue a statement of objections also in commitment cases). Some important issues have finally been settled by the ECJ in the *Alrosa* case (e.g. the Court ruled on the proportionality of commitments which for many years has been an open question and many commentators believed that commitments should undergo a strict proportionality test analogous to remedies under Article 7, until the ECJ ruled to the contrary). However, many issues are still not entirely clear, e.g. whether the undertaking offering commitments can subsequently appeal the decision making them binding.

<sup>126</sup> For a more comprehensive discussion on the Commission’s and companies’ incentives see e.g. J. TEMPLE LANG (2006), *supra* n. 45, pp. 271-276 (as well as his comments during the panel discussion, 368-369). In the same line C.J. COOK, *supra* n. 122, pp. 210-213. I.S. FORRESTER, *supra* n. 122, pp. 7-10 (working paper). F. WAGNER-VON PAPP, *supra* n. 25, pp. 958-960.

S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, pp. 175-176. D. GERARD, *supra* n. 20, p. 464.

<sup>127</sup> To the author’s knowledge, the question of the optimal enforcement (and more specifically, the optimal use of Article 9 commitment decisions) has been (directly or indirectly) addressed by seven academic papers so far. In the chronological order: W.P.J. WILS (2006), *supra* n. 33. E. GIPPINI-FOURNIER (2008), *supra* n. 33. W.P.J. WILS (2008), *supra* n. 122. A.J. PADILLA and K. EDWARDS (2009), *supra* n. 122. I.S. FORRESTER (2009), *supra* n. 122. N. PETIT (2009), *supra* n. 122. P. IBÁÑEZ COLOMO (2010), *supra* n. 11. To the contrary, the law and economics literature on the optimal use of settlements in the U.S. litigation, and more specifically, in antitrust trials, is extensive and deals mostly with the potential divergence between, on the one

### 1.5.1.1. The optimal use of commitment decisions

The optimal use of commitment decisions is mentioned, if at all, in the context of a broader question about the optimal antitrust enforcement. This discussion departs from restating well-known objectives which antitrust enforcement is supposed to achieve, namely, to put an end to anticompetitive practices in breach of Articles 101-102 TFEU<sup>128</sup> and also prevent their reoccurrence in the future. In view of these goals and the Commission's limited resources it is attempted to determine **(1)** *when* to intervene, i.e. establish the optimal standard of antitrust intervention both in terms of **(1a)** identifying cases which deserve an intervention and prioritising among them **(1b)** defining an adequate antitrust law response, as well as **(2)** *how* to intervene, i.e. strike the optimal balance between, on the one hand, fully contested proceedings possibly leading to an infringement decision often followed by a court litigation and, on the other hand, a more rapid and less costly disposal of a case by a commitment decision.

To the contrary, this thesis deals with an *instrumental use* of commitment decisions, a situation where antitrust enforcement is disconnected from the objectives rooted in Articles 101-102 TFEU<sup>129</sup> and instead pursues non-competition (regulatory) goals.

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hand, the parties' own interests in settling a case and, on the other hand, social welfare gains from court litigation. For instance, A.M. POLINSKY and D.L. RUBINFELD, 'The Deterrent Effects of Settlements and Trials' (1988) *International Review of Law and Economics* 8, 109-116, show that settlements are not always socially optimal. Their transaction costs are lower in comparison to trials, but they might also have lower deterrence effects. For an out-of-court settlement to take place, the victim's expected gain from litigation must be less than the injurer's expected loss from litigation. S. SHAVELL, 'The Level of Litigation: Private versus Social Optimality of Suit and of Settlement' (1999) *International Review of Law and Economics* 19, 99-115, shows that the use of settlements might be suboptimal from the social perspective, because the parties consider only their own legal costs (and not the cost of the other party or the state) and they don't consider the impact on deterrence or reduction of harm. Further, Shavell argues that the settlement option may have a negative impact on deterrence (because the injurer pays less than in litigation) and cause excessive lawsuits (as settlements make them cheaper). To alleviate these socially undesirable effects, Shavell proposes to impose a tax on settling injurers, and to increase fees for bringing lawsuits should be increased. J.M. PERLOFF, D.L. RUBINFELD and P. RUUD, 'Antitrust Settlements and Trial Outcomes' (1996) 78 *The Review of Economics and Statistics* 3, 401-409, build an empirical model which estimates both the probability of settlements and success at trial in private antitrust cases. According to the authors, a 1% increase in the likelihood that the plaintiff wins at trial raises the probability of a settlement by 0,13% which shows that in many cases parties enter a settlement simply because they are risk averse. They also find defendants do not care much about their reputation, so their risk aversion has a minor role in determining whether the parties go for a settlement or not. See also R.A. EPSTEIN, *Antitrust Consent Decrees in Theory and Practice. Why Less Is More*, The AEI Press, Washington D.C. 2007, for interesting in-depth case studies.

<sup>128</sup> Supra n. 15.

<sup>129</sup> Supra n. 15.

These ‘alien’ goals imported from other policies affect the parties’ incentives leading to suboptimal outcomes both in terms of standard of antitrust intervention and the balance between infringement decisions and commitment decisions. However, before focusing on these suboptimal outcomes, it is perhaps a good starting point to take a closer look at what is considered an optimum. The literature on commitment decisions provides some guidance on how to define optimal antitrust enforcement and when commitment decisions can or cannot be considered socially desirable.

(1) An optimal standard of antitrust intervention<sup>130</sup> can be defined by the gravity of the infringement identified and the intrusiveness of the antitrust response necessary to solve the anticompetitive problem. It is presumed that the relationship between the gravity of the infringement and the antitrust response is linear, i.e. the more serious the infringement, the farther-reaching the response.

In terms of (1a) the optimal case selection and prioritisation, the Commission should intervene in cases, where enforcement gains outweigh its costs. Given the investigatory resources are limited, they should be primarily allocated to cases where the infringement is sufficiently grave, so that its termination as a result of the Commission’s intervention would result in a substantial increase in consumer welfare. In other words, the Commission should not intervene below a certain threshold of gravity. Another aspect is the cost of enforcement which increases with the complexity/uncertainty of the case. The Commission should first pursue ‘strong’ cases (clear-cut infringement, sufficient evidence to prove it) where the probability of finding an infringement is high without investing too much investigatory resources. ‘Weak’ cases (legally ambiguous or lacking sufficient evidence) are much more expensive to investigate, and the Commission’s intervention can be justified only if enforcement gains exceed the costs of proving an infringement.

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<sup>130</sup> Based on Ibáñez Colomo’s model of ‘expected standards of intervention’, adapted for the purpose of this thesis. P. IBÁÑEZ COLOMO, *supra* n. 11, pp. 277-278.

**(1b)** The antitrust response might take form of remedies and/or fines imposed under Article 7 or commitments accepted under Article 9. Remedies and/or fines are generally supposed to bring the infringement to an end and restore effective competition (mostly in case of remedies) as well as punish and deter (mostly in case of fines). Commitments accepted under Article 9 are generally supposed to bring the *alleged* infringement to an end and restore competition in the market.<sup>131</sup> The intrusiveness of antitrust response, whatever form it takes, should be in direct proportion with the gravity of the infringement. In the context of Article 9, optimal enforcement would thus require that commitments are *proportional* to the alleged infringement identified by the Commission.<sup>132</sup>

**(2)** An optimal balance between commitment decisions and infringement decisions is determined by, on the one hand, efficiency gains of the commitment procedure and, on the other hand, considerations derived from the objectives of Articles 101-102 TFEU. In principle, cases should be closed by a commitment decision when the cost of further investigation and litigation is higher than the benefit resulting from it. For instance, Wils (2006) argues that an optimal use of commitment decisions would require to settle under Article 9 only these cases where the benefits of a commitment decision (earlier termination of the infringement and costs savings linked to shorter proceedings) outweigh the benefits of an infringement decision in terms of clarification of law, bringing an infringement to an end, public censure, deterrence, disgorgement of illicit gains, punishment and facilitation of damages actions.<sup>133</sup>

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<sup>131</sup> Commitments are not supposed to punish, given that cases are closed *without finding a breach of competition rules*. It is less clear whether commitments can in any way contribute to deterrence effects, or (according to a more popular view) whether they just decrease them. The Commission and many commentators find that commitment decisions have precedence value (see *infra* n. 221-222 and the accompanying text) so they might well deter other undertakings from engaging in anticompetitive conduct subject to a commitment decision, albeit to a lesser extent than infringement decisions (see European Commission, *Antitrust: Manual of Procedures*, *supra* n. 43, chapter 16, especially paras. 6 and 12). Further, to the extent that commitment cases free up some of the Commission's resources and allow it to focus on detecting serious infringements, they might *indirectly* increase deterrence. However, A.J. PADILLA and K. EDWARDS, *supra* n. 122, find that commitment decisions (or more generally, settlements – see *infra* n. 135) have a negative impact on *ex ante* deterrence, because a possibility to avoid fines by negotiating a commitment package with the Commission might encourage undertakings to engage in anticompetitive practices in the first place.

<sup>132</sup> W.P.J. WILS (2006), *supra* n. 33, p. 352. P. IBÁÑEZ COLOMO, *supra* n. 11, pp. 277-278. I.S. FORRESTER, *supra* n. 122, pp. 14-15 (working paper).

<sup>133</sup> W.P.J. WILS (2006), *supra* n. 33, pp. 348-350. In the same vein A. KLEES (2009), *supra* n. 122, pp. 376-377.

Similarly, in Padilla and Edwards' model a commitment decision is socially desirable when the costs of infringement proceedings and the loss in consumer welfare resulting from continued or unsuccessful Article 7 investigation are greater than the cost of settling the case under Article 9 in terms of foregone fines and diminished deterrence.<sup>134</sup> In other words, they weight the cost of infringement decision (i.e. the expected loss in consumer welfare associated to uncertain and protracted litigation plus the cost of litigation) against the cost of commitment decision (i.e. foregone benefits in terms of fines and deterrence effects).<sup>135</sup>

In addition, some authors and more recently, the Commission itself,<sup>136</sup> came up with certain *ex ante* criteria which would help to 'get the balance right'. Just to illustrate, Wils (2008) argues that in order to ensure optimal enforcement (i) the use of commitment decisions should be within the Commission's discretionary powers, (ii) the threat of successful enforcement under Article 7 should be credible (maintained by a record of infringement decisions upheld by the Courts), (iii) commitments should not be accepted before all the relevant facts are established to diminish the risk of an inadequate commitment package (iv) commitment procedure should be subject to regular evaluation.<sup>137</sup> Further, these authors usually try to restrict the scope of Article 9 rather than promote its use for certain types of cases. It is generally recognised that commitment decisions should not be used in cases of *serious* infringements, where goals such as deterrence, public censure, and punishment make the case worth pursuing to the end.<sup>138</sup> According to some, commitment decisions should also be excluded in cases involving *novel* questions, because of lost opportunity to clarify the

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<sup>134</sup> A.J. PADILLA and K. EDWARDS, *supra* n. 122.

<sup>135</sup> Padilla and Edwards' model applies to all antitrust settlements, and not specifically to commitment decisions. Given the focus of this thesis on commitment decisions, their arguments are put in the context of Article 9 (e.g. 'competition authority' is replaced with 'the Commission', 'settlements' are replaced with 'commitment decisions'). This also applies to contributions by some other authors (e.g. Petit, Wils(2008)) concerning settlement mechanisms in general. Cartel settlements as well as national settlement mechanisms equivalent to Article 9 commitment decisions are beyond the scope of this thesis.

<sup>136</sup> European Commission, *Antitrust: Manual of Procedures*, *supra* n. 43, chapter 16, paras. 5-18.

<sup>137</sup> W.P.J. WILS (2008), *supra* n. 122, pp. 14-15 (online version).

<sup>138</sup> Advocated by E. GIPPINI-FOURNIER, *supra* n. 33, p. 42. W.P.J. WILS (2008), *supra* n. 122, p. 13 (online version) and N. PETIT, *supra* n. 122, p. 37. The latter author refers to long-lasting restrictions of competition, but the context (consumer harm) implies that they are also serious.

law.<sup>139</sup> Also the Commission states that it is not going to accept commitments if it wants to establish a precedence; it will opt for Article 7 route instead.<sup>140</sup> Finally, several authors propose to exclude commitment decisions in cases of *clear-cut* infringements,<sup>141</sup> however difficult this task may be in practice, given that the Commission does not fully investigate commitment cases.<sup>142</sup> In sum, these all suggestions in the literature to exclude commitment decisions in certain types of cases seem to be prompted by Recital 13, which, due to its misleading wording, requires ‘corrective’ interpretation.<sup>143</sup> However, one should bear in mind that even though commitment decisions might not always be the best choice in certain types of cases, to the extent that they allow the Commission to focus on more serious infringements (and boost its detection rates), they may actually result in a more optimal use of resources overall.<sup>144</sup> Moreover, the proposed exclusions should not imply that commitment cases outside the no-go zone of serious and novel cases would always be socially desirable. Authors are generally careful about their use<sup>145</sup> and like Wils (2008), emphasise the importance of successful disposal of cases under Article 7 in parallel to commitment cases to keep both deterrence<sup>146</sup> and the Commission’s

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<sup>139</sup> Advocated by E. GIPPINI-FOURNIER, *supra* n. 33, p. 42. W.P.J. WILS (2008), *supra* n. 122, p. 13 (online version) and I.S. FORRESTER, *supra* n. 122, p. 10 (working paper).

<sup>140</sup> European Commission, *Antitrust: Manual of Procedures*, *supra* n. 43, chapter 16, para. 11.

<sup>141</sup> E. GIPPINI-FOURNIER, *supra* n. 33, p. 42. W.P.J. WILS (2008), *supra* n. 122, p. 13 (online version).

<sup>142</sup> As noted by Mel Marquis, ‘if the undertaking concerned proposes commitments before a persuasive case is built upon solid evidence, the infringement cannot yet be called clear-cut.’ See M. MARQUIS, ‘Cartel Settlements and Commitment Decisions’ in C.-D. EHLMERMAN and M. MARQUIS (eds.) *European Competition Law Annual 2008: Antitrust Settlements under EC Competition Law*, Hart Publishing, Oxford 2009, at note 18.

<sup>143</sup> Recital 13 does not permit the Commission to adopt a commitment decision *when it intends to impose a fine*. See, in that respect, N. PETIT, *supra* n. 122, p. 38, who finds that the restriction imposed by Recital 13 conflicts with the very nature of a commitment decision, because firms would not offer commitments if they didn’t face the risk of being sanctioned. Petit concludes that it is not the prospect of fine that should be the criterion for excluding cases from the scope of Article 9, but the type of infringement. One can observe that this is exactly the approach taken by the Commission in its enforcement practice, because it uses commitments also in cases which would otherwise lead to a fine. Article 9 is explicitly excluded only in ‘secret cartels that fall under the Notice on immunity from fines and reduction of fines in cartel cases.’ See Commission notice on best practices, *supra* n. 16, para. 116. See also *supra* n. 28 and *infra* n. 207 for references.

<sup>144</sup> A.J. PADILLA and K. EDWARDS, *supra* n. 122, at note 18 (working paper).

<sup>145</sup> E.g. E. GIPPINI-FOURNIER, *supra* n. 33, p. 43, argues that commitment decisions should be used sparingly and should not become a standard device to dispose of cases at the EU level, especially because the current regime of decentralised enforcement was so designed to allow the Commission to deal with cases on the front burner in terms of prosecution and retribution, and these in principle should not be commitment cases.

<sup>146</sup> W.P.J. WILS (2008), *supra* n. 122, p. 14 (online version). A.J. PADILLA and K. EDWARDS, *supra* n. 122, pp. 13-15 (working paper). The authors find that the very possibility of reaching a deal with the Commission under Article 9 (and thus avoiding a fine) increases the undertaking’s incentive to engage in anticompetitive

bargaining power<sup>147</sup> at a sufficient level. Lastly, it seems important that the Commission always makes an *informed* choice between commitment procedure and infringement procedure instead of rushing into Article 9 negotiations in uncertain cases.<sup>148</sup>

#### 1.5.1.2. Suboptimal use of commitment decisions

Not surprisingly, the question of the optimal use of Article 9 emerges in the commitment discussion only because it is feared that suboptimal outcomes are very likely, both in terms of (1) standard of the Commission's intervention and (2) the balance between infringement decisions and commitment decisions. To be more precise, concerns have been expressed that the introduction of commitment procedure might:

- (1) facilitate deviations from the optimal standard of intervention,
  - (1a) causing a distortion in the Commission's enforcement priorities<sup>149</sup> and
  - (1b) resulting in disproportional antitrust response,<sup>150</sup> and
- (2) lead to suboptimal outcomes both in form of *excessive* and *insufficient* use of commitment decisions, whereby most authors find the latter scenario unlikely.<sup>151</sup>

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behaviour and might thus lower deterrence effects. In order to prevent this, the authors suggest dedicating sufficient resources to the detection of anticompetitive behaviour (i.e. a record of successful Article 7 decisions).

<sup>147</sup> W.P.J. WILS (2008), *supra* n. 122, p. 14 (online version). G.S. GEORGIEV, *supra* n. 48, p. 1024.

<sup>148</sup> E. GIPPINI-FOURNIER, *supra* n. 33, p. 42. W.P.J. WILS (2008), *supra* n. 122, p. 14 (online version). See also European Commission, *Antitrust: Manual of Procedures*, *supra* n. 43, chapter 16, para. 10.

<sup>149</sup> W.P.J. WILS (2006), *supra* n. 33, p. 351. W.P.J. WILS (2008), *supra* n. 122, pp. 15-17 (online version). A.J. PADILLA and K. EDWARDS, *supra* n. 122. I.S. FORRESTER, *supra* n. 122, p. 12 (working paper). N. PETIT, *supra* n. 122. P. IBÁÑEZ COLOMO, *supra* n. 11, p. 278-279.

<sup>150</sup> P. IBÁÑEZ COLOMO, *supra* n. 11, p. 279-280. I.S. FORRESTER, *supra* n. 122, pp. 14-15 (working paper).

<sup>151</sup> *Supra* n. 127, except for Padilla and Edwards. According to them, suboptimal outcomes might occur both in form of *excessive* and *insufficient* use of commitment decisions. Whether there is an excess or a deficit of commitment decisions will depend on whether the Commission's preferences in terms of protecting short-term consumer welfare and deterrence reflect those of society, or whether it has a bias in favour of any of the two objectives. For instance, if the Commission has a bias in favour of deterrence, it prefers to litigate cases and there will be too few commitment decisions. If, on the other hand, the Commission values short-term consumers' well-being more than ensuring deterrence effects, the number of commitment cases might exceed the social optimum. Whether there is an excess or a deficit of commitment decisions further depends on the incentives on the part of the undertaking, as they must consent for the commitment route. From the undertakings' perspective, the incentive to enter into commitment negotiations with the Commission increases with the costs of infringement proceedings, the potential fine, probability of finding an infringement but drops

### *1.5.2. Debate on the use of commitments for regulatory purposes (instrumentalisation).*

The previous section explained what means an optimal use of commitment decisions and signaled that suboptimal outcomes might occur. These suboptimal outcomes have been subject to an extensive discussion in the literature. They will be revisited here, but particular attention will be paid to concerns about instrumentalisation of commitment decisions, i.e. their use for regulatory purposes. In other words, this section enters a broad area of competition versus regulation debate (see Figure 2).<sup>152</sup>

#### **1.5.2.1. Suboptimal outcomes and the risks of instrumentalisation**

**(1a)** Concerns have been raised that the introduction of Article 9 option might cause a distortion in the Commission's case selection and prioritisation.<sup>153</sup> In practice, the question whether to intervene or not depends entirely on the Commission, which is free in setting its enforcement priorities.<sup>154</sup> If the Commission decides that the case is not worth pursuing, because the enforcement costs would be disproportionately high to the enforcement gains, it will state that there are 'insufficient grounds for acting'.<sup>155</sup> It is argued that the accountability of the Commission to the outside world (obligation

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when the additional profits from pursuing its anticompetitive practice (in case no infringement is found) are substantial. So, for instance, if deterrence effects of the Commission's enforcement are low (e.g. low fines) and anticompetitive gains are high, undertakings might prefer to take the risk, carry on with their anticompetitive practice and let the Commission impose a fine in an infringement decision which they subsequently appeal, rather than abandoning their practice immediately following a commitment decision.

<sup>152</sup> To the author's knowledge, concerns related to the instrumental use of commitment decisions are most comprehensively discussed by G.S. GEORGIEV, *supra* n. 48, pp. 1023-1029. A recent contribution by P. IBÁÑEZ COLOMO, *supra* n. 11, pp. 276-280, provides the most developed analytical framework for the application of competition law in a regulatory fashion and also identifies these problems, however with no specific focus on commitment decisions.

<sup>153</sup> W.P.J. WILS (2008), *supra* n. 122, pp. 15-17 (online version). I.S. FORRESTER, *supra* n. 122, p. 12 (working paper). P. IBÁÑEZ COLOMO, *supra* n. 11, pp. 278-279.

<sup>154</sup> See cases T-24/90, *Automec Srl v. Commission (Automec II)* [1992] ECR II-2223, paras. 77-83, and C-119/97, *Union Francaise de l'Express (UFEX) v. Commission* [1999] ECR I-1341, paras. 88-95.

<sup>155</sup> Also known as the 'lack of Union interest'. See Article 7 of Regulation (EC) No 773/2004 of 7.04.2004 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty [2004] OJ L 123/18. See also Commission notice on best practices, *supra* n. 16, para. 136: 'Rejections based on "insufficient grounds for acting" concern in particular complaints where, given the limited likelihood of establishing the proof of the alleged infringements and the substantial investigatory resources which the Commission would have to invest in order to verify their existence, allocating the resources necessary to further investigate the case would be disproportionate, in light of its expected limited impact on the functioning of the internal market and/or the possibility of the complainant to have recourse to other means.'

to show results, make headlines) forces it to allocate its investigatory resources in an optimal way.<sup>156</sup> However, the option to settle cases under Article 9 lowers the enforcement costs and thus affects its initial cost-benefit exercise at case selection. Given that the intervention is cheaper with Article 9 option, the Commission might be encouraged to intervene in cases which otherwise would not be high on its priority list, because they would be too expensive in relation to the enforcement gains. This relates to cases that are (i) either not serious enough (small enforcement gains)<sup>157</sup> or (ii) not ‘strong’ enough,<sup>158</sup> i.e. complex/uncertain, which makes their investigation particularly costly, or (iii) both. Case resolution through commitment decisions would quickly boost up the Commission’s enforcement statistics at least cost. Further, it is argued that suboptimal case selection might be encouraged by the undertakings themselves. Given that the notification system has been abolished, undertakings, in search for legal certainty, might want to approach the Commission and seek its approval for their contracts in exchange for some minor commitments (notification through the back door).<sup>159</sup> In order to avoid suboptimal case selection, Wils (2008) suggests to develop ‘strict and effective internal procedures and controls ensuring that weak cases are not opened, or, if already opened, swiftly closed, without recourse to formal commitments.’<sup>160</sup>

The above discussion shows that the Commission can deviate from the socially desirable optimum *solely* because the existence of the commitment procedure lowers its enforcement costs and cases, which until now were socially too expensive to handle, now become available. Since the commitment procedure allows the Commission to intervene under competition rules there, where there might be no competition problems at all, and still achieve results in form of commitments, it has been suggested that the Commission might well misuse Article 9 to achieve desired

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<sup>156</sup> W.P.J. WILS (2008), *supra* n. 122, p. 16 (online version). I.S. FORRESTER, *supra* n. 122, p. 12 (working paper).

<sup>157</sup> W.P.J. WILS (2008), *supra* n. 122, pp. 16-17 (online version). P. IBÁÑEZ COLOMO, *supra* n. 1111, pp. 278-279.

<sup>158</sup> I. S. FORRESTER, *supra* n. 122, p. 12 (working paper).

<sup>159</sup> W.P.J. WILS (2006), *supra* n. 33, p. 351. The risk of ‘notification through the back door’ is well-recognised by the Commission. See *Antitrust: Manual of Procedures*, *supra* n. 43, chapter 16, para. 16.

<sup>160</sup> W.P.J. WILS (2008), *supra* n. 122, p. 17 (online version).

results beyond the scope of its competition powers.<sup>161</sup> The cost-benefit calculation behind the intervention remains the same in principle (enforcement cost < enforcement gains), only that under ‘enforcement gains’ is meant not the termination of infringement (and the resulting increase in consumer welfare) but other non-competition goals. Obviously, the risk of misuse of Article 9 is greater in sectors which are high on the Commission’s regulatory agenda, where the Commission has developed a clear idea about the results it wants to achieve.<sup>162</sup> Thus, many authors are concerned that the Commission might be tempted to intervene in a regulatory manner in certain less competitive markets and ‘correct’ them through far-reaching behavioural and structural commitments.<sup>163</sup> This brings us to the second suboptimal outcome resulting from the Commission’s deviation from its standard of intervention, namely, disproportionate antitrust response.

**(1b)** It has been argued that commitments may either go beyond addressing anticompetitive concerns or might not be related to them<sup>164</sup> or even worse, might be anticompetitive.<sup>165</sup> This mismatch arises mostly from the very logic of a settlement mechanism. Commitments are offered voluntarily, and nothing prevents an undertaking from offering more than it should have. More importantly, commitments are negotiated between the Commission and the undertaking in order to find a

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<sup>161</sup> W.P.J. WILS (2006), *supra* n. 33, pp. 351-352.

<sup>162</sup> I.S. FORRESTER, *supra* n. 122, p. 12 (working paper).

<sup>163</sup> W.P.J. WILS (2006), *supra* n. 33, pp. 351-352, points at the antitrust settlement practice of the US Department of Justice (DoJ) and observes that also in Europe competition authorities (or their officials) might be tempted to use commitments in order to achieve desired results beyond the scope of their legal powers. N. PETIT, *supra* n. 122, p. 32, observes that commitment decisions (and antitrust settlements in general – see *supra* n. 135) allow competition authorities to ‘intrusively regulate markets through behavioural and structural commitments’. G. BRUZZONE and M. BOCCACCIO, *supra* n. 122, p. 99, pointing at the excessive use of commitment decisions to increase competition on the various markets. See also S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 180, pointing at this risk of illegitimate competition enforcement in IP-related cases.

<sup>164</sup> See in particular P. IBANEZ COLOMO, *supra* n. 11, pp. 279-280 and other references, *infra* n. 167.

<sup>165</sup> Since the Commission does not fully investigate the case, it risks accepting commitments putting an end to legitimate (and sometimes even pro-competitive) business conduct, which would amount to restriction of competition on the merits. Undertakings offering commitments act in their own business interest and do not reliably represent the interest of protecting competition. J. TEMPLE LANG (2009), *supra* n. 25, pp. 134-135. F. WAGNER-VON PAPP, *supra* n. 25, pp. 950 and 955. See H. SCHWEITZER (2012), *supra* n. 48, p. 3 of the manuscript.

workable compromise, and not to come up with a commitment package mimicking an Article 7 outcome.<sup>166</sup>

It is beyond dispute that Article 9 needs a more relaxed procedural framework in order to serve its primary aims (administrative efficiency) and generate other benefits (finding innovative and tailor-made solutions to anticompetitive problems). However, it is feared that the Commission might be tempted to take an undue advantage of Article 9 route and extract far-reaching commitments from undertakings which it would otherwise not have been able to impose under Article 7.<sup>167</sup> This might happen, in particular, when the Commission's competition enforcement is affected by other policy considerations, like for instance, the need to correct less competitive sectors (1a). In other words, the Commission might want to pursue regulatory objectives and shape markets by extracting far-reaching commitments to obtain results, which it has no power to obtain under competition rules.<sup>168</sup> As Temple Lang puts it, 'the difference is in the essence that competition law allows [the Commission] only to prevent or to put an end to identified illegal conduct that restricts competition, but does not empower [it] to take steps to make a legal market more competitive, however desirable it may seem.'<sup>169</sup>

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<sup>166</sup> J. TEMPLE LANG (2006), *supra* n. 45, pp. 283-285, lists other reasons why commitments negotiated under Article 9 might not correspond to the obligations which the Commission would have been able to impose on the undertaking in an infringement decision.

<sup>167</sup> J. TEMPLE LANG (2003), *supra* n. 16, p. 356. J. TEMPLE LANG (2006), *supra* n. 45, pp. 275, 316-320. M. FURSE, *supra* n. 11, 5. M. SOUSA FERRO, *supra* n. 122, p. 451 and 458. C.J. COOK, *supra* n. 122, p. 219 and 221. W.P.J. WILS (2006), *supra* n. 33, pp. 351-352. G.S. GEORGIEV, *supra* n. 48, p. 1028. A. PERA and M. CARPAGNANO, *supra* n. 122, p. 672. D. WAELBROECK (2008), *supra* n. 38, p. 3. D. WAELBROECK (2009), *supra* n. 17, p. 234. A. KLEES (2009), *supra* n. 122, p. 377. H. SCHWEITZER (2010), *supra* n. 48, p. 11 of the working paper. G. BRUZZONE and M. BOCCACCIO, *supra* n. 122, p. 99. K. KOSTOPOULOS (2009), *supra* n. 26, p. 17-18. N. PETIT, *supra* n. 122, at note 138. S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 181. M. KELLERBAUER, *supra* n. 122, p. 4. L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 79. I. S. FORRESTER, *supra* n. 122, p. 14-15 (working paper). F. WAGNER-VON PAPP, *supra* n. 25, pp. 931 and 955, speaks about 'proactive' or 'extra-legal' remedies.

<sup>168</sup> See J. TEMPLE LANG (2006), *supra* n. 45, pp. 317-318, for a list of competition cases where the Commission acted in a regulatory manner and tried to achieve results which could have been done only by means of regulation. See also L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, and p. 76 and also p. 134 for comments of Bruno Lasserre on instances where the French competition authority was accused of acting as a price regulator. According to I.S. FORRESTER, *supra* n. 122, p. 12 (working paper): 'The risk of selecting weak cases is particularly high in industries which are high on the Commission's regulatory agenda, where influencing how the market functions may exceed in importance sound competition law enforcement.'

<sup>169</sup> J. TEMPLE LANG (2009), *supra* n. 25, p. 137.

(2) Moreover, much has been said about the potential bias on the part of the Commission in favour of commitment decisions. Ultimately it is the Commission to decide whether to pursue infringement proceedings or close a case under Article 9, if an undertaking is willing to settle.<sup>170</sup> The *rationale* of Article 9 is to provide a faster track to handle clear-cut or less serious infringements, so that the Commission can shift its limited investigatory resources to more serious cases, which, due to higher enforcement gains, are worth pursuing under Article 7. However, it is feared that the Commission might settle under Article 9 also these latter cases in order to bypass Article 7 route, if this one appears to be too complex, time-consuming or uncertain (so-called ‘exit strategy’).<sup>171</sup> The underlying argument for this concern is that closing ‘difficult’ cases under Article 9 does not best serve public interest, as the Commission foregoes the opportunity to clarify law through a precedence and leaves the business and competition community in a state of legal uncertainty.<sup>172</sup> Further, closing doubtful cases under Article 9 without fully investigating them might also have a chilling effect on possibly legitimate and pro-competitive conduct in an individual case (risk of type I errors).<sup>173</sup> Also, as Georgiev points out, once commitment decisions become surrogates for infringement decisions the quality of the commitment decisions might drop. This is because the lack of effective enforcement under Article 7 and consequently, the lack of a credible threat of such enforcement would substantially

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<sup>170</sup> The only restraint on the Commission provides Recital 13 of Regulation 1/2003, *supra* n. 14, according to which commitment decisions are not appropriate in cases which might give rise to a fine. The Commission’s practice demonstrates a very narrow interpretation of this provision, i.e. commitment decisions are excluded only in cartels which fall under the cartel settlement procedure. See *supra* n. 28 and *infra* n. 207 for references. For case law on the Commission’s discretion in setting its enforcement priorities, see *supra* n. 154.

<sup>171</sup> R. WHISH (2006), *supra* n. 45, 570. J. TEMPLE LANG (2006), *supra* n. 45, p. 316. C.J. COOK, *supra* n. 122, p. 213. G.S. GEORGIEV, *supra* n. 48, pp. 1023-1026. H. SCHWEITZER (2010), *supra* n. 48, p. 10-11 of the working paper. N. PETIT, *supra* n. 122, p. 33, calls it ‘exit strategy’. S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 186. A. KLEES (2009), *supra* n. 122, p. 377. F. WAGNER-VON PAPP, *supra* n. 25, pp. 931 and 961. I.S. FORRESTER, *supra* n. 122, p. 3 (working paper). L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 79 and comments by Ortiz Blanco at p. 135 (roundtable discussion).

<sup>172</sup> This criticism comes from the literature on alternative dispute resolution (ADR). See F. WAGNER-VON PAPP, *supra* n. 25, p. 961, about abandoning the “struggle for law”, i.e. litigation. See also his critical remarks about closing the *Rambus* case under Article 9, p. 963. However, commitment decisions might have some precedence-setting value. See discussion, *infra* section 1.5.2.3.

<sup>173</sup> E. GIPPINI-FOURNIER, *supra* n. 33, p. 42. See, however, J. TEMPLE LANG (2009), *supra* n. 25, pp. 143-144, who observes that commitment decisions might be a pragmatic way to deal with novel and complex exclusionary abuses, where the risk that the Commission gets the story wrong and impose an inadequate and unsatisfactory remedy under Article 7 is high. According to the author, in such cases accepting commitments might be better than nothing. In the same line S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 175.

decrease the Commission's bargaining power under Article 9, so that it could not extract sufficient commitments.<sup>174</sup>

High number of commitment decisions (in comparison to Article 7 decisions) in certain sectors might indicate that the Commission uses competition law for regulatory purposes. Looking at the Commission's enforcement so far, the biggest cluster of commitment decisions can be observed in the energy sector following the energy sector inquiry. But also commitment decisions adopted outside the energy sector relate to areas where the Commission pursues clear policy (i.e. joint selling of media rights for sport events, payment cards).<sup>175</sup> When the Commission decides to take action for *non-competition* purposes, the balancing exercise it makes in order to choose between Article 7 and Article 9 route might be much simpler. Article 7 route loses on its 'attractiveness' because all its benefits (clarification of law, bringing an infringement to an end, public censure, deterrence, disgorgement of illicit gains, punishment and facilitation of damages actions) are not relevant anymore, since Article 101-102 objectives are replaced with regulatory objectives. All what still counts is the enforcement cost and, most importantly, quick results, and both speak for Article 9 route.

#### 1.5.2.2. Formlessness of Article 9 and the opportunities it creates

Those, who raise concerns about potential instrumentalisation of commitment decisions, point at the *flexible* legal framework of Article 9. It is argued that commitment procedure in its current form leaves too much scope for a potential abuse of competition powers inviting the Commission to realise its regulatory-like ambitions

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<sup>174</sup> G.S. GEORGIEV, *supra* n. 48, p. 1024. See also A.J. PADILLA and K. EDWARDS, *supra* n. 122, who argue that the possibility of settling cases might have a negative impact on the deterrence effect of antitrust enforcement and should therefore be accompanied by an increase in resources dedicated to the detection of anticompetitive behaviour.

<sup>175</sup> H. SCHWEITZER (2012), *supra* n. 48, pp. 12-15 (online version), observes that national competition authorities use commitment decisions (based on national provisions) in the same areas, as if executing the policy set by the Commission.

through extracting excessive commitments.<sup>176</sup> In particular, the following six arguments speak for the risk of instrumentalisation:

First of all, the European Court of Justice ruled in the 2010 *Alrosa* case that the Commission can accept commitments which go beyond what it could itself impose under Article 7.<sup>177</sup> Under Article 9 the Commission needs only to make sure that accepted commitments address its concerns expressed in the preliminary assessment and that they do not *manifestly* go beyond what is necessary to address these concerns.<sup>178</sup> However, the Commission is under no obligation to seek out less onerous solutions than the ones proposed to it.<sup>179</sup> This means that as long as the commitments offered meet the Commission's concerns identified in the preliminary assessment and are not manifestly disproportionate, it can make them binding, regardless of whether it could itself impose the same measures after a thorough examination under Article 7 or not. This relates, in particular, to structural measures, which are generally seen as a remedy of last resort under Article 7, but which the Commission can easily extract in form of commitments.<sup>180</sup> In this way, a disproportionate and thus illegal hypothetical remedy imposed by the Commission under Article 7 can become proportionate and

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<sup>176</sup> J. TEMPLE LANG (2006), *supra* n. 45, pp. 316-320. J. TEMPLE LANG (2009), *supra* n. 25, pp. 136-137. H. SCHWEITZER (2010), *supra* n. 48, pp. 11 and 27 of the working paper. N. PETIT, *supra* n. 122, p. 32. H. SCHWEITZER (2012), *supra* n. 48, p. 3 (online version). T. KOZIEL, 'Commitment Decisions under the Polish Competition Act – Enforcement Practice and Future Perspectives' (2010) 3 *Yearbook of Antitrust and Regulatory Studies* 3, 71-91, p. 85 (in the context of the Polish commitment practice).

<sup>177</sup> Case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, paras. 47-48. The ECJ took account of the voluntary nature of commitments and stated that the obligation on the Commission to ensure that the principle of proportionality, which is a criterion for the lawfulness of any act of the EU institutions (para. 36), has a different extent and content under Article 9 (para. 38).

<sup>178</sup> Case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, paras. 41 and 120. Commission notice on best practices, *supra* n. 16, para. 115, restates this, referring to the judgment.

<sup>179</sup> The Commission must only make sure that the undertaking has not offered other less onerous commitments that also address those concerns adequately (case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 41). In that respect the Court refers to the specific circumstances of the *Alrosa* case, where two different sets of commitments were submitted in two parallel investigations. In such a case the Commission would have to choose the less onerous set of commitments, provided it meets its concerns (necessity test). Usually, however, the undertaking offers only one set of commitments. However, see F. WAGNER-VON PAPP, *supra* n. 25, pp. 937-938, about the possibility of engaging in so-called 'salami tactics', whereby an undertaking offers several sets of commitments of different scope which would force the Commission to engage in proportionality analysis in order to choose the least onerous set.

<sup>180</sup> Under Article 7, even though the Commission is allowed to impose remedies of structural and behavioural character, there is a general preference for behavioural remedies (see Article 7 and Recital 12 of Regulation 1/2003, *supra* n. 14). There is no such requirement under Article 9, because the Commission doesn't have to look for less onerous commitments than the ones proposed by the undertaking (C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 41).

legal if it is offered by the undertaking as a commitment under Article 9. Given that the Commission can during negotiations proactively suggest commitments which undertakings are expected to offer,<sup>181</sup> Article 9 opens a possibility to implement far-reaching remedies which are beyond the Commission's powers as an antitrust enforcer.<sup>182</sup>

As already established, the commitments must address the Commission's anticompetitive concerns following its preliminary assessment. Assuming that the Commission wants to extract far-reaching remedies, it needs to come up with serious concerns. The second argument for a potential instrumentalisation of competition rules is that Article 9 does not sufficiently shield those undertakings which consider that the Commission's allegations are far-fetched and would like to challenge them *before offering any commitments*. More in detail, since the Commission is not required to fully investigate the case, it does not need to issue a statement of objections, which would set out the exact scope of the suspected infringement and create on the part of the undertaking procedural rights to respond and defend its conduct.<sup>183</sup> Instead, what happens in practice is that the Commission presents its preliminary concerns to the undertaking in the so-called 'state-of-play meeting'. This is also when potential commitments are discussed. After these initial negotiations<sup>184</sup> the Commission issues a document which states its concerns ('preliminary assessment' in the wording of Article 9) and which serves the undertaking merely 'as a basis [...] to formulate appropriate commitments addressing the competition concerns expressed by the Commission, or to better define previously discussed commitments'.<sup>185</sup> It is a relatively short document and doesn't need to be as detailed

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<sup>181</sup> Such a possibility was implicitly acknowledged by the ECJ in the *Alrosa* ruling, case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 86.

<sup>182</sup> See also comments by Alexander Italianer in L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 136 (roundtable discussion): 'I agree, it may happen in theory that certain commitments proposed could go beyond what might be considered strictly necessary. But that is the nature of the process.'

<sup>183</sup> Issuance of the statement of objections creates procedural rights of defence on the part of the investigated undertaking: the right to access to the file (Article 27(2) of Regulation 1/2003, *supra* n. 14, and Article 15 of Regulation 773/2004, *supra* n. 155), the right to respond to the statement of objections in writing and orally (Article 27(1) of Regulation 1/2003, *supra* n. 14, Articles 10, 11(1) of Regulation 773/2004, *supra* n. 155) and finally, the right to a formal oral hearing (Article 12 of Regulation 773/2004, *supra* n. 155).

<sup>184</sup> Commission notice on best practices, *supra* n. 16, para. 121 *in fine*.

<sup>185</sup> Commission notice on best practices, *supra* n. 16, para. 122.

as a statement of objections.<sup>186</sup> In fact, it can even be issued once the commitments have already been agreed.<sup>187</sup> In practice, this often leaves undertakings under-informed with respect to the infringement they are accused of. Not only they might find it difficult to devise appropriate commitments, but also have no formal possibility to react to the charge (whether it is legitimate or not).<sup>188</sup> <sup>189</sup>

Thirdly, it is unclear whether the undertaking is sufficiently protected *once it has offered commitments*. At that stage the Commission, and only if it finds that the commitments *prima facie* address its concerns,<sup>190</sup> must publish them to allow interested third parties to submit their observations.<sup>191</sup> This so-called market test constitutes the only and imperfect reality check of the proposed measures. It is the only one, because the Commission does not fully investigate the case and sometimes might lack necessary industry-specific expertise to accurately assess all potential

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<sup>186</sup> European Commission, *Antitrust: Manual of Procedures*, supra n. 43, chapter 16, para. 26: '[Preliminary Assessment] does not require the same length and level of detail as a Statement of Objections. The length of a Preliminary Assessment may vary from case to case, depending, for example, on the complexity of the case or the Commission's interest to set a precedent case in the later commitment decision (which will, in turn, be based on the Preliminary Assessment).' See also para. 18: 'The required level of detail of a commitment decision may be lower than in the case of a "prohibition" decision or "imposed" remedy decision under Article 7 (e.g. facts pointing at a potential infringement is usually sufficient for a commitment decision, and some elements of the theory of harm – such as objective justifications - may not be discussed in detail). However, the Commission must have at its disposal sufficient facts to make an informed and sound assessment of the relevant competition concerns. In other words, the Commission must have reached the conclusion – even if only on a preliminary basis – that there may be or may have been an infringement of EU competition law which should be addressed. Often the preliminary assessment will contain considerably more detail than the commitment decision itself.' A standard preliminary assessment has about 20 pages, substantially less than a statement of objection which may reach up to 200 pages in complex cases. See E. GIPPINI-FOURNIER, supra n. 33, p. 35.

<sup>187</sup> This happened at least in two cases (*Coca-cola* and *REPSOL* listed in Table 1), see H. SCHWEITZER (2010), supra n. 48, pp. 8-9 of the working paper. D. WAELBROECK (2009), supra n. 17, p. 234. S. RAB, D. MONNOYEUR and A. SUKHTANKAR, supra n. 26, p. 173.

<sup>188</sup> For an alternative view, see e.g. S. RAB, D. MONNOYEUR and A. SUKHTANKAR, supra n. 26, p. 175, who find that bilateral negotiations over commitments offer undertakings an opportunity to explain and/or defend its conduct in contrast to a more unilateral approach under Article 7. For a more detailed discussion on preliminary assessment with sometimes diverging opinions, see C.J. COOK, supra n. 122, pp. 215-216. W.P.J. WILS (2006), supra n. 33, pp. 352-356. O. ARMENGOL and A. PASCUAL, supra n. 122, pp. 125-126. G.S. GEORGIEV, supra n. 48, p. 1005 and 1017-1020. D. WAELBROECK (2008), supra n. 38, p. 21. D. WAELBROECK (2009), supra n. 17, pp. 233-234. E. GIPPINI-FOURNIER, supra n. 33, pp. 33-35.

<sup>189</sup> Further, neither a preliminary assessment nor a statement of objections can be challenged before the General Court (the EGC), as these are merely provisional measures leading to a final decision. See case 60/81, *IBM v. Commission* [1981] ECR 2639, para. 10.

<sup>190</sup> Commission notice on best practices, supra n. 16, para. 129.

<sup>191</sup> Pursuant to Article 27(4) of Regulation 1/2003, supra n. 14. According to the provision, the Commission 'shall publish a concise summary of the case and the main content of the commitments or of the proposed course of action' in the Official Journal, whereas the full text of the commitments in their original language has to be made available online (MEMO/04/217 of 17.09.2004). Interested third parties have then minimum one month to submit their observations.

effects of a complex commitment package. It is the imperfect one, because third parties (especially competitors) might not always be objective in their observations.<sup>192</sup> If, on the basis of the market test results, the Commission finds that commitments do not address its concerns, it may reject them and/or ask the undertaking to modify them *without* giving reasons as to why it has changed its position following the market test.<sup>193</sup> Also, it is unclear whether the Commission is required to give the undertaking access to third parties' observations submitted during the market test.<sup>194</sup>

Fourthly, third parties are left out of the negotiations over commitments. It is true that while the Commission generally enjoys discretion in assessing the proportionality of commitments, it still needs – following the *Alrosa* ruling – ‘to take into consideration the interests of third parties’.<sup>195</sup> <sup>196</sup> In theory, the Commission complies with this obligation already, because it has to conduct market testing of commitments in each case. However, the fact that the Commission consults third parties and takes their observations into account does not mean that it is under any obligation to follow them.<sup>197</sup> Nor it is required to provide feedback to third parties regarding their

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<sup>192</sup> Third parties might pursue their own legal/commercial interests. E.g. competitors would generally be in favour of extensive commitments, regardless of whether they are proportionate or not. I.S. FORRESTER, *supra* n. 122, p. 14 (working paper) points at the risk of the Commission’s intellectual capture.

<sup>193</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, paras. 92 and 95. Commission notice on best practices, *supra* n. 16, paras. 132 and 133, states only that the Commission will inform the undertaking orally and in writing of the substance of the market test replies during another state-of-play meeting. In case market test results change the Commission’s view, ‘this will be brought to the attention of the undertakings offering the commitments’. This was, in fact, the Commission’s approach in the *Alrosa* case, see C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 16.

<sup>194</sup> See D. GERARD, *supra* n. 20, p. 464. C.J. COOK, *supra* n. 122, p. 220.

<sup>195</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 41. By saying this, the ECJ wished to recognise Alrosa’s right to be heard in the specific context of this case, once the Commission rejected its joint commitments with De Beers. For details of the case, see discussion *infra* n. 237 and the accompanying text.

<sup>196</sup> See F. WAGNER-VON PAPP, *supra* n. 25, pp. 949-951, for a number of reasons why the Commission might not be such a reliable agent for third-party interests (and the public interest) in the commitment procedure as it is in the infringement procedure.

<sup>197</sup> The ECJ ruling implies also that if third parties offer alternative and – in their view – less onerous commitments (as happened in the *Alrosa* case), the Commission has discretion to reject them and make binding commitments originally offered by the undertaking concerned. See C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, paras. 92-95.

For instance, as discussed in chapter 5, the Commission discarded valid third parties’ observations which were against SvK’s commitment to introduce market splitting. But see D. WAELBROECK (2009), *supra* n. 17, p. 237, at note 48, providing examples to the contrary, i.e. cases where third parties’ observations were duly taken into account by the Commission. However, it must be noted that in cases he refers to (*Alrosa* and *Premier League*, see Table 1) third parties considered commitments as *insufficient* to remedy anticompetitive concerns, whereas in the *SvK* case third parties found market splitting *too onerous* and asked for lighter commitments. See discussion in chapter 5.

submissions or, for instance, conduct another market test, once commitments have been amended following the negative responses during the first market testing.<sup>198</sup> It seems that apart from exercising their right to submit comments in the market test, third parties have no control over the commitment package, even in case they are directly affected by the commitments.<sup>199</sup> The lack of third parties' control over commitments makes Article 9 an attractive tool for the Commission to implement regulatory-like measures short-circuiting at the same time more democratic and thus much slower alternative routes.<sup>200</sup>

Third parties whose concerns are neglected by the Commission in the market test may want to seek annulment of an unfavourable commitment decision before the European Courts. This leads to the fifth argument, namely the lack of sufficient judicial control over the Commission's commitment decisions. To start with, it appears unlikely that an undertaking which has offered commitments can subsequently file an appeal for annulment of the Commission's decision to the European Courts *on substantive grounds* (e.g. manifest disproportionality of commitments).<sup>201</sup> So far, no such appeal has been filed which also suggests that undertakings have little interest in challenging decisions, which they, at least seemingly, previously agreed to. To the contrary, the right of affected third parties to appeal a commitment decision is not disputed<sup>202</sup> and in fact happened in practice.<sup>203</sup> However, if a third party manages to file an appeal to

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<sup>198</sup> A new market test will be conducted only if 'the amended version of the commitments alters the very nature or scope of the commitments', see Commission notice on best practices, *supra* n. 16, par. 133. Again, only the Commission can decide whether modifications of commitments need to be subject to another market testing.

<sup>199</sup> For their right to appeal, see *infra* next paragraph.

<sup>200</sup> See discussion in chapter 5 in the context of the SvK case.

<sup>201</sup> This question is still unsettled in the literature. Such a possibility is supported by R. WHISH, *supra* n. 45, p. 570, W.P.J. WILS (2006), *supra* n. 33, 363, W.P.J. WILS (2008), *supra* n. 122, p. 6 (online version), S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 184, and, with some caution, D. WAELBROECK (2008), *supra* n. 38, pp. 23-24 and (2009), *supra* n. 17, pp. 235-237. To the contrary argue J. TEMPLE LANG (2006), *supra* n. 45, p. 296, and C.J. COOK, *supra* n. 122, pp. 220 and 221-223, unless on procedural grounds. H. SCHWEITZER (2012), *supra* n. 48, at note 96 and the accompanying text (online version), points at the ECJ ruling in *Alrosa* and finds that a waiver of the right to appeal by the undertaking offering commitments seems to be 'part of the deal'. C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 48.

<sup>202</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 90.

<sup>203</sup> So far, a third party appeal has been brought in 2 cases but only one has been reviewed by the Courts (the other one has been rejected on procedural grounds). See *supra* n. 21. It should be noted that in order to get *locus standi*, a third party needs to demonstrate that the Commission's decision is of *direct* and *individual* concern to them (see Art. 263 (4) TFEU)). Participation in the market test might be indicative of this, but doesn't automatically grant the right to appeal. Similarly, it is doubtful that the Court's statement in *Alrosa* requiring the

the European Courts, the standard of their review, i.e. the degree of scrutiny exercised by the Courts over the legality of the commitment decision would be limited. According to the ECJ, the Commission enjoys a wide margin of discretion in making commitments binding or rejecting them,<sup>204</sup> and the Courts, in order not to intrude on this discretion, would only examine whether the Commission's assessment was *manifestly incorrect*.<sup>205</sup>

Of course, one could always argue that the voluntarily nature of commitments is a sufficient guarantee that the Commission doesn't abuse its policy-making powers. After all, an undertaking doesn't have to offer disproportionate commitments.<sup>206</sup> This reasoning usually meets a counterargument that undertakings do not care about competition policy and whether it is misused for other purposes or not. They only care about their own interests and it might be that concessions they make are for them the lesser of two evils. It is argued that undertakings demonstrate a strong short-term interest to close the proceedings and avoid fines<sup>207</sup> and that they might value it more than their interest not to be exposed to far-reaching regulatory measures in the medium-long term.<sup>208</sup> This is the sixth and last argument explaining why undertakings

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Commission to take third parties' interests into account would be sufficient to grant such right. See F. WAGNER-VON PAPP, *supra* n. 25, p. 967.

<sup>204</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 94.

<sup>205</sup> The European Court of Justice (the ECJ) ruled in the *Alrosa* case that commitment decisions are subject to limited judicial control under the so-called 'manifest error of assessment' standard. See C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 42. F. WAGNER-VON PAPP, *supra* n. 25, at note 47, doubts whether third parties could challenge the Commission's decision on proportionality grounds. H. SCHWEITZER (2012), *supra* n. 48, p. 19 (online version), finds that in the light of the Commission's discretion and the European Courts' deferential approach, 'a strong private enforcement seems to remain the only route by which effective judicial control can still be ensured.'

<sup>206</sup> For instance, M. KELLERBAUER, *supra* n. 122, p. 8.

<sup>207</sup> Recital 13 of Regulation 1/2003, *supra* n. 14, according to which commitment decisions are not appropriate in cases where the Commission intends to impose a fine, has been narrowly interpreted by the Commission so far, i.e. Article 9 is excluded only in hard-core cartel cases. See D. WAELBROECK (2008), *supra* n. 38, pp. 12-16. D. WAELBROECK (2009), *supra* n. 17, p. 235, at note 39. D. GERARD, *supra* n. 20, p. 464, at note 30. E. GIPPINI-FOURNIER, *supra* n. 33, pp. 28-29. T. KOZIEL, *supra* n. 176, p. 81, at note 52. H. SCHWEITZER (2012), *supra* n. 48, p. 6 (online version). F. WAGNER-VON PAPP, *supra* n. 25, at note 65. However, alternative views have also been expressed, see G. BRUZZONE and M. BOCCACCIO, *supra* n. 122, p. 100. M. KELLERBAUER, *supra* n. 122, p. 2. A. KLEES (2009), *supra* n. 122, p. 379.

<sup>208</sup> G. BRUZZONE and M. BOCCACCIO, *supra* n. 122, p. 100. W.P.J. WILS (2006), *supra* n. 33, p. 352. D. WAELBROECK (2009), *supra* n. 17, p. 235. H. SCHWEITZER (2012), *supra* n. 48, p. 3 (online version). In a recent account, F. WAGNER-VON PAPP, *supra* n. 25, pp. 943-956, points out important differences between commitments and private contracts and concludes that 'the voluntary nature of commitments is not a sufficient guarantee for the "correctness" of the negotiated outcome. In addition to the partial constraint that the requirement of consent undoubtedly exercises, the control of the substantive correctness of commitment decisions requires additional, external constraints.' (at p. 956).

offer extensive commitments voluntarily. A dramatic rise in *antitrust* fines over the last decade substantially enhances their short-term incentives to engage in Article 9 negotiations.<sup>209</sup>

Summing up, undertakings' inclination to settle 'at all costs' coupled with the Commission's broad discretion as to proportionality of commitments, insufficient procedural safeguards protecting undertakings' right of defence with the attendant lack of public participation and, on the top of that, limited judicial control all together create opportunities for the Commission to instrumentalise competition rules and extract commitments which go beyond the Commission's purview.<sup>210</sup> As noted by some authors, the only (and rather unreliable) safeguard against the Commission's abuse of powers is its own self-restraint.<sup>211</sup>

#### 1.5.2.3. Some final remarks

It has been argued in the literature that the problem of disproportionate commitments involves mainly two scenarios, i.e. (i) commitments addressing competition concerns but going beyond them or (ii) commitments not addressing competition concerns (or even further restricting competition). However, the potential mismatch between commitments and anticompetitive concerns might also involve a third scenario, which, for whatever reason, has received less attention in this debate.<sup>212</sup> Namely, (iii) the Commission accepts *less* than is required to remedy an anticompetitive problem. After

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<sup>209</sup> See generally D. GERARD, *supra* n.20, pp. 459-465, and W.J.P. WILS, 'The Increased Level of EU Antitrust Fines, Judicial Review and the ECHR (2010) 33 *World Competition: Law and Economics Review* 1, 5-29.

<sup>210</sup> This concern appears all the more legitimate given the peculiar EU institutional setting which allows the Commission to combine prosecution and decision-making powers D. WAELBROECK (2009), *supra* n. 17, p. 223.

<sup>211</sup> Advocated by W.P.J. WILS (2006), *supra* n. 33, p. 352. Other authors are rather skeptical, see e.g. H. SCHWEITZER (2012), *supra* n. 48, p. 19 (online version). F. WAGNER-VON PAPP, *supra* n. 25, pp. 931-932, 967-970.

<sup>212</sup> This scenario receives attention only insofar as it would have an impact on the possibility of follow-on antitrust investigations by national competition agencies and private enforcement, i.e. if the commitments made binding by the Commission do not eliminate all anticompetitive concerns, it is more likely that national competition authorities and national courts can still find an infringement of competition rules in the same case, despite the fact that the antitrust investigation at the EU level has been closed by a commitment decision with no finding of an infringement. For discussion see J. TEMPLE LANG (2006), *supra* n. 43, pp. 287-290. See also A. KLEES (2009), *supra* n. 122, p. 377, who mentions all three scenarios of 'inappropriate' commitments.

*Alrosa*, it is now clear that the Commission can accept more than it is sufficient to address its concerns expressed in the preliminary assessment. It still remains unclear whether it can accept less. The *Alrosa* ruling is not helpful in that respect. Even though the principle of proportionality obliges the Commission to make sure that the proposed commitments meet its concerns, it nevertheless enjoys wide discretion in making commitments binding or not.<sup>213</sup> Scholars are also divided in that respect. Some support the view that commitments must completely remove all the Commission's concerns,<sup>214</sup> whereas others suggest that it is enough if commitments reduce the Commission's concerns to such an extent that the case stops to be its enforcement priority.<sup>215</sup> Regardless of whether the Commission should be allowed to accept less or not, sometimes it might simply lack bargaining power (see Georgiev's example above)<sup>216</sup> or information (given the absence of a fully-fledged investigation) to extract sufficient commitments. This might well be the case that a commitment case becomes a bargaining chip in another deal struck outside the realm of competition enforcement. In particular, if the Commission pursues other strategic interests, an undertaking might negotiate a less burdensome commitment package in exchange of a promise not related to the case, but otherwise attractive for the Commission.<sup>217</sup> This is a rather extreme scenario, touching upon corruption or exercising political influence, but it helps to illustrate two valid arguments. First, competition rules are not applied in a vacuum. In a perfect world of competition enforcement the Commission should not be driven by other non-competition goals and also its decision-making should be immune to external pressure. In the real world this obviously happens, but certain procedural safeguards are meant to limit the scope for potential malfeasance. Article 9 does not have these safeguards, leaving the Commission an opportunity to misuse the

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<sup>213</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, para. 41, 67 and 94.

<sup>214</sup> E.g. D. WAELBROECK (2008), *supra* n. 38, p. 12-13. H. SCHWEITZER (2010), *supra* n. 48, pp. 24-26 of the working paper.

<sup>215</sup> E.g. R. WHISH (2006), *supra* n. 45, p. 569. This reasoning is based on the *Automec II* principle, *supra* n. 170, according to which the Commission is free to act on its priorities.

<sup>216</sup> *Supra* n. 174 and the accompanying text.

<sup>217</sup> A real-life example comes from the other side of the Atlantic, where antitrust settlements of the US DoJ have allegedly been an instrument to exercise political influence. The so-called ITT/Hartford controversy from the early 70s concerned allegations that one of the then biggest U.S. companies offered to sponsor the 1972 Republican National Convention in exchange for a favourable antitrust deal with DoJ. According to G.S. GEORGIEV, *supra* n. 48, pp. 1009, this was the main trigger behind the adoption of the Tunney Act in 1974, which introduced more transparency to the settlement negotiations.

law in pursue of other policies.<sup>218</sup> Second, negotiations over commitments involves two parties, but the commitment debate seems to downplay the undertaking's ability to influence the Commission and the fact that it might also have a role in the final shape of the commitment package.<sup>219</sup>

Sousa Ferro rightly points out that concerns about the potential mismatch between commitments and the (alleged) anticompetitive practice at issue was already present in the context of (informal) settlements, as the Commission could always exercise unwarranted pressure on companies to extract from them far-reaching promises.<sup>220</sup> These informal promises, however, were not enforceable, whereas the breach of a commitment allows the Commission to impose substantial fines and periodic penalties. Further, unlike promises made by undertakings in a settlement, commitments are made binding in a formal decision and thus might have *some* precedence value.<sup>221</sup> Especially in areas where there is no other Article 7 decisions or the Courts' case law to rely on, the Commission's preliminary assessment summarised in the commitment decision might be indicative of what type of conduct (if indeed it occurred) might be considered anticompetitive. Thus, a commitment decision setting forth the Commission's preliminary findings on market definition, dominance and practices raising concerns might influence business and competition community and might even lead to establishing new legal principles or rules,<sup>222</sup> whereas accepted

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<sup>218</sup> E.-J. MESTMÄCKER, *supra* n. 122, p. 441. H. SCHWEITZER (2010), *supra* n. 48, p. 11 of the working paper.

<sup>219</sup> However, see L.F. PACE, *European Antitrust Law. Prohibitions, Merger Control, Procedures*, Edward Elgar, Northampton 2007, p. 237, on risks of regulatory capture. See also G.S. GEORGIEV, *supra* n. 48, pp. 1009, H. SCHWEITZER (2010), *supra* n. 48, p. 11 of the working paper, and J. TEMPLE LANG (2009), *supra* n. 25, pp. 142-143. T. KOZIEL, *supra* n. 176, p. 75.

<sup>220</sup> M. SOUSA FERRO, *supra* n. 122, p. 458. His observation remains valid also with respect to the third scenario (2c).

<sup>221</sup> As argued by J. TEMPLE LANG (2006), *supra* n. 45, p. 275. C.J. COOK, *supra* n. 122, p. 227. G.S. GEORGIEV, *supra* n. 48, p. 1028. S. RAB, D. MONNOYEUR and A SUKHTANKAR, *supra* n. 26, p. 185. T. KOZIEL, *supra* n. 176, pp. 84-85 (in the context of commitment decisions under the Polish antitrust law), H. SCHWEITZER (2012), *supra* n. 48, p. 22 (online version). For an opposite view, see A. KLEES (2009), *supra* n. 122, p. 376.

<sup>222</sup> For instance, the Commission's commitment decision in the *Coca-cola* case (Table 1) is recognised as a decision which clarifies the Commission's stance on fidelity rebates. Some authors see it as an advantage and point out that commitment decisions, whereas they cannot establish decisive precedents (unlike infringement decisions) they might provide an important clarification for the companies on less straightforward market conduct in *individual cases*. See C.J. COOK, *supra* n. 122, p. 211 and 213. In the same vein S. RAB, D. MONNOYEUR and A SUKHTANKAR, *supra* n. 26, p. 175. However, the majority view it as a risky development for the quality of competition law in general. See e.g. G.S. GEORGIEV, *supra* n. 48, p. 1028. H.

commitments might set new standards of the Commission's intervention in a given sector. Not surprisingly, precedence-setting effects of commitment decisions are acknowledged and supported by the Commission.<sup>223</sup> This problem is aptly captured by Van Bael who called the Commission's settlement practice 'an alternative body of jurisprudence, surrounded by a cloak of mystery'.<sup>224</sup>

### *1.5.3. Research justification*

The above discussion illustrates various concerns raised in the debate on Article 9 that it might be used (or rather abused) by the Commission for regulatory purposes to the detriment of competition rules. At the same time, over the last decade the Commission has been openly speaking about harnessing competition rules *in order to* foster the liberalisation and integration of energy markets, and thus push forward its energy policy agenda. Without more ado, it launched the energy sector inquiry under competition rules and then followed up with a wave of commitment decisions in individual antitrust investigations against energy incumbents. This provides a substantial body of Article 9 cases which might be driven by energy policy objectives, i.e. liberalisation and integration of energy markets, rather than concerns about illegal (if indeed) past conduct.

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SCHWEITZER (2010), *supra* n. 48, p. 11 of the working paper. G. BRUZZONE and M. BOCCACCIO, *supra* n. 122, p. 99. D. WAELBROECK (2009), *supra* n. 17, p. 224. D. GERARD, *supra* n. 20, p. 465. H. SCHWEITZER (2012), *supra* n. 48, p. 22 (online version). F. WAGNER VON-PAPP, *supra* n. 25, p. 931 and 966. L. ORTIZ BLANCO and A. LAMADRID DE PABLO, *supra* n. 11, p. 78. E. GIPPINI-FOURNIER, *supra* n. 33, p. 43. I.S. FORRESTER, *supra* n. 122, pp. 2 and 12 (working paper). See also C.I. NAGY, 'Commitments as Surrogates of Civil Redress in Competition Law: the Hungarian Perspective' (2012) 11 *European Competition Law Review*, 531-536, p. 533, on precedence value of commitments in the Hungarian competition law.

<sup>223</sup> European Commission, *Antitrust Manual of Procedures*, *supra* n. 43, chapter 16 on commitment decisions, para. 2.6: 'Commitment decisions also serve to clarify the Commission's competition policy since a non-confidential version of the decision is published. Other market participants can learn from the decision and the commitments what was considered by the Commission sufficient to remove the competition concerns.'

<sup>224</sup> I. VAN BAEL, 'Comments on the ECC Commission's Antitrust Settlement Practice' (1984) *Swiss Review of International Competition Law Act*, p. 67 (cited after D. WAELBROECK (2009), *supra* n. 17, p. 222). This quote comes from the 80s and Van Bael obviously referred to the Commission's practice of informal settlements. However, given the greater precedence value of (more formal) commitment decisions coupled with the lack of procedural safeguards and judicial control over commitments, his concerns remain still valid.

The Commission's antitrust intervention in the energy sector over the last years has offered an opportunity to find out whether the concerns about instrumental use of commitment decisions for regulatory goals are well grounded. Surprisingly, these concerns still remain largely at the theoretical level and only few authors tried to explore them in the context of the Commission's energy policy and the objective to complete the internal energy market.<sup>225</sup> The other debate which falls under the scope of this thesis and concerns on the role of competition policy in achieving the EU internal market for energy (and more specifically for electricity – see Figure 2), provides no Article 9 case studies either.<sup>226</sup> These cases are worth analysing, all the more so because they do not seem to be just one-off intervention in the wake of the

<sup>225</sup> To the author's knowledge, there are no in-depth case studies of the Commission's commitment decisions in the energy sector. Nevertheless, a number of authors referred to these cases or discussed them to some extent as an example of instrumentalisation of competition rules (especially pointing at far-reaching structural or behavioural commitments). See A. DE HAUTELOCQUE and L. HANCHER, 'The Svenska Kraftnät case: introduction of bidding zones in Sweden' (2011) 13 *Network Industries Quarterly* 1, 20-22. K. KEHOE, 'Commitments as a Tool for Energy Sector Liberalisation' (2011) *MLex Magazine*, July - September Issue, 42-46, on E.ON (gas case) EdF and ENI. L. KJØLBYE, 'Refilling the Pipeline' (2011) *MLex Magazine*, July-September Issue, 52-55, on RWE, ENI, GdF, E.ON (el. and gas cases). P. IBÁÑEZ COLOMO, *supra* n. 11, pp. 296-301, on GdF and E.ON (el. case). KLEES (2009), *supra* n. 122, pp. 381-382, on E.ON (el. case). A. DE HAUTELOCQUE, 'Legal Uncertainty and Competition Policy in Deregulated Network Industries: The Case of Longterm Vertical Contracts in the EU Electricity Markets' (2008) Larsen Working Paper, on *Distrigaz*. J. TEMPLE LANG, 'The Use of Competition Law Powers for Regulatory Purposes' (2007) Regulatory Policy Institute, Oxford, 2007, p. 7, on ENI. J. TAPIA and D. MANTZARI, 'The Regulation/Competition Interaction' forthcoming in D. GERADIN and I. LIANOS (eds.) *Research Handbook on European Competition Law*, Edward Elgar, Northhampton 2012 (ch. 15), available online as a working paper Regcom WP 01-12, pp. 26-29, on *Distrigaz*, GdF, SvK, ENI and E.ON (el.). See also U. SCHOLZ and S. PURPS, 'The Application of EU Competition Law in the Energy Sector' (2012) 3 *Journal of European Competition Law & Practice* 1, 76-87, pp. 80-82, on Gazprom, Greek lignite and Deutsche Bahn. G. MONTI (2008), *supra* n. 11, pp. 139-140, on ENI/Gazprom settlement. P. WILLIS and P. HUGHES, 'Structural Remedies in Article 82 Energy Cases' (2008) 4 *The Competition Law Review* 2, 147-174, pp. 151-152, on *Distrigaz*. Substantially more has been written about instrumentalisation of competition rules in general. See J. TEMPLE LANG (2007), mentioned *supra*, this note, and J. TEMPLE LANG (2006), *supra* n. 32, pp. 317-318, for cases where the Commission acted in a regulatory manner and tried to achieve results which it has no power to achieve under competition rules, but which could have been done (if at all) only via regulatory means. See also G. MONTI (2008), *supra* n. 11, for analysis of issues raised in the Deutsche Telekom and Telefónica cases, and P. IBÁÑEZ COLOMO, *supra* n. 11, for an analysis of the Microsoft and UEFA Champions League cases, pp. 289-296. Commitment cases are subject to less commentary, apart from the Alrosa case which was extensively discussed due to the involvement of the Courts (for a fully-fledged case study see F. CENGİZ, *supra* n. 122), and the Coca-cola case (see O. ARMENGOL and A. PASCUAL, *supra* n. 122). Some authors analysed the instrumental use of commitment decisions as a means of market regulation by national competition agencies (see, for instance, an Italian account of C.B. CALINI, 'An "unusual use" of commitments: the investigation into Sky Italia's dominance abuse' (2011) *European Competition Law Review* 1, 50-52, or comments by T. KOZIEL, *supra* n. 176, p. 85, on the Polsat case. For an overview of national commitment practice see H. SCHWEITZER (2012), *supra* n. 48.

<sup>226</sup> Whereas merger control as a tool of energy liberalisation have been subject to extensive research (for a recent account see F. DE LA PEÑA FERNÁNDEZ-GARNELO, *supra* n. 68, and also A. CHRISTIANSEN, 'Regulation and EU merger control in the liberalised electricity sector' in F. FICHERT, J. HAUCAP and K. ROMMEL (eds.) *Competition Policy in Network Industries*, 1<sup>st</sup> ed., Lit Verlag, Münster 2007), the role of Article 9-based competition enforcement in achieving the Commission's energy policy goals has only been shortly discussed (see *supra* n. 225 for references).

energy sector inquiry. Judging from the Commission's recent antitrust activity (7 open cases, most of which in 2012) and its last declarations,<sup>227</sup> competition policy will not cease to play an important role in the implementation of the EU energy policy. Given that both the Commission and the undertakings are incentivised to close the case under Article 9, it is expected that commitment decisions will continue to be a common way of closing antitrust investigations in the energy markets. This thesis attempts to fill the gap in the existing research and take a closer look at these cases, which hopefully help drive the debate further.

## 1.6. RESEARCH QUESTION AND METHODOLOGY

***This thesis studies two commitment decisions in the electricity sector and asks what they have done for energy policy and what they have (not) done for competition policy.***

If one claims that competition rules are being instrumentalised, i.e. misused to achieve regulatory purposes then a silent question to ask is, first of all, what exactly those regulatory purposes are and whether competition rules can achieve them (or maybe already achieved)? Secondly, since ‘misuse’ has a negative connotation, another natural question that comes to mind is what the cost of the ‘misuse’ is.

The aim of this thesis is to confront the ‘theories’ on Article 9 with its application in the electricity sector. More precisely, it takes the concerns from the commitment debate about the misuse of commitment decisions for regulatory purposes and then test their validity in the context of the Commission’s energy policy, where the ‘regulatory purpose’, that is, the completion of the internal energy market, is well-defined. As already suggested, this exercise has two dimensions, competition policy dimension and energy policy dimension, which results from the position of this research at the intersection of two scholarly debates (see Figure 2). The commitment debate is concerned about instrumentalisation mostly because it might negatively

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<sup>227</sup> Supra n. 103 and the accompanying text.

affect competition rules and the market place. The other debate focuses on the results of instrumentalisation from the energy policy' perspective, asking only about the role of Article 9 in achieving the internal market for electricity. In sum, this thesis looks at the effects of the use of Article 9 *both* on the competition policy *and* the energy policy and boils down to one general question:

Has Article 9 contributed to creating the EU internal market for electricity, and if so, at what cost?

I do not follow one single method, but rather blend different research strategies commonly used in a law and economics framework, involving positive and normative analysis of legal rules (competition law and energy law) as well as market modelling (chapter 4). This is supported by a thorough review of the relevant legal and law and economics literature (esp. chapters 1-2) and some sector-specific economic literature (esp. chapters 3-5). The Commission's antitrust enforcement in the electricity sector is more closely scrutinised by means of two in-depth case studies. The first case study is about the Commission's intervention into the electricity wholesale markets in Germany (the *E.ON* case). The second case study relates to the Commission's antitrust action against Svenska Kraftnät (SvK), the Swedish transmission system operator (the *SvK* case).<sup>228</sup> A few interviews were held with the Commission's case handlers and the companies' in-house lawyers directly involved in Article 9 negotiations in these cases. Further interviews were carried out with policy officers at the Directorate-General for Energy, responsible for legislative proposals on electricity-specific issues discussed in this thesis. These confidential discussions were helpful in that they gave some insights from behind the scenes of the two cases.

Both the choice of electricity sector and selection of cases are not accidental and deserve a few words of explanation.

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<sup>228</sup> Cases are listed in Table 2.

### 1.6.1. Why electricity markets?

A particularly high number of energy cases among commitment decisions (see Table 1) explains why this research concerns energy markets, but does not explain its focus on electricity as opposed to gas, where the Commission's antitrust intervention appears to be equally forceful.<sup>229</sup> There are three main reasons why electricity sector might be more suitable for this research. First, the shift towards low-carbon economy makes the EU electricity reforms particularly urgent.<sup>230</sup> As a result, the Commission's electricity-specific policy appears more mature than its gas policy, and seems to meet with wider understanding and support of market players. The incentive to use competition policy for regulatory objectives might be stronger, if these objectives are clear and the Commission is more determined to pursue them.<sup>231</sup> Secondly, whereas electricity is produced in the EU, gas is mostly imported. Upstream supply is largely controlled by external suppliers and remains outside the scope of EU regulation. In consequence, competition enforcement in the EU gas markets often has foreign affairs overtones complicating the assessment of gas cases.<sup>232</sup> Lastly, the electricity markets possess some unique features<sup>233</sup> which make their organisation rather complex and different from most other commodity markets. To the extent these electricity-specific features require adaptation of 'general' competition rules<sup>234</sup> and thus increase the cost of competition enforcement the Commission might be more willing to resort to Article 9 in electricity cases than in gas cases.<sup>235</sup> For the same reason, the risk of incorrect

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<sup>229</sup> Out of 10 energy cases closed by a commitment decision so far, half is in the gas sector. See *supra* Table 2.

<sup>230</sup> Esp. the risks connected to the increasing share of intermittent electricity in the system.

<sup>231</sup> On the other hand, one could argue that slower results of the gas liberalisation and integration via regulatory means might actually prompt the Commission to intervene under competition rules instead. The second reason explains why this might not be the case.

<sup>232</sup> E.g. antitrust proceedings against Gazprom (COMP/39.816 – *Upstream gas suppliers in Central and Eastern Europe*). For a recent case study see N. SARTORI, 'The European Commission vs. Gazprom: An Issue of Fair Competition or a Foreign Policy Quarrel?' (2013) Istituto Affari Internazionali (IAI), Working Paper 13/03, available at <http://www.iai.it/pdf/DocIAI/iaiwp1303.pdf> accessed 20.05.2013. See also K. TALUS, 'Long-term gas agreements and security of supply – between law and politics' (2007) 32 *European Law Review* 4, 535-548.

<sup>233</sup> I.e. non-storability, demand fluctuations, instantaneous demand-supply equilibrium and grid dependency.

<sup>234</sup> For instance, whereas market shares are typically used to measure market power, they are not adequate to measure market power in electricity wholesale markets. Instead, electricity-specific indices should be employed (RSI – Residual Supply Index, PSI – Pivotal Supply Index). See *infra*, chapter 3, for discussion.

<sup>235</sup> So-called 'exit strategy', see *supra* n. 171 and the accompanying text.

anticompetitive assessment and devising disproportionate remedies might be higher in electricity cases than in gas cases.

### 1.6.2. Why the E.ON and the SvK cases?

The Commission's antitrust intervention in the electricity sector spans over a period of six years, from 2006 to date, and boils down to five commitment decisions.<sup>236</sup> The first commitment decisions have been adopted in 2008 and the last one in 2012. Three factors were taken into account when selecting the cases for the purpose of this research.

Firstly, the selected case studies are sufficiently different from each other to allow for making more general observations with regard to the application of competition rules to the *whole* EU electricity sector. They concern different countries (Germany and Sweden) and different levels of electricity supply chain (generation and transmission). The two targeted undertakings have a different ownership structure and are subject to different regulatory regimes, in that E.ON is a private undertaking active in a deregulated market segment of electricity generation, whereas SvK is a state-owned legal monopoly and operates national transmission grid. Further, whereas the E.ON case relates to a market national in scope, the SvK case has a clear cross-border dimension.

Secondly, the selected commitment decisions had to be adopted between July 2007, when the General Court quashed the Commission's decision in the *Alrosa* case (see Table 1) and June 2010, when this ruling itself was quashed on appeal by the ECJ. Without going into detail of this court saga,<sup>237</sup> suffice it to say that during that period

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<sup>236</sup> In other cases commitments have been offered, but the cases are still pending. Information based on the Commission's case record publicly known at the time of writing this chapter (01.2013), see *supra* Table 2.

<sup>237</sup> The *Alrosa* case ensued from an agreement for the supply of rough diamonds between the first (De Beers) and the second (*Alrosa*) biggest diamond mining company in the world. According to the Commission, this agreement was in violation of Article 101 TFEU and the Commission launched an investigation against both producers (COMP/E-3/38.381 – *De Beers*). In addition, it launched an Article 102 TFEU investigation against De Beers for abuse of dominance (COMP/E-2/38.381 – *De Beers*). After the parties failed to offer joint commitments which would meet the Commission's concerns under Article 101, De Beers offered individual

the Commission's decision-making under Article 9 was to some extent determined by the General Court's interpretation of Article 9. It has been observed that following this judgment the Commission started to draft its commitment decisions more carefully paying attention to the substance of the cases. In result, the 2007-2010 decisions (including the *E.ON* case and the *SvK* case) not only explain the theory of harm in a greater detail but also include a section discussing the proportionality of commitments.<sup>238</sup> To sum it up, the Court's restrictive interpretation made any potential instrumentalisation of commitment decisions more difficult, as the Commission was forced to conceal its energy policy objectives under a mask of

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commitments to close the second investigation into abuse of dominance. De Beers' commitments were substantial, as it undertook to gradually reduce the amount of diamonds purchased from Alrosa, and from 2009 onwards, to completely cease its business relationship with Alrosa. The Commission made these commitments binding upon De Beers in an Article 9 decision. Alrosa, directly affected by these commitments, filed an action for annulment of the Commission's decision, arguing, among others, that De Beers' commitments were disproportionate. In June 2007 the General Court upheld this appeal and annulled the Commission's commitment decision (case T-170/06, *Alrosa v. Commission* [2007] ECR II-2601). More importantly, the General Court provided an interpretation of several key issues regarding Article 9 which would have a substantial impact on the Commission's decision-making practice under Article 9. (1) Firstly, the General Court ruled that commitment decisions undergo a full judicial review, including the assessment whether commitments are proportionate (at paras. 107-111) (2) Secondly, to make this review possible, the Court obliged the Commission to make a sufficient economic assessment of the case. In the Court's own words, the Commission had to 'establish the reality of the competition concerns which justified its envisaging the adoption of a decision under [Articles 101-102 TFEU] and which allow it to require the undertaking concerned to comply with certain commitments. This presupposes an analysis of the market and an identification of the infringement envisaged which are less definitive than those which are required for the application of Article 7(1) of Regulation No 1/2003, although they should be *sufficient to allow a review of the appropriateness of the commitment.*' (at para. 100, emphasis added) 3) Finally, the General Court ruled that commitments made binding by the Commission needed to be proportionate to its initial anticompetitive concerns and it was the Commission's duty to assess this (at paras. 112 and 126). If less onerous measures exist (even if they were not proposed by the undertaking concerned) the Commission had to examine whether they are capable of addressing its concerns, before it adopts the more onerous solution (at paras. 92, 97 and 105). In sum, according to the General Court, the Commission's duty to assess proportionality of commitments was analogous to its obligation under Article 7 to impose only proportionate remedies. This also implied that the Commission was not allowed to make binding an obligation that it could not have imposed in an infringement decision under Article 7 (at para. 101). This time it was the Commission to lodge an appeal with the European Court of Justice (the ECJ) which three years later set aside the General Court's judgment putting an end to the *Alrosa* saga (see supra section 1.5.2.2 for some key findings of the Court). However, for three years, between July 2007 and June 2010, while the Commission's appeal was pending before the ECJ, the General Court's ruling provided the only statement of case law on Article 9 and affected to some degree the Commission's decision-making practice. For a fully-fledged discussion of the *Alrosa* case and its implications for the Commission's competition enforcement, see F. CENGIZ, supra n. 122. See also H. SCHWEITZER (2010), supra n. 48, pp. 14-18 of the working paper, analysing the EGC's judgment which has been overturned on appeal by the ECJ.

<sup>238</sup> See F. WAGNER-VON PAPP, supra n. 25, pp. 942-943. The *E.ON* commitment decision of 28.11.2008 was one of the first decisions (after *Distrigaz*) adopted after the General Court's ruling. The *SvK* case was closed on 14.04.2010, i.e. two and a half months before the ECJ judgment, however already after the Advocate General's (AG's) Opinion proposing to set aside the General Court's judgment and to recognise the Commission's wide discretion in assessing the proportionality of commitments (Opinion of AG Kokott delivered on 17.09.2009 in Case C-441/07 P, *Alrosa*, para. 72). The ECJ usually follows the AGs' opinions, and this might have created some expectations on the part of the Commission as to the outcome of the appeal or at the very least created more legal uncertainty as to the scope of the Commission's powers under Article 9.

competition concerns and argue that regulatory-like commitments are tailored to meet these concerns. Cases from that period are thus particularly interesting to look at.

Thirdly, the two selected cases go hand in hand with key electricity reforms on the EU regulatory front. E.ON's commitments were accepted in the run-up to the adoption of the 3<sup>rd</sup> Energy Package,<sup>239</sup> whereas the *SvK* case was formally opened just after its adoption. The Commission's regulatory objectives, once identified in the context of legislative measures, might be then easily spotted as 'transplants' within theories of anticompetitive harm.

## 1.7. CHAPTER OVERVIEW

***This section reveals what comes next and in which order.***

This thesis consists of six chapters. Chapters 2 to 5 constitute the core of this research. They have all been published in journals as separate articles<sup>240</sup> and are discussed below in a greater detail. Chapter 2 is theoretical and sets background for chapters 3 to 5, which take a more applied tack. Chapter 3 studies the *E.ON* case, whereas the *SvK* case is central to chapters 4 and 5, both of which are co-authored with Bert Willems. Chapter 1 is intended to link the four core chapters together, explaining the coherence of the whole. It also ushers readers to the research topic, and to this aim it includes all the key elements of an introduction, i.e. problem definition, explanatory background, research objectives, questions, methodology, structure as well as it puts the thesis in a wider context of the current scholarly debates. Chapter 6 concludes.

### 1.7.1. *Chapter 2*

'Energy Liberalisation: Excessive Pricing Dusted Off?' constitutes the first of the four core chapters of this thesis and is meant to provide some theoretical context to the

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<sup>239</sup> Supra, section 1.2.3.3.

<sup>240</sup> Some of them have been reprinted here with minor alterations.

readers before moving to case-specific studies. Regulation 1/2003 equipped the Commission with a specific set of competition enforcement instruments. In this chapter I highlight the importance of (1) sector inquiries, (2) commitment procedure and (3) the possibility to impose structural remedies in competition cases for achieving the internal market in the field of energy. The new antitrust enforcement toolbox enables the Commission to use competition policy in areas where it wants to increase competition in national energy markets (**market liberalisation**) and then integrate them into one European energy market (**market integration**).<sup>241</sup> This will have a visible impact on the EU competition enforcement, changing both the way competition rules are applied as well as the rationale for their application.

Potential impact of the new enforcement tools on competition policy is illustrated by an example of excessive pricing, problematic and often disputed anticompetitive behaviour. In principle, overpricing by a dominant firm is a form of direct exploitation of customers and should theoretically trigger an intervention on the part of the Commission under Article 102 TFEU. In practice, excessive pricing actions have always been considered controversial and not without practical problems, and thus launched by the Commission only in rare cases. However, since the adoption of Regulation 1/2003, the Commission has launched several antitrust investigations into price manipulation by energy incumbents, which might suggest that it assumes now a more pro-active approach to overpricing, a remarkable change of direction in the EU competition enforcement.

I have decided to select excessive pricing among various other anticompetitive practices potentially taking place in the energy sector. This is a deliberate exercise for several reasons. Firstly, competition enforcement in the energy sector has been triggered for the most part by rising gas and electricity wholesale prices.<sup>242</sup> Thus, price formation in the wholesale electricity markets is an important area of the Commission's energy sector inquiry and many of its following antitrust investigations

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<sup>241</sup> Supra, section 1.2.3.

<sup>242</sup> European Commission, *Inquiry pursuant to art. 17 of Regulation (EC) No 1/2003*, supra n. 78, para. 2.

also concerned price manipulation. For this reason, my focus on excessive pricing is supposed to reflect one of the key areas of anticompetitive concern. Secondly, a more comprehensive discussion on excessive pricing prepares the readers for the *E.ON* case study on alleged price manipulation in the German wholesale market. Thirdly, by choosing excessive pricing I would like to emphasise that Regulation 1/2003 may facilitate an antitrust action regardless of the Commission's anticompetitive concern, and even a rather cumbersome and sporadically used prohibition of excessive pricing can well serve as a legal basis for such action.

In addition, there is a stylistic reason behind this choice. I set the three new instruments of competition enforcement against the common criticism that surrounds excessive pricing actions. This allows me to give this chapter a more interesting structure than a simple review of the three instruments, even though the latter one remains my main objective.

The first well-known reason for abstaining from excessive pricing actions is that the antitrust intervention might be superfluous or even harmful for competition. This criticism does not hold for energy markets with high entry barriers and previous legal monopolies. In such a setting regulatory intervention appears necessary to correct market failures and involves no risk of chilling competition, given the already highly regulated environment.

The second point of criticism relates to complex and time-consuming assessment which would prove that prices are above competitive levels and competition rules have been violated. Competition authorities might lack both time and expertise to carry out this exercise in each individual case. As we learn from the Commission's practice in the energy sector, assessment problems can be overcome by closing excessive pricing cases under Article 9 instead of going for a full-fledged anticompetitive analysis with an attempt to find an abuse of a dominant position. Launching the energy sector inquiry was very helpful as well, as the Commission could substantiate its commitment decisions with more general findings pointing at

price manipulation, but without providing further evidence in individual cases. Sector inquiries are by far more complex and time-consuming than individual antitrust investigations. However, once the Commission decides to undertake one, data collected and assessed during such an industry-wide inquiry can subsequently support many individual antitrust investigations carried out in its aftermath.

The third and last reason for caution in antitrust intervention into excessive pricing is that it usually boils down to price regulation and therefore goes beyond competition policy domain. As argued in this chapter, the risk of price regulation is now largely mitigated by Regulation 1/2003, which allows the Commission to order structural remedies or, in cases closed under Article 9, accept structural commitments. The current monopolistic or at best oligopolistic structure of many European energy markets calls for structural intervention and the Commission apparently favours structural remedies, given its ambitious energy liberalisation agenda. Any concerns regarding proportionality of structural solutions for excessive pricing abuses are dispelled by the use of commitment procedure. According to the EU case law, commitments undergo a weaker proportionality test than remedies imposed under Article 7 and the Commission can accept structural solutions which could not be imposed under a standard infringement procedure.

In summary, this chapter highlights the importance of Regulation 1/2003, which makes competition enforcement an instrument of wider application. In particular, it puts forward an idea of using excessive pricing actions as a policy vehicle to foster liberalisation and integration of energy markets. However, it should be noted that excessive pricing cases are here just an example of competition enforcement in the energy sector. The Commission can as well intervene due to various reasons other than excessive pricing. The key message of this chapter is that Regulation 1/2003 might encourage the Commission to come up with various anticompetitive concerns and enforce competition rules in the energy markets in order to pursue its other policy goals.

Last paragraphs sum the chapter up and raise questions as to whether the Commission actually takes advantage of the new instruments provided for in Regulation 1/2003 and enforce competition law for its own energy policy agenda, in order to foster liberalisation and market integration. And if so, how would such instrumentalised competition enforcement look like and would it be effective? This bridges the theoretical discussion with the following, more applied, chapters, where I try to cast some light on the actual competition enforcement in the energy sector and its effects, in order to answer my research questions.

### *1.7.2. Chapter 3*

High market concentration in the energy markets has been one of the major problems identified in the energy sector inquiry. This is to some extent reflected in the follow-up antitrust actions where the Commission targeted uncompetitive market structure. 4 out of 9 abuse of dominance cases were closed after the companies committed to divest substantial shares of their businesses.<sup>243</sup> The main purpose of these actions was vertical and horizontal dismantling of dominant energy incumbents, in order to prevent discrimination and leave room for new market players.

Chapter 3 entitled ‘Energy Liberalisation in an Antitrust Straitjacket: A Plant too Far?’ introduces the first case study – the 2008 investigation in the German electricity wholesale market. The Commission investigated E.ON, one of the major German electricity incumbents, and accused it of abusing its dominant position on the German power exchange<sup>244</sup> primarily by withholding capacity to raise electricity spot price. As a result of this case, E.ON divested 20% of its generation business.

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<sup>243</sup> German electricity wholesale market (Case COMP/39.388), German electricity balancing market (Case COMP/39.389), RWE gas foreclosure (Case COMP/39.402), ENI (Case COMP/39.315). See Table 2.

<sup>244</sup> The European Energy Exchange (EEX) based in Leipzig.

This E.ON case fits well with the subject matter of the theoretical chapter, as capacity withholding is a form of excessive pricing.<sup>245</sup> Readers not familiar with capacity withholding will find necessary background information in the Annex to chapter 3. I explain there how capacity withholding works and what might drive a generator to engage in this business strategy. To this aim, I refer to the unilateral profit maximisation logic of a withholding generator developed by Joskow and Kahn (2002). Their simple equation demonstrates that the profitability of capacity withholding hinges upon several factors, the key of which are (1) the size of the power exchange and the size of the withholding generator trading on that power exchange, (2) timing of withholding and (3) an optimal asset mix in terms of fuel and technology, which would enable a generator to withhold its capacity at the most convenient moment and to gain its profit on the resulting price increase.

Another clear link with the previous chapter is that chapter 3 also builds on the argumentation set forth therein. Namely, it assumes from the outset that fostering energy liberalisation by vigorous antitrust enforcement is not only legally possible, but also makes sense from teleological perspective. Both liberalisation policy and competition policy strive for more competitive energy markets. Further, at the time of the E.ON case progress on the EU regulatory front was slow. The EU debate over the 3<sup>rd</sup> Energy Package seemed to come to a deadlock, as many countries with Germany in the forefront opposed to ownership unbundling provisions. Resorting to competition policy to foster liberalisation seemed both legitimate and necessary in these circumstances.

However, the main purpose of antitrust enforcement is to put an end to an anticompetitive practice taking place in the market. Once this primary objective of antitrust enforcement gets blurred by liberalisation objectives, then we face two kinds of risk in commitment cases. First, competition rules might be employed in situations where there is no or little anticompetitive harm, but where liberalisation process does

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<sup>245</sup> A generator can raise the market price by offering less capacity to the market (manipulate its output), or simply by submitting an arbitrary high bid on a plant during peak time.

not deliver expected results and the Commission wants to change the unsatisfactory *status quo* by targeting dominant players. As a result, the Commission might inflate anticompetitive concerns to extract far-reaching structural commitments from an undertaking under investigation. Second, even if anticompetitive harm does take place and the Commission's intervention under competition rules is legitimate, the incentive to foster market liberalisation might be stronger than the incentive to remedy actual anticompetitive concerns. In such cases, the Commission might opt for a commitment package which promotes market liberalisation, without necessarily addressing the anticompetitive harm at issue. I find that both kinds of risk materialise in the *E.ON* case and chapter 3 is an attempt to illustrate this.

This chapter builds on two corresponding sections. The first, shorter section entitled 'Far-fetched concerns' relates to inflated concerns which the Commission came up with in the *E.ON* case in order to strengthen its bargaining position and negotiate from *E.ON* substantial divestments. First of all, I find that the profitability of strategic capacity withholding is far from clear in real market setting, as it depends on many various factors. The Commission's theory of harm does not convince me and I question whether *E.ON* could indeed engage in this practice. Further, I underline the difficulty of proving an abuse in that respect. Given that this investigation was closed by a commitment decision, the Commission was not required to find an infringement of competition rules, only to formulate its anticompetitive concerns in a preliminary assessment. Thus, I point out shortcomings of the Commission's drive-by anticompetitive analysis. In particular, it seems striking that the Commission argued joint dominance to use Article 102 TFEU as a legal basis and supported it by a simple calculation of market shares. Moreover, the reliance on joint dominance led to further inconsistencies in the assessment of *E.ON*'s alleged capacity withholding. Further incoherence of the Commission's arguments results from the reference to *E.ON*'s alleged exclusionary practices. These involved deterrence of investment in generation by third parties. In my view, by accusing *E.ON* of these additional exclusionary practices the Commission undermined its theory of harm based on capacity withholding. This relation between the two alleged abuses is discussed in more detail

at the end of the first section. However, the Commission might have a valid reason for including these exclusionary concerns in its assessment, because they will later help to justify E.ON’s substantial divestments.

Inflated anticompetitive concerns allow the Commission to extract far-reaching commitments from targeted undertakings. These commitments reflect the Commission’s ‘real’ concerns about the slow liberalisation process, but not ‘formal’ anticompetitive concerns formulated against the undertaking, no matter whether they are true or not. The second section called ‘Far-reaching remedies’ attempts to demonstrate that E.ON’s divestments negotiated with the Commission might not eliminate anticompetitive concerns of strategic capacity withholding, the primary reason of the Commission’s intervention. Instead, they are a resultant of both the Commission’s and E.ON’s interests. In particular, they reflect the Commission’s objective to foster energy market liberalisation, as they make German electricity wholesale market generally more competitive.

To better illustrate this, the second section begins with a short theoretical part which compares Article 9 (commitment procedure) with Article 7 (infringement procedure), especially with regard to the proportionality of commitments. This comparison points at the difference between Article 7 and Article 9 procedures in the application of proportionality test to remedies and commitments respectively, which explains why, in theory, the Commission can use commitment cases in order to pursue various other policy goals (e.g. liberalisation of energy markets) by extracting disproportionate commitments reflecting these goals.

Chapter 3 becomes again more applied for the remaining part of the second section where I examine, in a two-step proportionality test, whether E.ON’s divestitures address the Commission’s ‘formal’ concerns of exploitative as well as exclusionary nature. Firstly, whether they effectively eliminate the risk of capacity withholding (alleged exploitation) and secondly, whether they prevent E.ON from deterring third parities’ investments in generation business (alleged exclusion).

In the first step of this test I discuss potential behavioural commitments. Some of them appear less onerous and equally effective to divestments in terms of mitigating the risk of capacity withholding (e.g. forward contracts commitments, VPPs). However, as I explain, they would not address concerns of exclusionary nature. This brings me to a conclusion that resorting to a structural solution seems justified, as there is no such behavioural remedy which could be less onerous for E.ON than divestments but at the same time equally effective in terms of addressing *all* the Commission's concerns, both exploitative and exclusionary. In the second step of my proportionality test I ask whether the proposed divestments are appropriate and necessary to address these concerns.

First I look at the proportionality of divestments in terms of eliminating the risk of capacity withholding. To this aim, I examine E.ON's generation portfolio and the selection of divested assets in terms of fuel and technology. I observe that the Commission negotiated with E.ON an across-the-board divestiture, amounting to a capacity reduction in absolute terms (by 20%) but having no substantial impact on the generator's portfolio structure. As mentioned above, the generator's assets mix is one of the key factors in the profitability of capacity withholding. Given that the offered divestments left E.ON's portfolio structure unchanged, it can be questioned whether they sufficiently mitigated the risk of engaging in such strategy. I support my view with economic literature, which suggests that the risk of capacity withholding would be most efficiently mitigated by a targeted divestment of high-cost generation. Ownership of high-cost, marginal plants confers on generators greater market power than a portfolio of base-load plants, simply because withholding high-cost capacity at times of peak demand becomes most profitable.

The situation changes, once I factor in exclusionary concerns regarding E.ON's deterrence of investments. In that respect, the Commission argued that an across-the-board divestment is a proportional remedy as it gives market entrants access to various generation assets, also involving technologies with higher fix costs (base-load

generation) and thus less attractive for investors. Hence, these additional exclusionary concerns make E.ON's divestments of base-load generation look proportional.

Summarising, the *E.ON* case well illustrates the risks arising from the Commission's antitrust enforcement in the energy sector. Firstly, the case appears 'weak' in that the Commission based its assessment on strained, not well-argued anticompetitive concerns and was not required by the commitment procedure to provide any evidence supporting them. There might be a valid reason for expressing serious, even if not well-founded, anticompetitive concerns as they might later justify substantial commitments. Secondly, E.ON's across-the-board divestment is maybe not best suited to address the risk of capacity withholding. However, the Commission also accused E.ON of investment deterrence and this makes the commitment package look proportional, as it needs to address *all* anticompetitive concerns. Their proportionality aside, E.ON's divestments were generally pro-competitive, as they reduced the firm's market share. Moreover, having sold off different technologies, E.ON faces now more competition on each demand level. Evidently, the Commission targeted E.ON's dominant position and tried to inject more competition in the German generation business. It was less concerned about remedying capacity withholding, the risk of which was supposed to be eliminated in the first place.

#### 1.7.3. *Chapter 4*

Whereas the Commission's action under competition rules in the *E.ON* case seems to be a natural consequence of opening generation and wholesale electricity markets to competition, the second case study illustrates an antitrust intervention in the electricity transmission segment, despite its regulated monopoly status. The *SvK* case, discussed in detail in chapters 4 and 5, shows that a legal (and natural) monopoly characteristics does not exclude electricity transmission services from the application of competition rules. This second case study is thus a step further in my analysis, showing the use of competition rules in a specific regulatory setting.

I have been working on this second case together with Bert Willems and our work is summarised in two papers. Chapter 4, corresponding to our first paper, analyses the SvK case from an economic perspective. Chapter 5 follows up with a legal discussion of this case and represents our second paper. Before reporting our results from the economic analysis, the next paragraphs provide necessary context and the main facts of the case.

The Swedish electricity transmission grid is linked with the neighbouring countries through interconnectors. The *SvK* case concerns Sweden, Denmark and the Øresund interconnector between them. Electricity in Sweden is produced mostly in the North, where all cheap hydro power plants are located. Then it is transported to big consumption areas in the South and further, via the Øresund interconnector, to Denmark.

Electricity transmission network can transport only a certain volume of electricity within the system security limits. This is referred to as **transmission capacity** of the network. Transmission network in Sweden lacks this capacity to carry all the cheap hydro power from the North to the South. There are several bottlenecks, where transmission congestion occurs. In order to avoid line overload leading to blackouts, SvK, the Swedish transmission system operator (TSO), has to relieve congestion in its network in a timely manner. This is referred to as **congestion management**, and the way SvK managed congestion within Sweden was the reason of the Commission's antitrust intervention. Namely, SvK used to restrict export of electricity to Denmark. Export limits reduced the total amount of electricity flows over the Swedish network and thus relieved internal congestion. This type of congestion management is commonly known as **congestion shifting**. By limiting export, SvK mimics a situation, where congestion occurs at the border, at the same time relieving the 'real' congestion within Sweden. Put differently, it 'shifts' congestion from the internal bottlenecks to the country's borders. Congestion management of this kind gave the consumers in South Sweden an opportunity to buy cheap hydro power from North Sweden. Danish consumers, on the other hand, were deprived of this cheap electricity. Denmark had to

use its more expensive thermal generation to meet the country's demand. Higher and more volatile electricity prices in Denmark gave rise to protests and triggered the Commission's intervention.

Dansk Energi, a trade association of Danish energy companies, filed a complaint to the Commission, claiming that SvK's congestion management is detrimental to competition and trade within the internal market. Following this complaint, the Commission launched an investigation against SvK, expressing its concerns that the TSO's actions are in violation of competition rules. Since SvK has monopoly over electricity transmission services in Sweden, the Commission argued it abused its dominant position on the market by discriminating between cross-border and domestic electricity transmission services (nationality-based discrimination) and market partitioning. Following some negotiations with the Commission, SvK agreed to offer commitments under Article 9.

As an interim remedy, it committed to relieve internal congestion through **counter-trading**, and not limiting export to Denmark. Counter-trading is a type of congestion management, where the TSO makes deals with individual generators to change their production plans. SvK would simply have to pay some generators in South Sweden to increase their (expensive) production. At the same time, it would compensate some generators in the North to shut down their power plants. The cost of counter-trading would be passed on to the Swedish consumers in form of higher transmission tariffs. What results is a transfer of money from consumers to generators.

After the initial period of increased counter-trading, SvK agreed to subdivide the Swedish market into several price zones, with diverging electricity prices in case congestion occurs between them. This market mechanism, called **market splitting**, puts an end to one uniform electricity price in Sweden. Prices in North Sweden would be lower than prices in South Sweden. Thus, by adjusting zonal prices and affecting zonal supply and demand, market splitting relieves congestion between the zones.

In this chapter we look at the SvK case from the efficiency perspective and ask whether the Commission's anticompetitive allegations are indeed justified. Should limiting cross-border trade in order to relieve congestion inside the country's transmission network really constitute an infringement of competition rules? After all, transmission capacity in Sweden is limited and not all demand in South Sweden and Denmark for cheap Northern energy can be met. In order to answer this question, we model SvK's alleged abuse and its commitments which were supposed to remove it.

Our model has a simple radial network with one bottleneck and covers three regions: North Sweden, South Sweden and Denmark. Electricity is produced in North Sweden and then transported to South Sweden and Denmark subject to a transmission constraint between North Sweden and South Sweden ( $k = 28$  units). We ignore the fact that the networks are meshed and loopflows can occur. Also, we do not consider effects on other regions. Lastly, we assume that the electricity demand in South Sweden equals the Danish one.

First off, we establish an efficient benchmark. Allocative efficiency requires that the network is used at full capacity to transport cheap hydro power from North Sweden to South Sweden and Denmark. Thus, North Sweden exports 28 units of electricity. Since South Sweden and Denmark have the same demand function, each region receives 50% of this electricity, that is, each consumes 14 units. Put differently, consumers in South Sweden and Denmark will have the same marginal valuation for electricity and the electricity prices in both regions will be the same.

In a similar way we model four other scenarios. In the first scenario, SvK relieves bottleneck  $k$  by restricting trade with Denmark. This corresponds to the alleged abuse. In the second scenario, SvK does not limit export, but solves congestion only through counter-trading. In this way we model the interim remedy. Third scenario combines the two methods: SvK shifts only some congestion to the border with Denmark, the remaining congestion is then counter-traded. Finally, the fourth and last scenario illustrates market splitting, which is the final remedy. We have calculated total market

surplus under each scenario. According to our results, two scenarios result in the highest market surplus, which equals first best.

We believe that market splitting is an efficient system, because it allows for using the Swedish network at full capacity. Congestion is relieved through adjusting zonal prices. Electricity prices in South Sweden and Denmark are equal and higher than the price in North Sweden, reflecting congestion on bottleneck k. In this way, consumers in South Sweden and Denmark have the same marginal valuation for electricity. This should give optimal long-term investment incentives to energy producers. However, our model also shows that the Commission's argumentation, according to which market splitting would prevent congestion shifting, is not entirely correct. Even if SvK implements market splitting, it can nevertheless reduce export, just to keep a uniform price within Sweden. Cross-border electricity exchange takes place subject to capacity declarations by the Swedish and the Danish network operator. Each of them declares how much electricity can be transmitted through interconnector within the system security limits and the lower of the two values applies. If SvK sets a low capacity value (in our model equal to 2 units), the price in South Sweden would drop and reach the North Sweden's price level, resulting in one electricity price across the country. To the contrary, Danish consumers would have to pay higher prices, just as in the first, 'abusive' scenario. By this example, we show that market splitting does not prevent SvK from manipulating cross-border capacity declarations. It can still limit cross-border trade with Denmark, the very reason of the Commission's antitrust intervention. Only monitoring SvK's behaviour would ensure that cross-border capacity is not reduced.

Interestingly, the combination scenario is also efficient. This shows that, in optimum, the Swedish network operator has to shift some (but not all) congestion to the border. The rest must be relieved through counter-trading. How much congestion exactly should be shifted to the border in the optimum? Just as in first best, electricity price in South Sweden and Denmark must be the same, so transmission capacity must be allocated in such a way to ensure that the consumers in South Sweden and Denmark

have the same marginal valuation for electricity. The other two scenarios, illustrating SvK's abuse and the interim remedy, are suboptimal, because consumers in South Sweden and Denmark have different valuation for electricity. On the one hand, if SvK does not reduce export to Denmark, but relieves all congestion through counter-trading, Danish consumers would purchase as much cheap hydro electricity from Sweden as they want, whereas consumers in South Sweden would only get a fraction of this electricity. As a result, consumers in South Sweden would value this electricity more than the Danish consumers. If, on the other hand, cross-border trade was severely restricted, consumers in South Sweden would have a lower valuation for electricity than the Danish consumers, who, due to export limits, would be deprived of it.

Based on our modeling exercise, we draw the following conclusions regarding the *SvK* case. Firstly, we do not agree with the Commission that any congestion shifting is in violation of competition rules. From the efficiency perspective, SvK needs to shift *some* congestion to the border with Denmark. We thus call for a more economic approach in the assessment of congestion shifting. Secondly, for the same reason, we find that solving all internal congestion through counter-trading, without reducing export to Denmark, is not efficient, and the Commission's argumentation regarding the interim remedy was not correct in that respect. Lastly, we agree with the Commission that market splitting is an efficient long-term market design. However, contrary to what has been argued in this case, it will not prevent SvK from reducing export. SvK can still limit cross-border capacity to keep one uniform price within Sweden. Thus, monitoring would be necessary to prevent further export reductions.

In other words, we are pleased with the introduction of market splitting in Sweden, but less so with the Commission's reasoning in the case itself. From the efficiency perspective, restricting trade at the Swedish-Danish border to relieve internal congestion should not violate competition rules, without a rigorous economic analysis. Cutting down on export can actually increase efficiency. Furthermore, introducing market splitting does not prevent SvK from restricting exports in the future.

#### *1.7.4. Chapter 5*

Chapter 5 represents the second paper on the *SvK* case, also co-authored with Bert Willems. Building on our results from the first paper, we set the *SvK* case in a broader legal, political and regulatory context. Firstly, we examine how the Commission uses competition policy to put an end to Swedish export reductions. We find that the Commission's primary objective was to foster energy market integration. Pursuing this goal had a substantial impact on the quality of the Commission's anticompetitive assessment, in which internal market arguments replaced solid economic analysis. However, as we show in this chapter, despite weak economic foundations, the Commission's intervention resulted in better congestion management by introducing market splitting in Sweden. Moreover, using competition rules seems to be the quickest way to market splitting. To support our view, we explore alternative instruments of market integration, one of political and the other one of regulatory nature, which could be potentially employed in this case and we find that they would not lead to market splitting in Sweden as quickly as by way of competition enforcement. To this aim, chapter 5 is subdivided into three sections, first of which focuses on the application of **EU competition rules**, and the two other sections deal with the two remaining tools – **political debate** about the introduction market splitting in Sweden and the **EU regulation** of congestion shifting.

EU competition rules are determined by the Commission's objectives. The *SvK* case is an example where promotion of market integration is clearly articulated in the Commission's decision. Pursuing this objective comes at the cost of a robust, economic welfare-oriented assessment of *SvK*'s behaviour and the negotiated commitments. The Commission considers congestion shifting an outright obstacle to cross-border trade and seeks to remove it. Such view is one-dimensional as the Commission's concerns are related to the well-functioning of the internal market, namely nationality-based discrimination and re-segmentation of the internal market. This recalls the Commission's formalistic approach towards quantitative restrictions on export or other protectionist measures having such effect. Such market-partitioning

practices have always been considered *per se* abuses, with no possibility to justify them. Similarly, congestion shifting is seen by the Commission primarily as a restriction to cross-border trade, and SvK's justifying arguments are not sufficiently taken into account.

We consider two potential justification grounds for the SvK's behaviour: efficiencies and public policy considerations. From an efficiency perspective, unlimited cross-border trade might not always be welfare-increasing. In fact, SvK should limit export to Denmark to some extent to manage internal congestion optimally. However, the Commission's focus on market integration does not leave room for a complete economic analysis of the case which would point out efficiencies connected to congestion shifting. Similarly, the Commission did not fully recognise the fact that SvK operates in a regulatory environment and its congestion management might be in line with public interest. Introducing different electricity prices across the country is never a popular solution from the government's perspective. Despite SvK's formal autonomy regarding congestion management, its decisions might have been influenced by the national policy of maintaining one electricity price in Sweden as well as various industry pressure groups.

We observe that harnessing antitrust rules to foster market integration is facilitated by Article 9 commitment procedure, as opposed to standard infringement procedure under Article 7. We compare the two procedural routes and point out that commitment procedure, primarily designed to streamline some of the Commission's less problematic antitrust investigations, might be misused to tackle difficult, borderline cases. Namely, certain procedural features of Article 9 enable the Commission to censure as 'anticompetitive' practices whose anticompetitive aspects are not at all that clear and finding an abuse of dominant position might be actually difficult, but for using these procedural shortcuts. In the SvK case, the Commission was only required to formulate its anticompetitive concerns about the Swedish congestion management, without actually finding an infringement of competition rules. Shifting attention from the anticompetitive analysis to the commitment package enabled the Commission to

deem SvK's congestion shifting abusive under antitrust rules without a proper anticompetitive analysis of such practice and its effects, and to negotiate tailor-made remedies removing its primarily internal market (and not anticompetitive) concerns.

Market splitting constitutes a serious intervention in the Swedish market design and the Swedish social policy domain, because Swedish consumers will face different electricity prices at certain hours, depending on their location. Given the intrusiveness of the Commission's action, chapter 5 contains a short discussion about the proportionality of SvK's commitments, which closes the section on EU competition rules. According to the recent case law on commitment decisions, the Commission can accept disproportionate commitments, provided they meet its concerns and are not manifestly disproportionate. In this chapter we test market splitting under the old, stricter proportionality test known from the standard infringement procedure, as well as under this new, relaxed proportionality test valid now for commitments. We find that market splitting would pass neither the old, nor the new version of proportionality test, because it does not address the Commission's concerns formulated in the preliminary assessment, the only requirement that has remained unchanged. This means that even in the light of the recent case law on commitments, the Commission might have breached the principle of proportionality.

The second section puts the *SvK* case in the context of a drawn-out political debate about splitting Sweden into smaller price zones. Our brief overview of policy developments at the regional (Nordic) and the national level demonstrates that the idea of introducing market splitting in Sweden is not new, but has been discussed for quite some time before the Commission opened the *SvK* case. Namely, the debate commenced as early as in 1993 and is marked by various policy reports issued by (or for) various Nordic and Swedish regulatory agencies, governmental bodies and stakeholders' associations over almost two decades. These reports study the possibility of introducing market splitting in Sweden and discuss its socioeconomic effects on the Swedish and Nordic electricity market. After the 2005 price spikes in Denmark it became clear that the changes in the Swedish congestion management are

necessary and the debate on market splitting rekindled. However, in spite of Danish constant protests, there was still no concrete plan to introduce market splitting in the years to come. Against this backdrop, the Commission's antitrust intervention appears very effective in introducing market splitting. In sum, we argue that the *SvK* case does not constitute a novel solution to relieve Swedish bottlenecks and its introduction has been long anticipated by market participants. Nordic debate on market splitting would eventually result in changes to the Swedish congestion management. However, we find that the *SvK* case played a crucial role in this debate and accelerated the introduction of price zones in Sweden.

A clear advantage in taking action under competition rules over engaging in political persuasion lies primarily in the Commission's ability to exercise its powers to order remedies and impose fines. However, since *SvK* case has been closed under Article 9, market splitting has not been simply imposed by the Commission, but offered by *SvK*, at most negotiated between *SvK* and the Commission. Since the exercise of authority by the Commission is less clear in a commitment case than in a typical antitrust case, we abstain in chapter 5 from pointing this out. Instead, we highlight bilateral nature of a commitment case as opposed to multi-level political discussions involving a number of stakeholders with oftentimes antagonistic interests. Even though the same stakeholders have right to express their views in the market test of commitments, the Commission has no obligation to follow them in its commitment decision. Again we observe the ease with which the Commission managed to discard arguments against market splitting in the market test of *SvK*'s commitments and point at the facilitating role of the commitment procedure in that respect.

The third and last section of chapter 5 concerns EU regulation and its potential impact on congestion management policies of Member States. Firstly, we focus on those EU provisions relating to congestion shifting, which were in force at the time of the *SvK* case, and which still remains applicable. The EU sector-specific law does not directly regulate national congestion management, but only refers to cross-border arrangements. However, congestion shifting does fall under EU regulation on account

of its cross-border effects. In our view, SvK did not infringe these provisions because they allow congestion shifting for exceptional reasons. Given the lack of guidance from the Commission, these reasons can be broadly interpreted and used by TSOs to justify shifting congestion to the borders. Based on these provisions, the Commission would not be able to induce SvK to cease congestion shifting and increase counter-trading, nor to split Sweden into price zones. The EU law only contains a vague requirement on the TSOs to develop more efficient, long-term congestion management solutions, and with no reference to any particular method.

The new EU network code on congestion management, to be adopted by the Commission in 2013, might bring new restrictions with respect to congestion shifting. Hence, we also take a look at its preliminary version put forward by the TSOs in September 2012 and discuss potential impact of this code on national systems of congestion management. We find that the proposed provisions are going to bring some harmonisation of congestion management rules at the regional level, because they require the TSOs to take similar actions to relieve congestion. The code also aims to improve cross-border capacity calculation, so that it takes account of physical flows and is also regionally coordinated.

However, despite the EU attempts to harmonise congestion management rules and improve TSOs' cross-border capacity calculation, congestion shifting can still occur and the new regionally coordinated model proposed in the network code leaves some scope for that. Ultimately, the decision to shift or not to shift congestion to the border remains with each national TSO. At the same time, the network code introduces more transparency into national congestion management systems, as it foresees obligations on TSOs to report congestion and steps taken to relieve it. Instances of congestion shifting will become more observable which should have a deterring effect. Findings from these reports may also trigger changes in network topology, leading to more efficient congestion management in the future.

Chapter 5 concludes that the *SvK* case is not a ‘clean’ case, both in terms of EU competition enforcement as well as EU energy policy. On the one hand, the Commission’s focus on market integration and the lack of a robust economic analysis leaves mistaken guidance on anticompetitive nature of congestion shifting and its classification as abuse under Article 102 TFEU. On the other hand, the Commission’s assessment provides incorrect insights for efficient congestion management and does not help to develop a sound EU regulatory framework in that respect. However, we also show deficiency of political debate and the EU energy legislation to control *SvK*’s congestion shifting or introduce market splitting in Sweden. Against this backdrop, the Commission’s intervention under antitrust rules achieved something which would have not been achieved only through political or regulatory means, at least not in such a short time. At the same time we would like to emphasise that the EU competition rules were not applied here in a vacuum, and both the stakeholders’ awareness of the need to improve congestion management in Sweden as well as the EU attempts to regulate it facilitated the antitrust deal with *SvK* and the implementation of price zones. Similar antitrust actions against TSOs in other Member States would be more difficult to launch and are rather unlikely. The *SvK* case is and should remain a one-off intervention and should not replace a comprehensive approach towards congestion management, based on harmonisation of national systems and effective coordination between TSOs and power exchanges under stronger regulatory supervision.

## 2. ENERGY LIBERALISATION: EXCESSIVE PRICING ACTIONS DUSTED OFF?<sup>246</sup>

### 2.1. ABSTRACT

Whenever a competition authority engages in price regulation, it generates knee-jerk criticism from the legal and economic community. For this reason, excessive pricing actions, although theoretically possible under the EU competition law, remain the forgotten instrument of antitrust enforcement. However, the new antitrust enforcement regime created by the 2004 reform allows for an alternative use of excessive pricing actions in the energy sector, turning them into an instrument of energy liberalisation policy. The new enforcement toolbox (sector inquiries, commitment decisions and structural remedies) not only provides a framework for a rather unproblematic use of excessive pricing actions in the energy cases, but also assures that their application does not revert to regulation of energy prices, running counter to the energy liberalisation policy objective. The chapter deals with most commonly expressed arguments against excessive pricing actions and shows that they may not hold in view of the new enforcement possibilities.

### 2.2. INTRODUCTION

Direct exploitation of consumers in form of setting excessive prices by a dominant firm is prohibited under EU competition law. Literally, “*directly or indirectly imposing unfair purchase or selling prices*” takes the first place on the Article 102 TFEU list of potential abuses of dominant position.<sup>247</sup> In spite of an obvious consumers harm caused by unfairly high prices, Article 102 (a) actions against

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<sup>246</sup> First published in *European Competition Law Review* 9 (2011). I am grateful to Massimo Motta, Klaus Heine, Firat Cengiz and Andrew Gavil for their helpful comments and suggestions. The usual disclaimer applies.

<sup>247</sup> In the following ‘Article 102 (a)’. The wording of the Treaty, emphasising consumers’ exploitation, indeed drew some legal scholars’ attention in the early days of the EU antitrust enforcement. A. JONES and B. SUFRIN, *supra* n. 61, pp. 270-272, cite in this respect a former ECJ judge, René Joliet, who back in the 70s argued that Article 102 should cover exploitative abuses only. The Commission’s decision practice has never reflected these views.

exploitative abuses have been so far seldom used by the Commission and are generally seen as an instrument of last resort in the competition law toolkit.<sup>248</sup> Excessive pricing actions provoke controversy and have been subject of many debates as to their usefulness and impact on the market. This criticism boils down to three main arguments: (i) the intervention might be harmful or at least superfluous, (ii) it is difficult to measure the price “excess” and (iii) price regulation is beyond the competences of a competition authority. These commonly expressed critical views may have been the reason for certain reluctance on the side of the Commission to embark on this line of action.

However, under the new competition enforcement regime and in the light of the Commission’s energy liberalisation agenda, Article 102 (a), this rather inconvenient and controversial competition law tool, may turn into an instrument of energy liberalisation policy and as such may be (and actually has been) enforced in the energy sector in a rather trouble-free way. The new competition enforcement framework has been introduced by 2004 reform.<sup>249</sup> The then adopted Regulation 1/2003 provides for three key enforcement mechanisms: (i) sector inquiries, (ii) commitment decisions and (iii) the power to impose structural remedies in antitrust actions, thereby greatly extending the Commission’s discretionary powers and enabling the transformation of Article 102 (a) into a liberalisation vehicle. As argued in the following paragraphs, this new antitrust enforcement toolbox employed in the context of energy liberalisation policy disqualifies the commonly expressed reasons for taking a hands-off approach to overpricing.

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<sup>248</sup> The history of the EU competition enforcement with regard to exploitative abuses boils down to six cases. See *General Motors Continental* (Case IV/28.851) Commission Decision 75/75/EC [1975] OJ L 29/14. *Chiquita* (Case IV/26.699) Commission Decision 76/353/EEC [1976] OJ L 95/1. *British Leyland* (Case IV/30.615) Commission Decision 84/379/EEC [1984] OJ L 207/11. *British Post / Deutsche Post* (Case COMP/36.915) Commission Decision 2001/892/EC [2001] OJ L 331/40. *Euromax v. IMAX* (Case COMP/C-2/37.761) Rejection Decision of 25.03.2004. *Scandlines Sverige AB v. Port of Helsingborg* (Case COMP/A.36.568/D3) Rejection Decision of 23.07.2004. *Sundbusserne v. Port of Helsingborg* (Case COMP/A.36.570/D3) Rejection Decision of 23.07.2004 (both decisions were adopted with regard to the same case - high port charges of the port of Helsingborg).

<sup>249</sup> Regulation 1/2003, *supra* n. 14.

Even though this chapter refers to excessive pricing actions in the energy sector only, the message it conveys is of a more general nature. The Commission may harness in this way any antitrust rules to foster liberalisation in the recently deregulated sectors, where introducing competition did not deliver anticipated benefits, due to the presence of still very rigid monopolistic structures. The focus here on otherwise uncommonly used excessive pricing actions is a deliberate attempt to show that even the most problematic and disputed competition law tool, which would hardly ever stand up in court once reached for under standard antitrust procedure, can easily be employed in the new laxer, more discretionary enforcement framework. The energy sector serves here as an example, where this experimental application of antitrust rules in pursue of wider liberalisation policy objectives actually takes place.

### 2.3. THE PARADOX

The activation of antitrust rules in the energy sector was triggered off by high energy prices. The steady rise in electricity and gas wholesale prices since 2003 seemed to be the most apparent sign that the energy liberalisation process does not produce the expected results.<sup>250</sup> In particular, the sharp increase in electricity prices in 2005 and the subsequent complaints of many energy-intensive industrial consumers induced the Commission to launch the energy sector inquiry.<sup>251</sup> Price formation on the electricity wholesale markets was one of the examined areas.<sup>252</sup> The Commission's inquiry confirmed the initial concerns that electricity prices go beyond the competitive levels and concluded that there is scope for price manipulation in the electricity wholesale markets. The inquiry then prompted a wave of antitrust investigations against the major electricity and gas incumbents.<sup>253</sup> Most of these investigations were based on

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<sup>250</sup> According to the provisions of the 2<sup>nd</sup> Energy Package, full liberalisation of markets for electricity and gas has been introduced as from 1 July 2007, see Article 21 of Directive 2003/54/EC, *supra* n. 73. Article 23 of Directive 2003/55/EC of the European Parliament and of the Council of 26.06.2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L 176/57.

<sup>251</sup> Energy Sector Inquiry, *supra* n. 78 and accompanying text.

<sup>252</sup> Final Report, *supra* n. 78, paras. 368-448.

<sup>253</sup> See Table 2.

exclusionary abuses, but some of them involved allegations of exploitation.<sup>254</sup> In none of these cases, however, price manipulations form a stand-alone basis to open the proceedings, which suggest that the Commission still acts cautiously, not to be accused of pursuing purely exploitative practices.

Historically, energy prices in Europe were regulated. The objective of liberalisation was to abolish the former state-owned vertically integrated structures and to introduce competition (also price competition) in these segments which are not natural monopolies. And although regulated supply tariffs are still present in many countries as a transitory measure, the desired outcome of liberalisation process are freely negotiable energy prices.<sup>255</sup>

In this context, an idea of using excessive pricing actions as a tool of energy market liberalisation appears paradoxical in nature. An intervention against excessive prices is clearly a form of price control, the very antithesis to the free market objective, and as such not only would not encourage market opening but even implies a step backwards in the liberalisation process. This paradox, stark at first sight, disappears with a more calibrated use of excessive pricing actions. The new laxer enforcement framework allows for a wide range of antitrust responses, more discretionary fashioning of remedies and their adaptation to goals of energy liberalisation policy.

## 2.4. INVALIDATING THE CRITICISM

There are three main reasons for a cautious application of Article 102 (a). This section deals with them consecutively and shows how the Commission can evade the criticism of its actions against exploitative abuses in the energy sector with the help of a broader set of enforcement tools.

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<sup>254</sup> E.g. *German electricity wholesale market* (Case COMP/39.388). The 3 ongoing investigations in *CEZ & Others* (Case COMP/39.727), *French electricity wholesale market* (Case COMP/39.442) and *Upstream gas suppliers in Central and Eastern Europe (Gazprom)* (Case COMP/39.816) also involve allegations of price manipulation (see MEMO/09/518 of 24.11.2009, MEMO/09/104 of 11.03.2009 and MEMO/11/641 of 27.09.2011 and IP/12/937 of 04.09.2012).

<sup>255</sup> Final Report, supra n. 78, paras. 610-613.

#### *2.4.1. Intervention might be superfluous or even harmful*

A common caveat considered in the literature on excessive pricing is that high prices invite new entry and the appearance of new competitors brings the prices down to a more competitive level. Not only is an antitrust intervention superfluous in such cases but it also entails a risk of chilling competition in a dynamic perspective, when errors in antitrust enforcement lead to false convictions of firms reaping rewards of their past investments and innovation.<sup>256</sup>

This argument, plausible in a market with low entry barriers, does not hold for the energy sector. Characterised by high legal (past monopolies) and economic (substantial sunk costs) entry barriers, electricity wholesale market is not self-corrective. Its market features stand to the criteria developed by the economic and legal scholars to determine the industries where an excessive pricing action is well-founded. The proposed tests differ in certain respects, but they all point to a particular market structure which disrupts the functioning of market forces in a permanent way. The common market features that are mentioned include substantial (near monopoly) dominant position<sup>257</sup>, high barriers to entry (and expansion)<sup>258</sup>, elements of legal monopoly (past or current)<sup>259</sup> and the absence of an (effective) sector-regulator.<sup>260</sup>

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<sup>256</sup> M. MOTTA and A. DE STREEL, ‘Excessive pricing in Competition Law: Never say Never?’ in N. STRAND and A. FREDENBERG (eds.), *The Pros and Cons of High Prices*, Konkurrensverket (Swedish Competition Authority), Lenanders Grafiska AB, Stockholm 2007, p.20; D.S. EVANS and A.J. PADILLA, ‘Excessive Prices: Using Economics to Define Administrative Legal Rules’ (2005) 1 *Journal of Competition Law and Economics* 1, 97-122, pp. 113–115.

<sup>257</sup> D.S. EVANS and A.J. PADILLA, *supra* n. 256. R. O'DONOGHUE and A.J. PADILLA, *The Law and Economics of Article 82 EC*, Hart Publishing, Oxford 2006. M. MOTTA and A. DE STREEL, *supra* n. 256, M. VAN DER WOUDE, ‘Unfair and excessive prices in the energy sector’ (2008) 2 *European Review of Energy Markets* 3, available at <http://www.eeinstitute.org/european-review-of-energy-market/erem6-article-van-der-woude> accessed 20.05.2013.

<sup>258</sup> D.S. EVANS and A.J. PADILLA, *supra* n. 256, R. O'DONOGHUE and A.J. PADILLA, *supra* n. 257, M. MOTTA and A. DE STREEL, *supra* n. 256, E. PAULIS, ‘Article 82 EC and exploitative conduct’ and L.-H. RÖLLER, ‘Exploitative Abuses’ as well as A. FLETCHER and A. JARDINE, ‘Towards an Appropriate Policy for Excessive Pricing’ in C.-D. EHLMANN and M. MARQUIS (eds.), *European Competition Annual 2007: A Reformed Approach to Article 82 EC*, Hart Publishing, 2007.

<sup>259</sup> D.S. EVANS and A.J. PADILLA, *supra* n. 256, L.-H. RÖLLER, *supra* n. 258, M. MOTTA and A. DE STREEL, *supra* n. 256, F. LÉVÈQUE, ‘Antitrust Enforcement in the Electricity and Gas Industries: Problems and Solutions for the EU’ (2006) 19 *The Electricity Journal* 5, 27-34.

<sup>260</sup> L.-H. RÖLLER, *supra* n. 258, M. MOTTA and A. DE STREEL, *supra* n. 256.

The Commission's stance falls in line with the prevalent opinion of the economic and legal scholars. According to the Article 102 Guidance Paper, the Commission does not exclude the possibility of launching an excessive pricing action, yet underlies its extraordinary nature.<sup>261</sup> Thus, it may decide to intervene against excessive prices in cases, where there are no competitive forces that could alone correct the abusive behaviour due to the presence of still very rigid monopolistic structures, for example in the energy sector.<sup>262</sup>

This is not a new approach. It reflects the Commission's former decision-making practice. The almost fifty-years-long enforcement in this area boils down to seven formal decisions.<sup>263</sup> Six of them involved (past or present) legal monopoly in form of concessions<sup>264</sup> or intellectual property rights.<sup>265</sup> Several other excessive pricing cases were heard by the ECJ. Most of them have been referred under Article 267 TFEU for a preliminary ruling. Almost all of them involved particular circumstances or legal monopoly rights.<sup>266</sup> In these premises, an excessive pricing action in the energy sector is in line

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<sup>261</sup> European Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 45, para. 7.

<sup>262</sup> P. LOWE, 'How different is EU anti-trust? A route map for advisors — An overview of EU competition law and policy on commercial practices', speech at ABA 2003 Fall Meeting, 16.10.2003, Brussels: 'It is not in our power to change the Treaty. And, in my view, we should continue to prosecute such [excessive pricing] practices where the abuse is not self-correcting, namely in cases where entry barriers are high or even insuperable. It probably makes also sense to apply those provisions in recently liberalised sectors where existing dominant positions are not the result of previous superior performance.'

<sup>263</sup> Supra n. 248.

<sup>264</sup> *General Motors, British Leyland, British Post/Deutsche Post, Port of Helsingborg* cases. See supra n. 248 for case references.

<sup>265</sup> *Euromax/IMAX*, supra n. 248 for case reference.

<sup>266</sup> Case 24/67, *Parke Davis and Co. v. Probel, Reese, Beintema-Interpharm and Centrafarm* [1968] ECR 55. Case 40/70, *Sirena, S.r.l. v. Eda S.r.l. and others* [1971] ECR 69. Case 78/70, *Deutsche Grammophon* [1971] ECR 487. Case 26/75, *General Motors v. Commission* [1975] ECR 1367. Case 27/76, *United Brands v. Commission* [1978] ECR 207. Case 298/83, *CICCE* [1985] ECR 1105. Case 30/87, *Bodson v. Pompes Funèbres des Régions Libérées* [1988] ECR 2479. Case 53/87, *Renault* [1988] ECR 6039. Case 395/87, *Tournier (SACEM I)* [1989] ECR 2521. Cases 110/88, 241/88 and 242/88, *Francois Lucaleau and others v. Sacem and others (SACEM II)* [1989] ECR 2811. Case 66/86, *Ahmed Saeed* [1989] ECR 803. For a comprehensive overview of these cases see M. MOTTA and A. DE STREEL, 'Excessive Pricing and Price Squeeze under EU Law' in C.-D. EHLMERMAN and I. ATANASIU (eds.), *European Competition Law Annual 2003: What is an Abuse of a Dominant Position?*, Hart Publishing, 2006. See also M. VAN DER WOUDE, supra n. 257.

#### *2.4.2. Assessment problems*

Another drawback of Article 102 (a) enforcement lies in measuring the price “excess”. All methods used to assess the costs and profit margins involve complex calculations and require a thoroughgoing knowledge of the sector at issue. None of them is sufficiently accurate, yet simple enough, to provide a one-size-fits-all solution easily applied in all excessive pricing cases on a stand-alone basis.<sup>267</sup> A competition authority is considered ill-equipped to carry out such a costly and time-consuming exercise in each individual case.<sup>268</sup>

Two new enforcement tools may help the Commission to dodge the difficult question how high is “too high” in an excessive pricing case, namely (i) sector inquiry and (ii) commitment decisions.

##### *2.4.2.1. Sector inquiry opens the case...*

The 2004 antitrust reform enables the Commission to open sector-wide inquiries into these industries, in which competition appears not to work properly.<sup>269</sup> Sector inquiry is a proactive fact-finding exercise allowing the Commission to gather necessary information on the problems of the sector in order to launch further antitrust investigations in individual cases. The legal basis of a sector inquiry expressly refers to the follow-up company-specific antitrust investigations. Pursuant to Article 17 of Regulation 1/2003, during the sector inquiry the Commission collects evidence ‘to give effect to Article [101] and [102] of the Treaty’.<sup>270</sup> To that end, the Article vests in the Commission the same investigative powers it enjoys in the individual Article 101 and 102 proceedings.<sup>271</sup>

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<sup>267</sup> In the same vein E. PIJNACKER HORDIJK, ‘Excessive Pricing Under EC Competition Law: An Update in the Light of “Dutch Developments”’ in B. HAWK (ed.), *2001 Fordham Corporate Law Institute*, 2002, pp. 476–477, 495. D.S. EVANS and A.J. PADILLA, *supra* n. 256, pp. 100-103. M. MOTTA and A. DE STREEL, *supra* n. 256, p. 18. M. VAN DER WOUDE, *supra* n. 257, p. 7.

<sup>268</sup> M. MOTTA and A. DE STREEL, *supra* n. 256, p. 19.

<sup>269</sup> Sector inquiry is not a novel instrument in the EU competition enforcement. *Supra* n. 77.

<sup>270</sup> Article 17 of Regulation 1/2003, *supra* n. 14.

<sup>271</sup> Articles 18, 19, 20 and 22, read in conjunction with Article 17 of Regulation 1/2003, *supra* n. 14.

In these premises, it came as no surprise that the energy sector inquiry triggered off further company-specific antitrust investigations, also with regard to overpricing. From the very start the Commission was rather plain-spoken about its plans,<sup>272</sup> encouraged by its enforcement experience in the aftermath of the telecommunications sector inquiry.<sup>273</sup> Article 102 (a) proved to be an effective deterrent on telecoms operators when the Commission opened investigations into their pricing strategies. Motta and de Streel (2006) point out a number of excessive pricing cases in the telecoms sector which, instead of resulting in formal decisions, were closed following price decreases.<sup>274</sup> According to Lévêque (2006)<sup>275</sup> the function of Article 102 (a) in these cases was to increase the power of sector inquiry which in turn exerted a disciplining pressure on the telecoms operators. Similarly, in the light of problems with the third energy liberalisation package and strong political resistance to proposed reforms<sup>276</sup>, the Commission might have hoped to bypass the legislative process and achieve its policy objectives quicker, through the back door of antitrust enforcement, by direct negotiations with the energy incumbents.

The energy sector inquiry found high price mark-ups in electricity wholesale markets. It thus delivered sufficient evidence to launch excessive pricing actions against the energy incumbents. However, one can cast doubt whether the collected information is robust enough to stand up in court in individual cases. The Commission's prohibition decision in *United Brands*, the only case which did not involve any government-

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<sup>272</sup> European Commission, *Report on Competition Policy*, 2005, para. 41: 'The objective [of the inquiry] is to identify whether infringements of Articles 81, 82 and 86 EC are responsible for the apparent malfunctioning of the electricity and gas markets, in which case the Commission could undertake proactive corrective action. Based on the facts collected in the inquiry and consequent priorities for enforcement, the Competition DG will take up cases under Articles 81, 82 or 86 EC as soon as they emerge.'

<sup>273</sup> <http://ec.europa.eu/competition/sectors/telecommunications/archive/index.html> accessed 20.05.2013.

<sup>274</sup> M. MOTTA and A. DE STREEL, *supra* n. 266, pp. 105-108. See also E. PIJNACKER HORDIJK, *supra* n. 267, pp. 472-474, on settlements in telecommunications and air transport sector.

<sup>275</sup> F. LÉVÈQUE, *supra* n. 259, p. 33.

<sup>276</sup> Due to strong opposition of eight Member States (Germany and France, later joined by Austria, Bulgaria, Greece, Luxemburg, Latvia and Slovakia) to the introduction of ownership unbundling of energy production and distribution assets, the political compromise on the final shape of the 3<sup>rd</sup> Energy Liberalisation Package reached in summer 2009 was far less ambitious than the Commission expected: ownership unbundling is optional; the companies are allowed to opt for two less radical unbundling models, one of which has been proposed by the eight 'blocking' countries. See MEMO 09/622 of 22.04.2009 and press release <http://www.euractiv.com/energy/eu-strikes-deal-energy-market-li-news-221555> accessed 20.05.2013.

granted exclusive rights, was quashed on appeal.<sup>277</sup> According to the ECJ, the Commission failed to demonstrate sufficient evidence of alleged excessive pricing.<sup>278</sup> The annulment of the *United Brands* decision, the flag Article 102 (a) case, surely had a bearing on the Commission's subsequent enforcement of unfair pricing provisions, which since then were applied only in the legal monopoly context.<sup>279</sup> Similarly, all three excessive pricing energy cases based on the sector inquiry results involve allegations of exclusionary conduct on the top of exploitation. Shifting the legal basis away from problematic 'section (a)' concerns may be a deliberate attempt of the Commission, simply not to run the risk of having its decisions overturned on appeal on the grounds that, as happened in the *United Brands* case, it failed to demonstrate sufficient evidence of abusive behaviour. In an individual antitrust investigation the Commission would have to go beyond the findings of the energy sector inquiry and provide evidence of strategic pricing behaviour of a specific generator against whom the case is brought.

Some assessment problems might arise already at the stage of finding dominance. Particularly, oligopolistic structures (e.g. German electricity wholesale market) provide a difficult setting for abuse of dominance cases. In such cases, where market shares of the players do not exceed 30%, to be able at all to invoke Article 102, the Commission finds several generators jointly dominant.<sup>280</sup> However, the concept of collective dominance may substantially complicate the assessment of the abuse, as the Commission needs to take account of collusive environment. Even if the Commission ventures into a more complex analysis of oligopolistic interaction, it still does not mean that the Courts will appreciate the effort. A simple theory of harm presented in a readily comprehensible manner may often be much more convincing in court than sophisticated game-theoretic models of collusion which do not provide straightforward answers. This might be also the reason why the Commission in its

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<sup>277</sup> Case 27/76, *United Brands v. Commission* [1978] ECR 207.

<sup>278</sup> *Ibid.*, para. 267.

<sup>279</sup> Only two cases concerned pure exploitation, namely excessive port fees. Both of them were rejected by the Commission. For a case study, see M. LAMALLE, L. LINDSTRÖM-ROSSI and A. CARLOS TEIXEIRA, 'Two important rejection decisions on excessive pricing in the port sector' (2004) 3 *Competition Policy Newsletter*, Autumn Issue, 40-43.

<sup>280</sup> E.g. German electricity wholesale market (Case COMP/39.388).

decisions usually relies on crude market share calculation instead of using electricity specific indices (Residual Supply Index, Pivotal Supplier Indicator) to measure market power in the electricity wholesale markets, even if the former are widely considered inadequate for that purpose. Market shares can solely give a first proxy (negative test) of potential market power in generation markets and, what economic literature suggests should be accompanied by further electricity specific indices.<sup>281</sup> These however, taking account of the specific features of the electricity generation, indicate price setters for each specific period of time. This specific market power, which is not constant over time, might not stand up to the traditional proof of dominance standard required by the Courts.

The same limitations apply to the finding of an exploitative abuse. It is true that the legal framework developed by the Court allows the Commission for a high degree of arbitrariness in estimation of the price excess. According to the United Brands judgment, which sets the standards for the assessment of unfair pricing, the price is excessive when ‘it has no reasonable relation to the economic value of the product’.<sup>282</sup> The ECJ further proposes to apply the price-cost benchmark to measure the profit margin and thereby resulting price excess. Yet this method is in no way definitive and the Court eventually gives free rein as to the mode of practice in determining the price excess. In fact, a range of measuring techniques has been developed since the *United Brands* case.<sup>283</sup> They all however involve complex sector-specific calculations and even if they exist in the economic literature, they may not be accepted by the Court in a specific case.

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<sup>281</sup> D. HARBORD and N. FABRA, *Market Power in Electricity Markets: Do Electricity Markets Require Special Regulatory Rules?*, Market Analysis Ltd, 2000, p. 66. D. PEREKHODSTEV, L.B. LAVE and S. BLUMSACK, ‘The Model of Pivotal Oligopoly Applied to Electricity Markets’ (2002) mimeo, Carnegie-Mellon Electricity Industry Center, Working Paper CEIC 02-06, p. 14. F. WOLAK, ‘Diagnosing the California Energy Crisis’ (2003) 16 *The Electricity Journal* 7, August/September Issue, 11-35, p. 15. D. BIGGAR, ‘Competition Issues in the Electricity Sector - Background Note’ (2005) 6 *OECD Journal of Competition Law and Policy* 4, 97-162, pp. 109–112. G. FEDERICO and X. VIVES (with collaboration of N. FABRA), *Competition and Regulation in the Spanish Gas and Electricity Markets*, Reports of the Public-Private Sector Research Centre 1, IESE Business School, University of Navarra, 2008, p. 12.

<sup>282</sup> Case 27/76, *United Brands v. Commission* [1978] ECR 207, para. 250.

<sup>283</sup> For an overview of the methods applied in excessive pricing cases see M. MOTTA and A. DE STREEL, *supra* n. 266.

#### 2.4.2.2. ...and commitment decision closes it...

Application of a simplified procedure that, for one thing, does not require a high standard of proof, and for the other thing, diminishes the risk of appeal, can overcome the assessment difficulties with respect to finding of excessive pricing. This is achieved by a commitment decision.

Article 9 of the EC Regulation 1/2003 provides for ‘formalised settlements’ of antitrust investigations, in which the commitments offered by the undertakings are made binding upon them in the so called commitment decision issued by the Commission.<sup>284</sup> Prior to the entry into force of the EC Regulation 1/2003, the Commission settled sparse cases of abuse of dominant position in the energy markets in a similar way, only informally, when the undertakings offered sufficient commitments that met its anticompetitive concerns.<sup>285</sup> However, these informal antitrust settlements were not enforceable. The 2004 reform formalised them thereby creating an attractive alternative to standard infringement proceedings under Article 7 of the EC Regulation 1/2003.<sup>286</sup> Commitment decision, unlike Article 7 decision, does not oblige the Commission to find an infringement, but solely to state that in the light of the offered commitments there are no longer grounds for further investigation.<sup>287</sup> This means that in the commitment procedure the Commission neither proves a dominant position nor an abuse. Instead, it expresses its anti-competitive concerns in a document called preliminary assessment, shorter and less detailed than a statement of objections prepared for the purposes of Article 7 decisions.<sup>288</sup> Hence, the lowered standard of proof in commitment procedure would not require any further findings of excessive pricing abuse beyond those already established in the energy sector inquiry.

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<sup>284</sup> Supra, section 1.2.1.

<sup>285</sup> E.g. *Marathon/Ruhrgas/GDF et alia* (Case COMP/36.246), IP/04/573 of 30.04.2004, and *Natural Gas/Endesa* (Case COMP/37.542), IP/00/297 of 27.03.2000 (this case concerned also Article 101 abuses). Even now, despite the possibility of closing cases by commitment decisions, some cases are still settled informally. See, for instance, IP/04/1314 of 06.10.2004, IP/05/195 of 17.09.2005, IP/05/710 of 10.06.2005 (energy sector), IP/05/1033 of 03.08.2005, IP/06/139 of 09.12.2006, IP/08/22 of 09.01.2008. See also supra n. 55.

<sup>286</sup> Article 7 of Regulation 1/2003, supra n. 14.

<sup>287</sup> Recital 13 of Regulation 1/2003, supra n. 14.

<sup>288</sup> Article 27 (1) of Regulation 1/2003, supra n. 14.

In addition to that, commitment procedure minimises the risk of appeal. Commitment decisions are formal decisions of the Commission and as such can be challenged before the European Courts, either by the undertaking concerned or by interested third parties. In practice, such an appeal is highly unlikely. Commitment decisions are convenient not only for the Commission, in terms of procedural efficiency, but also for the undertakings (e.g. avoiding fines, saving reputation costs of not being accused of infringement, resolving uncertainty about the outcome of the case and the legal duties, reducing the risk of the follow-on private damages actions before national courts).<sup>289</sup> An undertaking prefers to offer even substantial commitments just to avoid further antitrust proceedings. It is thus hard to imagine that it would want to challenge the outcome of a voluntarily entered agreement.<sup>290</sup> In the now six-year-long history of enforcement under Regulation 1/2003 two of the Commission's commitment decisions have been challenged, and not by the undertakings offering commitments but by third parties. Only one of them has been reviewed by the Courts<sup>291</sup> and eventually upheld by the ECJ's much-anticipated judgment in the *Alrosa* case, concerning the proportionality of commitments.<sup>292</sup> In 2007 the General Court quashed the Commission's decision in *Alrosa/de Beers group* case on the grounds that, among others, the accepted commitments were disproportionate to the alleged abuse. The Commission appealed to the ECJ which ultimately upheld its decision. Thereby, the Court acknowledged the Commission's wide discretionary powers under Article 9, rendering an eventual third party appeal even less likely to succeed. This risk is further minimised by the market test phase, whereby the Commission publishes the proposed commitments and interested third parties have minimum one month to give their observations. The Commission can take third parties' comments into consideration<sup>293</sup> (but is not required to follow them) and ask the undertaking concerned to modify its commitments accordingly before finally approving them.<sup>294</sup>

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<sup>289</sup> See discussion, supra section 1.2.1.1.

<sup>290</sup> However, see supra n. 21 and 201.

<sup>291</sup> Two appeals in the *REPSOL* case have been rejected on procedural grounds, supra n. 21.

<sup>292</sup> Case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949. Supra n. 237 for a brief description of the case and the appeal.

<sup>293</sup> However, the Commission is not required to follow them. Supra section 1.5.2.2.

<sup>294</sup> See Article 27 (4) of Regulation 1/2003, supra n. 14.

### 2.4.3. Price regulation

Finally, the third generally accepted argument justifying a hands-off approach to overcharging is that price regulation goes beyond the competences of a competition authority.<sup>295</sup> Indeed, in all excessive pricing cases the Commission ordered to bring the infringement to an end and imposed a fine, sometimes accompanied by less onerous behavioural remedies (e.g. periodical reporting requirement).<sup>296</sup> Such measures seem to be designed to address the symptoms of an anti-competitive setting (high prices) but they do not eliminate the causes (anti-competitive market structure). In addition, behavioural remedies are usually very costly to implement as they boil down to constant monitoring of the firm's pricing behaviour. Burdensome both for the undertaking and for the Commission they eventually amount to price regulation.

#### 2.4.3.1. ...with a structural solution.

The risk of price regulation through antitrust enforcement does not arise if the Commission takes account of a broader spectrum of antitrust responses under the new regulatory framework. The EC Regulation 1/2003 gives the Commission power to impose 'any remedy, whether behavioural or structural, which is necessary to bring the infringement effectively to an end, having regard to the principle of proportionality.'<sup>297</sup> As a rule, behavioural remedies are preferred in antitrust cases, since they are considered less intrusive in comparison to structural remedies.<sup>298</sup> However the specifics of the deregulated energy sector justify the use of structural remedies. To bring about changes in the market structure, the Commission clearly favours structural remedies in energy antitrust actions, whereas fines and behavioural

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<sup>295</sup> E. PIJNACKER HORDIJK, *supra* n. 267, with regard to the excessive pricing actions taken by the Dutch competition authority, NMa.

<sup>296</sup> See e.g. *Chiquita*, *supra* n. 248, Article 3 and 4 of the Commission decision.

<sup>297</sup> Recital 12 of Regulation 1/2003, *supra* n. 14.

<sup>298</sup> Recital 12 of Regulation 1/2003, *supra* n. 14: 'Structural remedies should only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. Changes to the structure of an undertaking as it existed before the infringement was committed would only be proportionate where there is a substantial risk of a lasting or repeated infringement that derives from the very structure of the undertaking.'

remedies are considered ill-suited to achieve the liberalisation goal.<sup>299</sup> Thus, this is the energy liberalisation policy that assures excessive pricing actions will not amount to price regulation. In the current enforcement regime the Commission may reach out for excessive pricing actions and fine-tune them according to its policy targets, ultimately intervening in the market structure instead of controlling firms' pricing practices. Not only does the legal framework allow for a structural response to excessive pricing. The ECJ *Alrosa* judgement clearly supports the Commission's energy market liberalisation zeal. The Court recognised that the commitments provide a rapid solution resolving competition problems and the Commission should actually enjoy a wide margin of discretion with regard to the shape of the commitment package. Hence, if the Commission opts for a structural intervention as a remedy for overpricing, it is likely that the Courts do not object, not to trench upon the Commission's discretion.

## 2.5. CONCLUSIONS

This chapter points out a possibility to employ excessive pricing actions in the energy markets. Article 102 (a) was initially designed to protect the consumers from unfairly high prices, however, due to conceptual and practical problems, hardly ever served its purpose. There exist valid reasons for the Commission's reluctance towards pursuing exploitative abuses. However, the 2004 antitrust reform significantly relaxed the enforcement standards and granted the Commission new discretionary powers. Under the new regime the Commission can and actually does use Article 102 (a) to achieve its liberalisation policy goals with respect to the energy sector. To start with, the findings of the sector inquiry point at excessive pricing in the energy sector which is sufficient to open company-specific antitrust investigations. Secondly, the new commitment procedure with a low standard of proof and a reduced risk of appeal ensures that an excessive pricing case can be closed a timely manner, with no additional costs of finding an exploitative abuse and eventual follow-up court proceedings. Finally, the new power to accept structural commitments in antitrust

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<sup>299</sup> N. KROES, *supra* n. 85.

actions allows for a smarter design of an antitrust response. The Commission can opt for a structural solution which fits well with its energy liberalisation plans and does not entail the risk of price regulation.

In addition, the *Alrosa* judgment provides a twofold underpinning for an eventual use of excessive pricing actions as an instrument of energy liberalisation policy. First, it further discourages the interested parties from lodging an appeal against a commitment decision. Second, it confirms the Commission's discretionary powers to negotiate and accept structural commitments as a remedy for purely exploitative abuses.

High energy prices activated antitrust enforcement in the energy markets. Excessive pricing actions are a natural antitrust response but not as a direct intervention in the pricing strategies of energy incumbents but rather as a vehicle for introducing structural changes in the energy sector. Provided that the enhanced antitrust interventions on the market structure lead to more competitive market setting, the allegedly excessive prices should go down to a (more) competitive level. This would ultimately solve a problem which excessive pricing actions were originally meant to address. However, things are not that simple in the real world and an ex-ante assessment of the effectiveness of the accepted structural commitments, taking account of the long and short-term efficiency trade-offs, further blurred by non-economic goals common in the energy sector, can be a highly complex exercise.<sup>300</sup> The Commission, in spite of having all the necessary tools and the Courts' go-ahead to correct energy markets through antitrust actions, might nevertheless fail to do so due to a sub-optimal shape of the commitment package or errors in their implementation.

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<sup>300</sup> L. HANCHER and A. DE HAUTECLOCQUE, 'Manufacturing the EU Energy Markets: The Current Dynamics of Regulatory Practice' (2010) 11 *Competition and Regulation in Network Industries* 3, 307-334, pp. 326-328, analyse the difficulties of the assessment of the impact of antitrust remedies in the case of VVPs.



### 3. ENERGY LIBERALISATION IN AN ANTITRUST STRAITJACKET: A PLANT TOO FAR?<sup>301</sup>

#### 3.1. ABSTRACT

The European Commission has launched a number of antitrust investigations against the major energy incumbents in the aftermath of the energy sector inquiry. Most of them have already been closed under Article 9 of the EC Regulation 1/2003 and the undertakings offered far-reaching, sometimes structural, commitments. This chapter studies the 2008 investigation into price manipulation in the German electricity wholesale market. In spite of no convincing evidence and flaws in the assessment, the Commission was able to negotiate from E.ON substantial capacity divestments.

The Commission is straightforward about using antitrust rules to open up energy markets. Sector inquiries, commitment procedure, and structural remedies allow for a quick intervention and flexible problem-solving and bring about decisive changes in the energy market setting. However, harnessing antitrust for the purpose of energy liberalisation policy has an adverse impact on competition enforcement itself. First, it leads to a number of ‘weak’ cases, based on far-fetched arguments. Second, it results in remedies that are not tailored to the abuse at issue but are in line with a wider objective of energy market liberalisation and, as an outcome of negotiations, further swayed by the firm’s own interest in the ultimate shape of the commitment package.

#### 3.2. INTRODUCTION

A wave of antitrust investigations has shaken the European energy sector in the recent years.<sup>302</sup> In spite of being formally liberalised in 2007, energy markets remained in

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<sup>301</sup> First published in *World Competition: Law and Economics Review* 34, 3 (2011). Many thanks are due to Massimo Motta, Klaus Heine, Natalia Fabra, Jan Bouckaert, Pierre Larouche, Firat Cengiz, Bert Willems, Niels Philipsen, Killian Kehoe, and the participants of the seminars at Tilburg Law and Economics Center (TILEC), Tilburg University, and Rotterdam Institute of Law and Economics (RILE), Erasmus University Rotterdam, for their insightful comments and discussions. The views expressed and all remaining errors are that of the author.

fact closed to competition.<sup>303</sup> To get a better insight into the problem, the Commission opened a sector-wide inquiry which confirmed the concerns and identified several areas where competition issues are likely to arise.<sup>304</sup> The sector inquiry was then followed by a number of individual antitrust investigations targeting energy incumbents in several Member States. Ten out of fifteen cases have already been closed and in eight of them companies offered far-reaching, sometimes structural, commitments, ushering in a new pattern of antitrust enforcement. In the light of the slow-paced energy liberalisation process this no-nonsense go-ahead application of competition rules comes as no surprise. Energy market reforms face strong governmental opposition in several countries,<sup>305</sup> and this lack of political will holds up market opening via regulatory measures.<sup>306</sup> The Commission may hope to achieve the same effects by reaching antitrust deals with energy incumbents, bypassing at the same time the difficult legislative process.

Liberalisation and competition policy pursue effectively coinciding goals with respect to the European energy markets. Liberalisation removes monopolies and exclusive rights and fosters competitive forces up to a point where they, alone, can exercise disciplining pressure on the market players.<sup>307</sup> Competition policy ensures that these competitive forces are not disrupted, impacting either on the market structure or the firms' conduct. Hence, competition policy plays crucial role in the liberalisation

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<sup>302</sup> Supra Table 2.

<sup>303</sup> N. KROES, supra n. 85. Full liberalisation of markets for electricity and gas has been introduced as from 01.07.2007, see Article 21 of Directive 2003/54/EC, supra n. 73. Article 23 of Directive 2003/55/EC, supra n. 250.

<sup>304</sup> Energy Sector Inquiry, supra n. 78. The underlying methodology and the outcomes of the inquiry are set out in the DG Competition report on energy sector inquiry (Final Report). The sector inquiry assessment is supported by an in-depth quantitative analysis of six European electricity markets (incl. Germany) carried out by external consultants at the request of the Commission. For the results see London Economics, *Structure and performance of six wholesale electricity markets in 2003, 2004 and 2005*, Study for the European Commission, DG Competition, February 2007 (LE Study) and Final Report, paras. 997-1020, for the summary.

<sup>305</sup> Germany and France, later joined by Austria, Bulgaria, Greece, Luxemburg, Latvia and Slovakia formed a strong opposition towards the Commission's proposal of ownership unbundling of energy production and distribution assets.

<sup>306</sup> Due to resistance of eight 'blocking' countries, the political compromise on the final shape of the 3<sup>rd</sup> Energy Package reached in 2009 was far less ambitious than initially expected: ownership unbundling is not mandatory; the companies are allowed to opt for two less radical unbundling models, one of which has been supported by the eight 'blocking' countries. See IP/09/622 of 22.04.2009.

<sup>307</sup> M. ARMSTRONG and D. SAPPINGTON, 'Regulation, Competition, and Liberalisation' (2006) 44 *Journal of Economic Literature*, 325-366, p. 359.

process. Seen from this angle, it seems there is nothing wrong in harnessing antitrust rules to accomplish the objective of energy liberalisation. Further, the 2004 reform introduced changes to antitrust enforcement substantially facilitating the application of antitrust rules in the energy sector. First of all, the new Regulation 1/2003 empowered the Commission to launch sector inquiries in markets where competition appears to be restricted or distorted.<sup>308</sup> Secondly, Article 9 provided for a relatively simple and quick procedure for closing antitrust cases, where the remedy package is negotiated between the Commission and the investigated undertaking (the commitment procedure).<sup>309</sup> Finally, pursuant to Article 7 and Recital 12, the Commission can impose structural remedies in antitrust cases.<sup>310</sup> Hence, under the new antitrust enforcement regime, the Commission is well-equipped to intervene in the energy sector and negotiate structural solutions directly with the energy incumbents.

Even though the idea of using antitrust policy to foster energy market liberalisation appears sound from a teleological and legal point of view, its application may raise concerns. The new pattern of antitrust enforcement marked by a widespread use of commitment procedure and increased intervention on the market structure has two serious implications.

First, the Commission may come up with a number of serious anticompetitive allegations, simply in order to increase its bargaining power and negotiate far-reaching commitments. At the same time, Article 9 allows the Commission to close antitrust investigations with no finding of an infringement, significantly lowering the standard of proof. Since neither the dominant position, nor the abuse requires further evidence, the Commission's preliminary concerns are not further investigated rendering the assessment far more perfunctory than it would be under a standard infringement procedure. Article 9 cases may be thus 'weak' cases, based on far-fetched allegations.

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<sup>308</sup> Article 17 of Regulation 1/2003, *supra* n. 14.

<sup>309</sup> Article 9 of Regulation 1/2003, *supra* n. 14.

<sup>310</sup> Article 7 and Recital 12 of Regulation 1/2003, *supra* n. 14.

Second, the commitments, often extensive structural measures, are not designed to address the antitrust concerns but are rather an outcome of negotiations and horse-trading between, on the one hand, the Commission, concerned with the slow pace of the energy liberalisation process and, on the other hand, the firm, possibly having its own interest in the ultimate shape of the commitment package, which is not always obvious to observers.

To illustrate these arguments, the following sections take a closer look at the E.ON case – an 2008 investigation under Article 102 TFEU mainly into price manipulation on the German wholesale electricity market.<sup>311</sup> In this case, in spite of no convincing evidence and a questionable theory of harm, the Commission negotiated with E.ON far-reaching structural commitments.<sup>312</sup> The commitments, requiring E.ON to sell 20% of its generation capacity and hence substantially diminishing its market share, altered the structure of the German electricity wholesale market, yet did not necessarily address the concerns with respect to E.ON's abusive behaviour.

This case study provides a twofold underpinning for the arguments of this chapter, which are based on insights provided by economic theory. First, it emphasises the weak points in the Commission's cursory analysis of E.ON's alleged anticompetitive behaviour. Second, it demonstrates that the commitments accepted in this case are not tailored to address the Commission's concerns with regard to the alleged price manipulation. Instead, they are designed to accomplish wider policy objectives of energy market liberalisation and, on the top of that, they are swayed by E.ON's own strategic interests.

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<sup>311</sup> *German electricity wholesale market* (Case COMP/39.388).

<sup>312</sup> The analysis of the E.ON case presented in this chapter is based on the publicly accessible case documents. However, one cannot exclude that the Commission might have been in possession of a 'smoking gun' evidence that induced E.ON to offer substantial commitments just to avoid a high fine in an alternative scenario under the Article 7 infringement procedure. Whatever was E.ON's motivation to engage in Article 9 negotiations with the Commission, it is irrelevant for the hereby presented argumentation and can be left out of the scope of the paper.

### 3.3. FAR-FETCHED CONCERNS

The commitment procedure provides for a quick and efficient closing of antitrust cases. Instead of launching a standard infringement procedure under Article 7 of the EC Regulation 1/2003 the Commission may close an antitrust case on the basis of a preliminary assessment and with no need to find an infringement of competition rules. Hence, in case of an (alleged) abuse of a dominant position, neither a dominant position nor an abuse needs to be demonstrated. Instead, pursuant to Article 9, if an undertaking offers commitments addressing the anticompetitive concerns expressed in the preliminary assessment, the Commission may issue a decision that makes those commitments binding on the undertaking. Such a commitment decision closes the case, stating that there are no longer grounds for the Commission to take action.

The efficiency gains of the commitment procedure come at a cost however, given that no in-depth analysis of the case takes place. The fact that no infringement decision is made allows the Commission to focus its resources on the negotiations and their outcome whereas its preliminary anticompetitive concerns do not undergo any in-depth economic analysis. The lack of this ‘reality check’ combined with the Commission’s fervour to open up the energy markets entails a risk of far-fetched competition assessment. Namely, in order to increase its bargaining power and to negotiate extensive commitments in line with its liberalisation plans, the Commission may deliberately extend the scope of the anticompetitive concerns in the preliminary assessment. Since commitments are supposed to meet the Commission’s concerns, the more substantial these concerns are, the more radical commitments the Commission may expect from the undertaking. This would not be possible under a standard infringement procedure, where any alleged abuse of a dominant position must be eventually found. The commitment procedure, enabling such easy proliferation of anticompetitive concerns which are not subsequently verified or further analysed, promotes ‘weak’, unconvincing cases. The E.ON case provides a good example to demonstrate that under Article 9 anticompetitive concerns may be stretched beyond their proper limits.

The German electricity wholesale market is broadly divided between four large electricity suppliers: E.ON, RWE, Vattenfall and EnBW. In 2007 the Commission launched an antitrust investigation into this market on the basis that E.ON may have abused its dominant position for the most part by price manipulation through strategic capacity withholding.<sup>313</sup> In that respect the preliminary assessment refers to the general findings of the energy sector inquiry.<sup>314</sup> According to them, the German electricity wholesale prices include noticeable mark-ups over and above the competitive benchmark.<sup>315</sup> Strategic withholding of capacity may be one of the reasons for high electricity prices.<sup>316</sup> ‘Load factor’ calculations for German plants demonstrated significant discrepancies between the load factors of plants having similar marginal costs below the market price level, indicating that some plants did not operate at their full nameplate capacity at times when they were supposed to.<sup>317</sup> However, there might be several other plausible explanations for a lower capacity factor, i.e. equipment failure, routine maintenance, minimum operational and standstill times, cogeneration, emissions quota used up, transmission constraints limiting the economic dispatch or provision of control and reserve capacity. Further, whether a given generator is actually willing and able to behave strategically and reduce its capacity to manipulate the market price depends on many factors, like the size and structure of the market, technology mix employed, demand level, eventual capacity and transmission constraints, the amount of capacity covered by bilateral contracts and market architecture.<sup>318</sup>

<sup>313</sup> See Annex to chapter 3, infra section 3.6. The case involves also deterrence of investment in generation by third parties.

<sup>314</sup> Final Report, supra n. 78, para. 427 and p. 150, Conclusions.

<sup>315</sup> LE Study, supra n. 304, Executive summary, p. 17.

<sup>316</sup> Final Report, supra n. 78, paras. 428-448. Suppliers can influence electricity prices in two ways, either by reducing output below the competitive, price-taking level (physical withholding) or by raising the price above the marginal cost (economic or financial withholding). S. STOFT, *Power System Economics: Designing Markets for Electricity*, IEEE Press/Wiley Interscience, New York 2002, p. 454 (Glossary); D. KIRSCHEN and G. STRBAC, *Fundamentals of Power System Economics*, Wiley & Sons, Chichester (UK) 2004, p. 40.

<sup>317</sup> The term ‘load factor’ is somewhat misleading, since in the electrical engineering it represents the ratio between the average load and peak load (see e.g. S. STOFT, supra n. 316, p. 13). What is actually calculated here applies to the supply side and is the ratio between the actual generation of a plant over a period of time and its output if it had operated at its full nameplate capacity for the time considered. For details see Final Report, supra n. 78, paras. 439-446 and LE Study, supra n. 304, pp. 389-394.

<sup>318</sup> Based on the unilateral profit maximization logic of a withholding generator by P. JOSKOW and E. KAHN, ‘A Quantitative Analysis of Pricing Behavior in California’s Wholesale Electricity Market During Summer 2000: The Final Word’ (2002) 23 *The Energy Journal* 4, 1-35. See infra section 3.6, n. 379 and accompanying text.

### *3.3.1. Dominance*

Article 102 TFEU deals with abuses of market power by dominant firms. Accordingly, in the first step the Commission focuses on E.ON's alleged dominant position on the German electricity wholesale market. Already at this initial stage the Commission's assessment raises questions.

First, the analytical techniques used by the Commission for the assessment of dominant position are based solely on traditional concentration indices, despite the fact that these are widely considered inadequate for measuring market power in generation markets. Market shares can only give a first proxy (negative test) of potential market power in electricity wholesale markets and must be accompanied by further electricity specific indices.<sup>319</sup> According to structural market concentration indices, E.ON in fact owned at that time a moderate (in the context of the energy sector) share in the German electricity wholesale market, holding 20-30% of generated capacity between 2002 and 2006.<sup>320</sup>

Second, and because the calculation of E.ON's market share did not point to a dominant position<sup>321</sup>, the Commission used a concept of collective dominance to be able at all to invoke Article 102 as the legal basis of the charge. Instead of using electricity specific indices to measure E.ON's market power, which would have prolonged the investigation, the Commission preferred instead to state that 'the German wholesale electricity market is collectively dominated by the three operators E.ON, RWE and Vattenfall Europe within the meaning of Article 82 [ Article 102

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<sup>319</sup> D. HARBORD and N. FABRA, *supra* n. 281, p. 66. D. PEREKHODSTEV, L.B. LAVE and S. BLUMSACK, *supra* n. 281, p. 14. F. WOLAK, *supra* n. 281, p. 15. D. BIGGAR, *supra* n. 281, pp. 109-112. B. WILLEMS and E. DE CORTE, 'Market power mitigation by regulating contract portfolio risk' (2008) *Energy Policy* 36, 3787-3796, p. 3788. G. FEDERICO, X. VIVES (with collaboration of N. FABRA), *supra* n. 281, p. 12.

<sup>320</sup> See Commission Decision of 26.11.2008 in case *German electricity wholesale market* (Case COMP/39.388), Table 1 at p. 5. The accurate market share could not be disclosed due to confidentiality requirements.

<sup>321</sup> The crucial range for establishing dominance is 40-50%: A. JONES and B. SUFRIN, *supra* n. 61, p. 399. Taking into consideration E.ON's strong competitors (RWE: 20-30%; Vattenfall: 10-20%) it would be extremely difficult for the Commission to find E.ON individually dominant in this market.

TFEU ] of the Treaty.<sup>322</sup> The concept of joint (or collective) dominance has been developed by the European Courts to allow Article 102 application to abusive practices in an oligopolistic setting. According to the settled case law, economically independent firms may be found collectively dominant if they are ‘sufficiently linked between themselves to adopt the same line of action on the market’.<sup>323</sup> Thus the Commission referred to the characteristics of the German wholesale electricity market (which involved high concentration, high entry barriers, a homogeneous product and transparency) and the existence of structural links between the generators (network of supply agreements) to justify the finding of collective dominance. When combined, the market share of the three firms stood at 67% (and at 77% in the German market for base-load generation only, namely, hydro, nuclear and lignite).<sup>324</sup>

It is true that the characteristics of the electricity wholesale markets and the repetitive interaction of the generators makes these markets prone to collusive outcomes.<sup>325</sup> The Commission was clearly right to take account of this possibility. However, particularly for that reason, it should have used other techniques to measure market power than simple market share calculation. Evidence of market power on the basis of electricity specific indices (PSI, RSI)<sup>326</sup> which would indicate actual price-setters, would be particularly adequate to support any theory of collusion. It could even lead to finding each of the major generators individually dominant.<sup>327</sup>

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<sup>322</sup> Commission Decision, *supra* n. 320, p. 4.

<sup>323</sup> Case C-393/92, *Almelo* [1994] ECR I-1477, para. 42 (concerning the electricity market). Joined cases T-191/98, T-212/98 to T-214/98, *Atlantic Container Line AB and Others v. Commission* [2003] ECR II-3275, para. 595. For the overview of collective dominance cases see A. JONES and B. SUFRIN, *supra* n. 61, pp. 827-841.

<sup>324</sup> Commission Decision, *supra* n. 320, Table 1 and para. 15, p. 5.

<sup>325</sup> D. NEWBERY, ‘Electricity Liberalisation in Britain: the Quest for a Satisfactory Wholesale Market Design’ (2005) *The Energy Journal* 26, Special Issue, 43-70, p. 57. B. WILLEMS and E. DE CORTE, *supra* n. 319, p. 3787 (at note 3). G. FEDERICO, X. VIVES (with collaboration of N. FABRA), *supra* n. 281, p. 10.

<sup>326</sup> *Supra* n. 234.

<sup>327</sup> The German Competition Authority (Bundeskartellamt) came to such a conclusion in 2011 when presenting results from its own energy inquiry into the German electricity generation and wholesale markets, launched as a follow-up to the *E.ON* case. It found that at least three (and in 2007 even four) major German electricity generators were held dominant individually (and not collectively). The Bundeskartellamt carried out the so-called pivotality analysis, based on RSI. The calculation showed that the electricity from the three major generators (E.ON, RWE and Vattenfall) was necessary to meet demand in a significant number of hours during the period analysed (2007-2008) and from four generators (also EnBW) in year 2007 only. See Bundeskartellamt, *Sectoruntersuchung Stromerzeugung Stromgrosshandel Bericht gemäß § 32e Abs. 3 GWB* (Sector Inquiry into Electricity Generation and Wholesale Markets, Report in accordance with Section 32e (3)

Last but not least, the Commission's argumentation lacked coherence. After having quoted all the findings of the preliminary assessment with regard to the joint dominant position of all three generators, the Commission raised doubt as to whether Vattenfall could belong to the collectively dominant group, due to structural and cost differences reported in the market test, and the decisional practice of the German courts. This question was left open, since '*under both alternatives E.ON would be considered part of the collective dominant position*'.<sup>328</sup> Yet throughout the decision only one alternative was considered, that is the joint dominance of the three generators. The Commission disregarded the fact that exclusion of one big player from the group changes the dynamics of the oligopolistic interaction. If the asymmetries between Vattenfall and the two remaining operators were indeed so apparent that it could not be part of the collectively dominant group, E.ON and RWE might not have pursued any common policy at all, either because it was less attractive in the first place or the collusion was unsustainable.

Establishing collective dominance is often a very demanding exercise involving the application of models of oligopoly interaction. Considering that the commitment procedure does not require any infringement to be found, finding of dominance is also not necessary. For that reason, a simple market share calculation supported by the Commission's arguments on the existence of collective dominance was sufficient to adopt a commitment decision in the E.ON case.

### 3.3.2. Abuse

Further inconsistencies emerge in the Commission's assessment of the abuse. The logic behind a profitable capacity withdrawal suggests that it is a unilateral exercise of

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of the German Act against Restraints of Competition – ARC, in German), 01.2011, pp. 96-114. Executive Summary available in English at

[www.bundeskartellamt.de/wEnglish/download/pdf/2011-05-05\\_SU\\_Strom\\_Executive\\_Summary\\_EN\\_final-2.pdf](http://www.bundeskartellamt.de/wEnglish/download/pdf/2011-05-05_SU_Strom_Executive_Summary_EN_final-2.pdf) accessed 20.05.2013. See also a recent survey made by U. SCHOLZ and S. PURPS, *supra* n. 225, p. 82.

<sup>328</sup> Commission Decision, *supra* n. 320, paras. 23-24.

market power, and that it not require collusion among generators.<sup>329</sup> This does not mean, however, that several generators could not collude and reduce their capacities in concert in order to make one of them pivotal. As a result of strategic output reduction of its competitors, a pivotal generator may explore capacity constraints and bid above its marginal costs with no risk of being excluded from the dispatch. The higher market-clearing price would benefit all colluding generators.<sup>330</sup>

Even though the Commission found E.ON, RWE (and potentially Vattenfall) jointly dominant in the German electricity wholesale market, it still argued that only E.ON pursued the strategy of capacity withdrawal. According to the settled case law, the concept of joint dominance does not require the undertakings to exercise market power collectively. It may well be a unilateral abuse as long as it is committed to protect the joint dominant position.<sup>331</sup> However, according to the Commission's finding in the preliminary assessment, E.ON, RWE (and potentially Vattenfall) could have pursued a common policy to raise prices given the structural links on production and the high degree of transparency allowing the operators to detect and counter possible deviations.<sup>332</sup> To quote the Commission, 'in terms of production, if an undertaking carrying out a withdrawal of capacity identifies that another one is increasing its production, given transparency the first undertaking could immediately react by doing the same. In terms of prices, the undertakings can immediately react to price offers on OTC markets and wage a price war'. This suggests that withdrawal appertained to the common policy adopted by the two (or potentially three) operators and should not be assessed as a unilateral exercise of market power. However, for the purposes of the commitment decision, the Commission did not have to go beyond the concerns expressed in the preliminary assessment. They in turn echoed the results of the sector inquiry and depicted E.ON's capacity withdrawal as a unilateral profit

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<sup>329</sup> See Annex to chapter 3, *infra* section 3.6. P. JOSKOW and E. KAHN, *supra* n. 318, consider a case where only one generator withdraws capacity whereas all the other generators submit bids equal their marginal costs. The authors show that the rational capacity withdrawal is a unilateral exercise of market power and does not require collusion among generators.

<sup>330</sup> G.S. CRAWFORD, J. CRESPO and H. TAUCHEN, 'Bidding Asymmetries in Multi-Unit Auctions: Implications of Bid Function Equilibria in the British Spot Market for Electricity' (2007) 25 *International Journal of Industrial Organization* 6, 1233-1268, p. 1258, at note 48.

<sup>331</sup> Case T-228/97, *Irish Sugar plc v. Commission* [1999] ECR II-2969, para. 66.

<sup>332</sup> Commission Decision, *supra* n. 320, para. 20.

maximising strategy of a dominant generator.<sup>333</sup> Hence, the only valid argument for the adoption of a common policy to raise prices by two (or potentially three) generators remains the advantage they take from the price increase. However, the price increase brings a windfall profit for all the generators in the market and as such cannot constitute a stand-alone ground for developing a theory of coordination with respect to the two (or potentially three) of them.

Lastly, the very design of the European Energy Exchange (EEX)<sup>334</sup> is such that the market players – even if they wanted to manipulate the market price – would not do it by limiting their output, but rather by excessive bids. The generators do not submit plant-specific bids. Plants are chosen only after the market clears. An energy regulator or competition authority cannot really observe whether the bids reflect the production costs of the chosen plant. Hence, a market-savvy generator would simply submit a higher bid to raise the market clearing price rather than trying to manipulate outages.<sup>335</sup> The general conclusions of the energy sector are thus far from conclusive and need to be further investigated on a case-by-case basis.<sup>336</sup> This however is not required in a commitment procedure.

The E.ON case does not deal only with price/capacity manipulation. According to the Commission's findings, E.ON abused its (collective) dominant position on the German electricity wholesale market through '*withholding* of capacity and deterrence of investment in generation by third parties'.<sup>337</sup> The latter element of the charge points at an exclusionary strategy that only complements the exploitative behaviour and as such seems to be of secondary relevance. The Commission does not elaborate on this

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<sup>333</sup> *Ibid.*, paras. 27-40.

<sup>334</sup> Germany's energy exchange with seat in Leipzig.

<sup>335</sup> Thanks are due to Bert Willems for his insightful comments.

<sup>336</sup> Interestingly, in the German energy sector inquiry of 2011, *supra* n. 327, the Bundeskartellamt examined the actual power plant operation management of all the major electricity producers in 2007 and 2008 and found no evidence of abusive capacity withholding. According to the Bundeskartellamt, p. 19 (Executive Summary), 'abusive practices of this kind are extremely difficult to prove. To do so would require extensive data on the operations of each of the 340 electricity generating units over lengthy periods as well as the opportunity to more effectively check these company data and information on marginal costs, which are subject to frequent variation and include a large number of individual cost items. Also, the fact that the undertakings do not offer power plant capacity individually from each particular generating unit, but on the basis of complex stochastic optimisation from a pool of generating units also poses particular challenges.'

<sup>337</sup> *Ibid.*, para. 1.

abuse in its decision. It takes solely four short paragraphs to explain that the short-term capacity withdrawal might be complemented by ‘a medium and long-term strategy of deterring actual or potential competitors from entering the generation market and thereby limiting the market volume in electricity generation’.<sup>338</sup> The exclusion consists of long-term electricity supply contracts and offering new competitors a participation in an E.ON power plant. According to the findings of the Commission, the deterrence of investments enabled E.ON to maintain the excessive price achieved by output reduction.

Again, the Commission’s concerns with respect to E.ON’s exclusionary abuse build upon the findings of the sector inquiry. According to that, long-term power purchase agreements (PPAs) might reduce liquidity of the wholesale electricity markets, depending on the nature of such contracts.<sup>339</sup> The Commission studies this effect in nine Member States, yet for some reason this analysis has not been done for Germany.<sup>340</sup> This raises doubts as to the validity of the charge and suggests a deliberate attempt of the Commission to extend the scope of concerns to include the allegations of exclusionary nature. First of all, by multiplying its concerns in the preliminary assessment, the Commission may hope for far-reaching commitments.<sup>341</sup> Secondly, an exclusionary abuse shifts the legal basis to section (b) of Article 102 and in this way the Commission avoids criticism of pursuing purely exploitative ‘section (a)’ abuses.

One more remark must be made with respect to the link between the exploitative and exclusionary abuses which the Commission listed in the E.ON case. According to the Commission, E.ON’s long-term supply contracts complemented the output limiting strategy, as they effectively reduced the liquidity of the German electricity wholesale

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<sup>338</sup> *Ibid.*, paras. 41-44.

<sup>339</sup> The question is whether they are purely domestic, or import / export contracts. Domestic contracts and export contracts indeed reduce volumes of electricity traded on the wholesale market. Long-term import contracts, on the contrary, increase the liquidity of the domestic market. See also D. BIGGAR, *supra* n. 281, p. 115.

<sup>340</sup> Final Report, *supra* n. 78, paras. 467-473 and Figure 57 at p. 158.

<sup>341</sup> For example, as later explained (*infra* section 3.4.1), the Commission’s concerns with regard to foreclosure effects of E.ON’s long-term PPAs might justify the choice of structural remedies instead of simply accepting less onerous behavioural forward contract commitments.

market and enabled E.ON to maintain the higher price resulting from capacity withdrawal. It is true that the long-term electricity supply agreements dry out spot markets. However, at the same time, by limiting the volume that contributes to the price formation process, they actually mitigate the potential pricing abuse on these markets.<sup>342</sup> If a big share of E.ON's capacity is tied up by contracts (excluded from the electricity pool) its incentive and ability to reduce output in order to manipulate the price decreases, since less volume is traded in the pool and the higher price accounts only for the uncontracted capacities. Once the gain from the price increase does not offset E.ON's output reduction, the strategic capacity withdrawal ceases to be profitable. The Commission did not mention in the decision the volume of E.ON's generation sold under fixed-price supply contracts. Paradoxically, supporting the case with alleged foreclosure effects of long-term supply contracts, the Commission undermined the theory of a profitable capacity withdrawal. Since the decision was adopted under Article 9, further explanation of the Commission's concerns in that regard was not required.

### 3.4. FAR-REACHING REMEDIES

The negotiated character of the commitment procedure entails an inherent risk of accepting commitments disproportionate or even unrelated to the (alleged) abuse they are supposed to eliminate in the first place. The remedies imposed by the Commission in an Article 7 infringement decision<sup>343</sup>, either behavioural or structural, must be ‘proportionate to the infringement committed and necessary to bring the infringement effectively to an end.’ Article 9 of Regulation 1/2003, unlike Article 7, does not refer

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<sup>342</sup> P. JOSKOW and E. KAHN, *supra* n. 318, p. 24. S. BORENSTEIN, J. BUSHNELL and F. WOLAK, ‘Measuring market inefficiencies in California’s restructured wholesale electricity market’ (2002) 92 *American Economic Review* 5, 1376-1405. D. NEWBERY, *supra* n. 325, p. 48. D. BIGGAR, *supra* n. 281, pp. 144-145. E. ARMINGTON, E. EMCH and K. HEYER, ‘The Year in Review: Economics at the Antitrust Division, 2005-2006’ (2006) 29 *Review of Industrial Organization* 4, 305-326, p. 320. F. WOLAK and S. MCRAE, ‘Merger Analysis in the Restructured Electricity Supply Industries: The Proposed PSEG and Exelon Merger’ in J. KWOKA and L. WHITE (eds.) *The Antitrust Revolution: Economics, Competition and Policy*, OUP, Oxford 2008, available online at <http://www.ucei.berkeley.edu/POWER-08/Files/3a.pdf> accessed 20.05.2013, pp. 16-18 (online version). See also M.A. DE FRUTOS and N. FABRA, ‘How to Allocate Forward Contracts. The case of electricity markets’ (2009) Universidad Carlos III de Madrid Working Paper, for an analysis of pro-competitive allocation of forward contracts.

<sup>343</sup> Article 7 of Regulation 1/2003, *supra* n. 14.

expressly to proportionality. As a fundamental principle of EU law, however, the principle of proportionality applies to all measures adopted by the European institutions, including Article 9 commitments.<sup>344</sup> Hence, as in the case with all EU measures, Article 9 commitments ‘must not exceed what is appropriate and necessary for attaining the objective pursued.’<sup>345</sup> Evidently, the legal framework of the EC Regulation 1/2003 grants the Commission much more leeway as to the shape of accepted commitments than it enjoys when designing remedies in its infringement decisions. The proportionality test formulated in Article 7 demonstrates a clear direct link between the infringement (e.g. an abuse of dominant position through strategic capacity withholding) and the remedy imposed. The Commission can impose only such remedies which contribute to bringing the infringement to an end (abuse-remedy match). In contrast, an Article 9 application allows for an abuse-remedy mismatch. The principle of proportionality does not require the commitments to match the abuse but rather to be consistent with the *objective* pursued by the measure in question (resulting in an objective-remedy match). The wording of Article 9 provides further information as to the objective of commitments; they are offered by the undertakings ‘to meet the concerns expressed to them by the Commission in its preliminary assessment.’ It is true that the concerns of the Commission expressed in the preliminary assessment do refer to the alleged abuse. However, these concerns can well be of a more general nature, for example referring to the lack of competition in the market or to several possible abuses. After all, the Commission’s assessment is, by its very nature, preliminary. Furthermore, it might well be the case that the Commission adopts its preliminary assessment after having discussed the commitment package with the undertaking concerned.<sup>346</sup> This would allow the Commission to extract

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<sup>344</sup> Recital 12 of Regulation 1/2003, *supra* n. 14.

<sup>345</sup> Case 265/87, *Schräder* [1989] ECR 2237, para. 21; Case T-260/94, *Air Inter v. Commission* [1997] ECR II-997, para. 144; case T-65/98, *Van den Bergh Foods v. Commission* [2003] ECR II-4653, para. 201 [emphasis added].

<sup>346</sup> This happened in, for instance, the *Coca-Cola* case (Case COMP/39.116) where preliminary assessment was adopted after the Commission already ‘informally’ accepted a draft version of commitments. As soon as the preliminary assessment was released, Coca-Cola formally submitted the commitment package after merely four days. See *supra* n. 187 and accompanying text. Similarly, this period was suspiciously short in the *GDF* case (Case COMP/39.316) – two days, and in the *E.ON gas foreclosure* case (Case COMP/39.317) – two weeks (including Christmas break), which allows assuming that a draft version of commitments was negotiated with the Commission well in advance. In other cases, where the Commission released Preliminary Assessment (and not Statement of Objections), it took the undertakings one month on average to submit their commitments

excessive commitments in the bilateral negotiations and then formulate its anticompetitive concerns *ex post*, so that they correspond to the already negotiated draft version of commitments.

The conclusion is that the legal framework grants the Commission more latitude when accepting commitments under Article 9 than when imposing remedies under Article 7. The link between the abuse and remedy in Article 7 decisions is straightforward and leaves no discretion for the Commission in the assessment of proportionality of the remedies imposed. On the other hand, the principle of proportionality applied to commitments under Article 9 makes an indirect link between the (alleged) abuse and the commitments and allows the Commission, by extending the scope of concerns, to pursue wider liberalisation goals through antitrust actions in individual cases (see Figure 3).

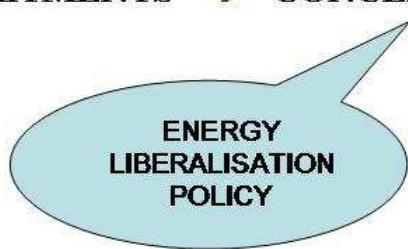
Figure 3. The concept of proportionality under Article 7 and Article 9 of EC Regulation 1/2003 – comparison.

***INFRINGEMENT PROCEDURE UNDER ARTICLE 7:***

**REMEDY → ABUSE**  
[infringement]

***COMMITMENT PROCEDURE UNDER ARTICLE 9:***

**COMMITMENTS → CONCERNS → ABUSE**  
[alleged]



Source: own illustration.

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(*German electricity wholesale market* (Case COMP/39.388), *German electricity balancing market* (Case COMP/39.389) *Swedish Interconnectors* (Case COMP/39.351), *RWE gas foreclosure* (Case COMP/39.402), *IBM* (Case COMP/39.692), *Cannes Agreement* (Case COMP/36.681)).

A more elastic concept of proportionality under Article 9 makes procedural sense. First of all, commitment cases, free of unnecessary red tape, are supposed to offer an attractive alternative to lengthy procedures under Article 7. In this respect requiring the Commission to carry out an extensive investigation into the proportionality of the offered commitments would run contrary to the very spirit and purpose of Article 9. Secondly, a commitment package is an outcome of negotiations, not a unilateral measure imposed by the Commission. Engaging into negotiations with the Commission and offering the commitments (voluntarily), the firm implicitly agrees on their final shape. Its active role in Article 9 proceedings means there is a questionable role for the principle of proportionality. In any event, a strict proportionality test under Article 9 would substantially complicate the negotiations, as the firms may often have their own (not always case-related) strategic interest in offering certain commitments in antitrust deals. In these cases, imposing a strict proportionality requirement on commitments would make Article 9 considerably less attractive for the firms.

In spite of what the wording of the EC Regulation suggests, until very recently it was not clear whether there should be a difference in the application of the proportionality test to the remedies imposed in Article 7 cases and the application of the principle of proportionality to the commitments accepted under Article 9. Until recently, the Commission lacked supporting case law to provide precedent in commitment cases. However, in June 2010 the European Court of Justice (the ECJ) took a clear and conclusive stance on that matter, setting aside the General Court's (the EGC) judgment in the *Alrosa* case.<sup>347</sup> The ECJ recognised that the commitments provide a more rapid solution resolving competition problems than the remedies imposed under Article 7 and hence their assessment in the light of the proportionality rule differs

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<sup>347</sup> The question of proportionality of commitments emerges into the limelight in the context of the *Alrosa* saga. In 2007 the EGC quashed the Commission's decision in the *Alrosa/De Beers* case, one of the two commitment decisions eventually on appeal, on the grounds that the accepted commitments were disproportionate to the alleged infringement. The EGC made clear that the proportionality test applied to the commitments does not differ from the assessment of remedies imposed in an infringement decision. The case was long time pending before the ECJ. The Advocate General's Opinion issued in September 2009 proposed to set aside the EGC judgment. AG Kokott argued that the Commission should be granted 'the same margin of assessment in the context of Article 9 of Regulation 1/2003 which it enjoys, according to case-law, in connection with the assessment of commitments in merger control' (Opinion of AG Kokott, *supra* n. 238, para. 72). Finally, in June 2010, the ECJ followed the AG's Opinion and overruled the EGC judgment. See *supra* n. 237 for case references.

from the proportionality test applied in the infringement procedure. According to the Court, ‘[Article 9] does not require the Commission to make a finding of an infringement, its task being confined to examining, and possibly accepting, the commitments [...] in the light of the problems identified by it in its preliminary assessment and having regard to the aims pursued. Application of the principle of proportionality by the Commission in the context of Article 9 [...] is confined to verifying that the commitments in question address the concerns it expressed to the undertakings concerned and that they have not offered less onerous commitments that also address those concerns adequately.<sup>348</sup> By acknowledging this, the ECJ clearly gave the Commission a judicial ‘green light’ to implement the energy liberalisation policy through commitment cases.

The E.ON investigation provides an interesting case study to find out whether the Commission takes advantage of a greater margin of assessment left to it under Article 9 and negotiates commitments that are not designed to fit the abusive behaviour but are supposed to achieve wider policy objectives. In the light of the German government’s opposition towards the 3<sup>rd</sup> energy liberalisation package, especially in the context of ownership unbundling, one might speculate that the Commission will try to negotiate structural commitments from a German energy incumbent, having a clear energy liberalisation objective in mind. And indeed, to address the Commission’s concerns E.ON offered to sell off about one-fifth of its generation capacity.<sup>349</sup> The attempt of this section is to examine, in a two-step proportionality test, whether the divestiture imposed in the E.ON case matched the alleged abuse (strategic capacity withdrawal) or not. A negative outcome of this test (abuse-remedy mismatch) would mean that the commitment procedure allows the Commission to accept remedies which it could not otherwise impose in an Article 7 infringement decision.

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<sup>348</sup> C-441/07 P, *Commission v. Alrosa* [2010] ECR I-5949, paras. 40-41. Emphasis added.

<sup>349</sup> European Commission, *Report on Competition Policy*, 2008, p. 50. Press Release IP/08/1774 of 26.11.2008.

### *3.4.1. Step 1: alternative behavioural commitments?*

According to the principle of proportionality, the Commission should not require divestment in circumstances in which a less onerous but equally effective behavioural remedy is available.<sup>350</sup> Obviously, controlling E.ON's bids and constant monitoring of its power plants to prevent eventual capacity withdrawal would be indeed burdensome both for the Commission and for the operator.<sup>351</sup> Even though monitoring remedies are easily reversible, once sloppily implemented, they would remain ineffective. By contrast, forward contract commitments might effectively reduce E.ON's incentives and the ability to use its capacities strategically. E.ON could offer to sell a sufficient amount of its generation under fixed-price contracts so that further capacity reduction in the pool would cease to be a profitable strategy to manipulate the market-clearing price.<sup>352</sup> Such a remedy however would run contrary to the Commission's concerns of exclusionary nature, as it would further decrease the volume of electricity traded in the pool. For the same reason capacity divestment commitments, i.e. virtual power plants (VPPs), could not be considered an effective remedy in the E.ON's case where one of the alleged abuses lies in strategic deterrence of investment in generation, in particular by offering new entrants to participate in E.ON's power plants. It is not clear whether a 'virtual' divestment is equally effective in terms of mitigating market power in the pool to a 'physical' one. However, it is clear that it will deter rather than foster investments in generation (at least in the short run).<sup>353</sup> Therefore, it might not address the alleged exclusionary abuse. For this reason only it would not constitute an equally effective behavioural remedy to the divestiture of assets.<sup>354</sup> It appears that by

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<sup>350</sup> Supra n. 345.

<sup>351</sup> The legal test in Article 7 suggests that the Commission cannot impose a structural remedy just because an equally effective behavioural remedy is more burdensome (in monetary terms but not only) for the Commission to implement. Recourse to structural remedies is only justified if an equally effective behavioural remedy is more burdensome for the undertaking at issue. In the same line A. TAJANA, 'Structural Remedies and Abuse of Dominant Position' (2005) Tilburg University, TILEC Discussion Paper DP 2005-033, p. 12.

<sup>352</sup> Supra n. 342 and accompanying text.

<sup>353</sup> They may, however, stimulate investments in generation indirectly (in the long term, as a part of the Commission's two-stage strategy). See L. HANCHER and A. DE HAUTECLOCQUE, supra n. 300, p. 327.

<sup>354</sup> There are few economic studies attempting to measure the effectiveness of VPPs. F. BOISSELEAU and P. GIESBERTZ, 'Assessing Regulatory Measures in Electricity Markets: The Case of VPP in the Netherlands' (2006) 29th IAEE International Conference, 7.06-10.06 Potsdam, study the impact of VPPs on competition and liquidity in the Dutch electricity market. G. FEDERICO and A.L. LÓPEZ, 'Divesting Power' (2009) Public-Private Sector Research Centre, IESE Business School – University of Navarra, Working Paper 812, study

extending the scope of its concerns to exclusionary abuses, the Commission precludes any potentially equally effective behavioural remedies, and justifies recourse to a structural solution. Accordingly, it states in its decision that there exists no equally effective behavioural remedy to an asset divestment to address its concerns for the German electricity wholesale market. Further, it argues that ‘a substantial risk of a lasting or repeated infringement by the alleged withholding of capacity [...] derives from the very structure of the undertaking’ and that ‘withholding was possible due to the nature of E.ON’s electricity generation portfolio’.<sup>355</sup> Clearly, these lines reflect the Commission’s plans to restructure the energy industry according to its liberalisation agenda.

Assuming that a structural solution is justified in the light of the Commission’s preliminary assessment, that is, no equally effective behavioural remedy is available in the present case, it is still to be asked whether there is a less onerous but equally effective structural measure that would address the Commission’s anticompetitive concerns.

### *3.4.2. Step 2: appropriate and necessary structural commitments?*

The following paragraphs take a closer look at E.ON’s generation portfolio and the selection of divested power plants in terms of fuel and technology.

Table 3 below presents E.ON’s total generation capacity in the German wholesale electricity market short before the divestiture. The calculated percentage shows which technologies play a major part in E.ON’s generation portfolio.

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alternative market power mitigating measures and argue that an optimal divestiture of assets can be significantly more pro-competitive than the sale of capacities. According to their results, Virtual Power Plants (VPPs) can be at best as effective in bringing the prices down as divestiture of baseload generation of the same size, whereas divesting high-cost generation would mitigate market power more effectively.

<sup>355</sup> Commission Decision, *supra* n. 320, paras. 81-82.

Table 3. E.ON's generation capacity by sources – Germany, 2007.

ENERGY SOURCE	C <sup>S</sup> (MW)	C <sup>S</sup> /TC (%)
hydro (incl. pump storage)*	3153	12%
nuclear	8548	33%
lignite coal	1314	5%
hard coal	7466	28%
gas	4219	16%
oil	1145	4%
others (wind, biomass et al.)	406	2%
<b>TOTAL CAPACITY</b>	<b>26251</b>	<b>100%</b>

C<sup>S</sup> – capacity by source

TC – total capacity

\* Pumped storage hydroelectric power plants provide peak load power.

Source: Own calculation on the basis of data from E.ON, *Strategy and Key Figures*, 2008, pp. 39-42.

The first three technologies (hydro<sup>356</sup>, nuclear, lignite) represent E.ON's base-load generation. Together they account for half of E.ON's total capacity. Hard coal, the next cheapest fuel source along E.ON's merit-order curve, amounts to 28% of its generation. The smallest, but still not negligible share of E.ON's production covers peak demand (especially gas and oil – 20%). Thus, E.ON's generation portfolio reflects a cross-section of technologies covering all demand levels with a substantial share of low-cost generation, nuclear in particular. According to the Commission's preliminary assessment, E.ON had both the ‘incentive’ to withdraw capacity (because it had a substantial number of low-cost power plants) and the ‘availability’ to implement this strategy (because it had a number of higher-cost plants in the middle of the merit-order curve).<sup>357</sup> Due to the lack of information on E.ON's contract coverage, this analysis assumes that E.ON's total capacity is traded in the electricity pool in which case E.ON's incentive (and ability) for unilateral capacity withdrawal is the biggest (see section 3.3.2).

It ought to be examined whether the structural remedy imposed in the E.ON's case was designed to address the alleged abuses. To this end, Table 4 lists the divested

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<sup>356</sup> E.ON's hydroelectric business consists of conventional power plants (mostly run-of-river) providing constant supply of electricity and pumped-storage peak-load power plants. Due to the lack of data, this calculation does not differentiate between hydro base-load and hydro peak-load generation.

<sup>357</sup> Commission Decision, *supra* n. 320, paras. 40 and 82.

assets by fuel sources. The calculated percentage demonstrates what share of each technology has been divested.

Table 4. E.ON's divested capacity by sources – November 2008.

DIVESTED ENERGY SOURCE	CD <sup>S</sup> (MW)	CD <sup>S</sup> /C <sup>S</sup> (%)
hydro (run-of-river)	359,3	11%
nuclear	1500	17%
lignite coal	604,5	46%
hard coal	1744,6	23%
gas	491	11%
oil	0	
hydro (pump-storage)	347	11%
others (wind, biomass et al.)	0	
<b>TOTAL CAPACITY DIVESTED</b>	<b>5046</b>	<b>19%</b>

CD<sup>S</sup> - capacity divested by source

C<sup>S</sup> - capacity by source (see Table 3)

Source: Own calculation on the basis of the Commission Decision, supra n. 320, Annex ‘Commitments to the European Commission’ (Schedule 1 and 3) and E.ON, *Strategy and Key Figures*, 2008, pp. 39-42.

E.ON offered to divest a big share of its base-load generation. These divestitures include hydroelectric run-of-river power plants (approx. one-tenth of its total hydro generation<sup>358</sup>), nuclear (also nearly one-fifth) and lignite (almost half of its brown coal generation).<sup>359</sup> Moreover, E.ON offered additional divestitures further up the merit order: disposal of 20% of its coal-based generation, one gas-fired power plant (approx. one-tenth of E.ON’s gas-fuelled business) and two pump-storage hydro power plants. The offered commitments prompt two general observations. First, the divestiture reduced E.ON’s capacity in absolute terms (by 20%). Second, it did not change its portfolio structure. Following the divestiture, the shares of the technology sources in E.ON’s total generation remained virtually unchanged. To demonstrate this,

Table 5 reflects E.ON’s generation structure post-divestiture and juxtaposes it with its pre-divestiture production.

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<sup>358</sup> Incl. pump-storage, supra n. 356. In reality, divestiture of run-of-river plants accounted for a higher share of E.ON’s hydro base-load generation.

<sup>359</sup> However it must be borne in mind that the biggest share in E.ON’s base-load generation goes to nuclear technology, whereas lignite-fired power plants account only for 5% of E.ON’s total generation capacity.

Table 5. E.ON's generation portfolio post- versus pre-divestiture.

ENERGY SOURCE	POST-DIVESTITURE		PRE-DIVESTITURE
	C <sup>S</sup> (MW)	C <sup>S</sup> /TC (%)	C <sup>S</sup> /TC (%)
hydro (incl. pump storage)*	2446,7	12%	12%
nuclear	7048	33%	33%
lignite coal	709,5	3%	5%
hard coal	5721,4	27%	28%
gas	3728	18%	16%
oil	1145	5%	4%
others (wind, biomass et al.)	406	2%	2%
<b>TOTAL CAPACITY</b>	<b>21204,6</b>	<b>100%</b>	<b>100%</b>

C<sup>S</sup> – capacity by source

TC – total capacity

\* Pumped storage hydroelectric power plants provide peak load power.

Source: Own calculation on the basis of the Commission Decision, supra n. 320, Annex ‘Commitments to the European Commission’ (Schedule 1 and 3) and E.ON, *Strategy and Key Figures*, 2008, pp. 39-42.

### 3.4.3. Commitments and exploitative concerns

It has been discussed above that the profitability of capacity withholding to drive up prices depends on many factors.<sup>360</sup> It appears from the reasoning in the E.ON decision that the Commission attached the greatest importance to the size and the structure of the generation portfolio, claiming that it created both the incentive and the possibility for E.ON to pursue the abusive strategy.<sup>361</sup> The accepted divestiture indeed scaled the generator’s production portfolio down in terms of figures, but did not change its structure. In fact, each technology owned by E.ON accounts for the same proportion of its total production as it did pre-divestiture.

Economic literature provides some guidelines as to the remedy design addressing the exercise of market power in electricity wholesale markets. To start with, it is widely accepted in the literature that the ownership of marginal generation confers greater market power than the ownership of base-load plants, even though both types of assets contribute to the presence of market power.<sup>362</sup>

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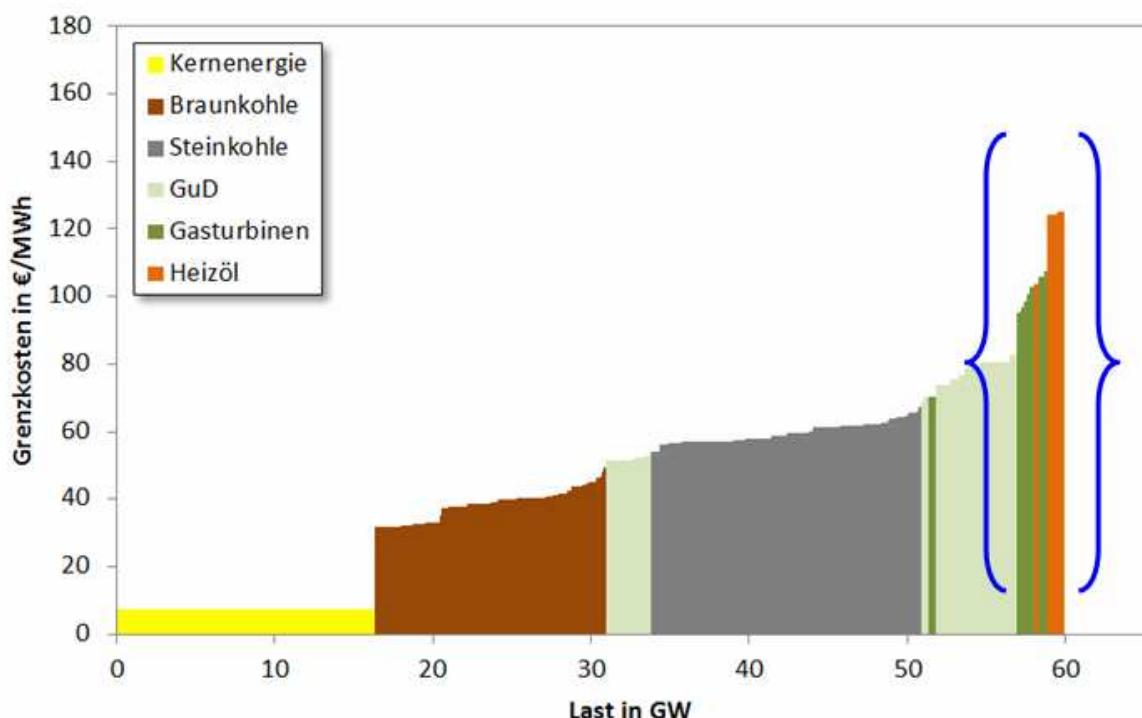
<sup>360</sup> Supra n. 318 and accompanying text. For a more detailed discussion, see infra section 3.6 (Annex).

<sup>361</sup> Commission Decision, supra n. 320, paras. 82 and 84.

<sup>362</sup> D. NEWBERY, supra n. 325, p. 68. D. BIGGAR, supra n. 281, pp. 116-117. M. ARELLANO and P. SERRA, ‘A model of market power in electricity industries subject to peak load pricing’ (2007) 35 *Energy*

It is in fact highly profitable to withhold capacities at periods of high demand (Figure 4, blue braces). The merit order curve gets very steep, so even a small amount of capacities withheld results in a substantial price increase. At the time of low demand, on the contrary, a generator would have to create a serious outage to trigger off any price increase at all.

Figure 4. Merit order curve for Germany, 2008.



Source: S. VON ROON and M. HUCK, *Merit Order des Kraftwerksparks*, Forschungsstelle für Energiewirtschaft e. V., München 2010, p. 3 (Abbildung 3: Merit Order für das Jahr 2008, Kraftwerksausfälle berücksichtigt). Blue braces added.

In line with this argument, some recent economic studies suggest that divestiture of high-cost (marginal) assets is more effective in mitigating market power than the divestment of base-load generation. Crawford, Crespo and Tauchen (2007) used the Bid Function Equilibria (BFE) approach to model the British electricity wholesale market. According to their results, divestiture of higher-cost generation was more

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*Policy* 10, 5130-5135. G. FEDERICO, X. VIVES (with collaboration of N. FABRA), *supra* n. 281, p. 13. G. FEDERICO and A.L. LÓPEZ, *supra* n. 354, p. 4. A. BANAL ESTAÑOL and A. RUPÉREZ MICOLA, ‘Composition of Electricity Generation Portfolios, Pivotal Dynamics, and Market Prices’ (2009) 55 *Management Science* 11, 1813-1831.

effective in bringing the prices down than divestiture of base-load generation.<sup>363</sup> Wolak and McRae (2008) came to the same conclusion when discussing the remedies imposed in a U.S. merger case between Exelon and PSEG (2005/06).<sup>364</sup> The US DoJ<sup>365</sup> ordered divestiture of assets with the lowest opportunity cost of withholding them from the market, that is, with marginal costs close to the market-clearing price. DoJ argued in this case that the remedy would effectively reduce the incentives of the merging firms to manipulate electricity wholesale prices. No divestiture of the parties' numerous nuclear assets was required, since withholding them would be too costly. Wolak and McRae welcomed the remedy package in the Exelon/PSEG case and reasoned that the divestiture of high-cost generation, affecting the shape of the marginal cost function (rendering it flatter), diminished the incentives to exercise market power more effectively than selling off base-load plants.<sup>366</sup> More recently, the paper by Federico and López (2009) produced similar results. The authors found that for sufficiently large divestments, a divestment of higher-cost capacity<sup>367</sup> can be several times more effective in bringing the prices down than a divestment of base-load generation of the same size. More specifically applicable to the E.ON case is a model of capacity withholding equilibrium designed by Lave and Perekhodtsev (2001) and applied to the California electricity market. According to their model, an eventual

<sup>363</sup> G.S. CRAWFORD, J. CRESPO and H. TAUCHEN, *supra* n. 330, pp. 1257-1258: 'This difference in results highlights the importance of the location of divested capacity in marginal cost order for the consequences of divestiture: when intermediate load generation is divested there is less inframarginal capacity and the foregone markup from pricing out units is higher. When base load is divested, there is less inframarginal capacity over which markups can accrue, but the forgone revenues from pricing out intermediate units remains little changed.'

<sup>364</sup> *United States v. Exelon Corporation and Public Services Enterprise Group, Inc.* Wolak assisted the US DoJ in the competitive assessment of this merger. See also E. ARMINGTON, E. EMCH and K. HEYER, *supra* n. 342, pp. 320-322, for a description of remedies.

<sup>365</sup> *Supra* n. 163

<sup>366</sup> F. WOLAK and S. MCRAE, *supra* n. 342, pp. 28-30. The authors use the residual demand analysis framework to study the impact of different technologies on wholesale prices. They demonstrate that the shape of the marginal cost curve of a generator affects its incentives to exercise unilateral market power.

<sup>367</sup> G. FEDERICO and A.L. LÓPEZ, *supra* n. 354, argue that an optimal divestment (resulting in the greatest price reduction) includes plants that become marginal post-divestment, that is, whose range of costs encompasses the post-divestment competitive price (implying that some but not all of the divested capacity produces in post-divestment equilibrium). Extending their model, in 2010 the authors used the data from the Italian electricity wholesale market to design a single divestment package capable of reducing market power across multiply demand levels; see G. FEDERICO and A.L. LÓPEZ, 'Selecting Effective Divestments in Electricity Generation Markets' (2011) 21 *European Transactions on Electrical Power* 6, 1914-1922 (first published online in 2010 as Working Paper 845, Public-Private Sector Research Centre, IESE Business School – University of Navarra).

divestiture of gas-fired price-setting generation might reduce withholding incentives.<sup>368</sup>

The insights from the economic literature on the electricity markets suggest that a targeted divestiture reduces prices more effectively than an across-the-board divestiture. Disposal of high-cost generation flattens the individual merit order curve of a portfolio generator and thus reduces its incentive to use its assets strategically. It does not mean, however, that the remedy imposed on E.ON was not pro-competitive. In the electricity wholesale market, these are the assets with similar marginal costs that exercise competitive constraint at a given demand level. This competitive pressure is gone, once the assets belong to one and the same generator. Thus, it can raise the price with no risk of being undercut by competitors' generation. A pivotal generator does not even have to strategically reduce its output to be able to raise the price. If, however, the assets with similar marginal costs belong to competing generators, the submitted bids are lower reflecting the attempts of the generators to undercut each other. In other words, E.ON's across-the-board divestiture does mitigate market power in the German wholesale electricity market, as it assures that E.ON faces competition at each demand level, reducing its pivotalness.<sup>369</sup> It does not, however, address the alleged strategy of unilateral capacity withdrawal directly, the risk of which the Commission wanted to eliminate in the first place.

The Commission reaffirmed in its decision that 'the commitments shall address specific concerns of an abuse expressed in the preliminary assessment and not the dominant position of the undertaking concerned'.<sup>370</sup> Accordingly, with respect to the proportionality of remedy in the E.ON case, the Commission stated that the divestiture proposed by E.ON 'removes the incentive to withdraw generation capacity profitably' and that 'the selection of power plants in terms of fuel and technology [...] was necessary and proportionate to meet the concerns on the wholesale market for

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<sup>368</sup> L.B. LAVE and D. PEREKHODSTEV, 'Capacity Withholding Equilibrium in Wholesale Electricity Markets' (2001) Carnegie-Mellon Electricity Industry Center, Working Paper CEIC 01-01, p. 19.

<sup>369</sup> E. ARMINGTON, E. EMCH and K. HEYER,, *supra* n. 342, p. 317. F. WOLAK and S. MCRAE, *supra* n. 342, pp. 28-30.

<sup>370</sup> Commission Decision, *supra* n. 320, para. 60.

electricity'.<sup>371</sup> This would suggest that the amount of divested generation was sufficient to prevent further withdrawals of capacity. The Commission seems to have taken it for granted, since no calculation has been done to assess whether the capacity withdrawal was profitable for E.ON in the first place, nor whether it ceased to be profitable post-divestiture. Such exercise was not required in a preliminary assessment under Article 9. Assuming that it was profitable enough for E.ON to pursue the alleged strategy, it remains doubtful whether the divestiture of higher-cost generation effectively eliminated the risk of further withdrawal. The divested generation, aside of low-cost plants, included one-fifth of E.ON's hard coal generation, one peak-load gas power station (one-tenth of E.ON's gas generation) and two pump-storage hydro power plants. The disposal of hard coal- and gas-fired power plants lessens the volume of 'generation to withdraw' but does not remove it, since post-divestiture E.ON is left with the remaining 83% of its high-cost generation (hard coal, gas- and oil-fired generation together). Moreover, E.ON could have some interest in divesting certain uncompetitive or older assets. For example, hard coal power plants, which are heavily subsidised, are supposed to be closed by the end of 2018.<sup>372</sup> In these circumstances it might have been convenient for E.ON to divest one-fifth of its loss-making business in an antitrust deal. With regard to the pump-storage hydro assets, their divestment is clearly pro-competitive. A competitor owning such assets would be able to 'store' electricity and sell it on the market during peak demand periods mitigating E.ON's market power. However, it is questionable whether these plants could play part of a profitable withdrawal strategy, since their production depends highly on changing weather conditions. Taking into consideration their specific function (balancing market, energy reserves), they do not provide capacities that could be withdrawn from the market.

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<sup>371</sup> *Ibid.*, paras. 80 and 84.

<sup>372</sup> European Council, Council Decision of 10.12.2010 on State aid to facilitate the closure of uncompetitive coal mines [2010] OJ L 336/24.

### *3.4.4. Commitments and exclusionary concerns*

The concerns of the Commission related also to E.ON's deterrence of investment in the power generation business. In that respect the Commission argued that 'the divestiture commitment is necessary and proportionate as it also addresses the concerns with regard to deterrence of investment'. Again, the literature on electricity markets would rather suggest that a disposal of high-cost generation would be more appropriate, since the divestment of price-setting capacity to competitors constrains the incumbent to a greater extent than the divestment of base-load generation. The entry of independent marginal generation can be much more pro-competitive than the entry of low-cost plants.<sup>373</sup> However, as observed in the sector inquiry, the competitors actually do have access to peak-load generation. According to the findings, the investments in generation of the past few years focused on high-cost gas and wind technologies.<sup>374</sup> Similarly, the Commission mentions in the decision that 'in practice only more expensive gas-fired capacity was added to the market by the new entrants after 2001'.<sup>375</sup> Base-load generation usually comes along with higher fixed costs and the new entrants find it more attractive to invest in peak generation. The Commission thus reasoned that 'the divested plants will help actual and potential competitors to get access to new plants and plants with technologies that they do not possess. The acquisition of such generation capacity will allow the competitors to have a more balanced portfolio and more capacity to exert competitive pressure on the incumbents in the wholesale electricity market'.<sup>376</sup> Assuring the competitors' balanced portfolios justifies the divestiture of base-load generation characterised by higher economic barriers of entry and investment. Hence, the concerns of exclusionary nature

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<sup>373</sup> According to G. FEDERICO and A.L. LÓPEZ, *supra* n. 354, pp. 10-11, entry of price-setting plants can be significantly more effective in reducing prices than the entry of base-load plants: 'Entry of this type [high cost capacity] shifts the residual demand function of the dominant firm in the same way as a divestiture but does not affect its cost curve. Its impact on prices is therefore the same as obtained with a divestiture, as long as the dominant firm prices on its pre-divestment cost function (i.e. its costs do not increase relative to the pre-divestment equilibrium). [...] Preposition 1 therefore indicates that marginal (or price-setting) entry is more effective than baseload entry in constraining market prices, assuming the cost of the new capacity is determined by the same cost function as the dominant firm.'

<sup>374</sup> Final Report, *supra* n. 78, para. 407.

<sup>375</sup> Commission Decision, *supra* n. 320, para. 39.

<sup>376</sup> *Ibid.*, para. 85.

appear to be an excuse for the across-the-board divestiture, as only in that way the Commission is able to explain the disposal of E.ON’s base-load generation.

To sum up, it is highly questionable whether a divestment of power plants representing a cross-section of E.ON’s generation portfolio is the best-suited remedy for a strategic capacity withdrawal. Nonetheless, the accumulation of anticompetitive concerns in the preliminary assessment, which went beyond the alleged capacity withdrawal abuse, allowed the Commission first to recourse to a structural solution disregarding alternative behavioural remedies and then to justify an across-the-board divestiture, reducing E.ON’s market share in absolute terms. The ultimate shape of the commitment package was thus a result of negotiations between the Commission, pursuing a goal of energy market liberalisation, and E.ON, acting in its own strategic interest.

### 3.5. CONCLUSIONS

The attempt of this chapter is to signal a risky development in the EU antitrust enforcement in the context of energy markets. Coming out with the sector inquiry report the Commission was plain-spoken about its plans to deploy competition rules as a vehicle for liberalising the energy sector.<sup>377</sup> The follow-up antitrust actions have been tailored to give effect to these plans. The new antitrust enforcement framework with commitment procedure and structural remedies enabled the Commission a quick intervention, flexible problem-solving and allowed for decisive changes in the energy market setting.

However these cases are not dealing with antitrust anymore. They constitute a new phenomenon, a peculiar ‘negotiated antitrust’, characterised by weak cases with extensive remedies. The Commission’s reasoning in the E.ON decision is far-fetched and lacks consistency. These flaws in argumentation result from the fact that the outcome of negotiations between the Commission and E.ON has to comply with the

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<sup>377</sup> See e.g. N. KROES, *supra* n. 85.

standard Article 102 framework, according to which the Commission needs to express its concerns as to the alleged dominant position and its abuse and the commitments it accepts must address these concerns. One should bear in mind that the E.ON decision was issued in the end of 2008, which is a year after the General Court quashed the Commission's decision in the *Alrosa* case. At the time of the E.ON investigation, the *Alrosa* case was pending before the ECJ and the outcome was still far from clear.<sup>378</sup> Accordingly, the Commission formulated the E.ON decision with a great caution trying to comply with the principle of proportionality and to defend the accepted divestitures with additional exclusionary concerns, sometimes resorting to strained arguments.

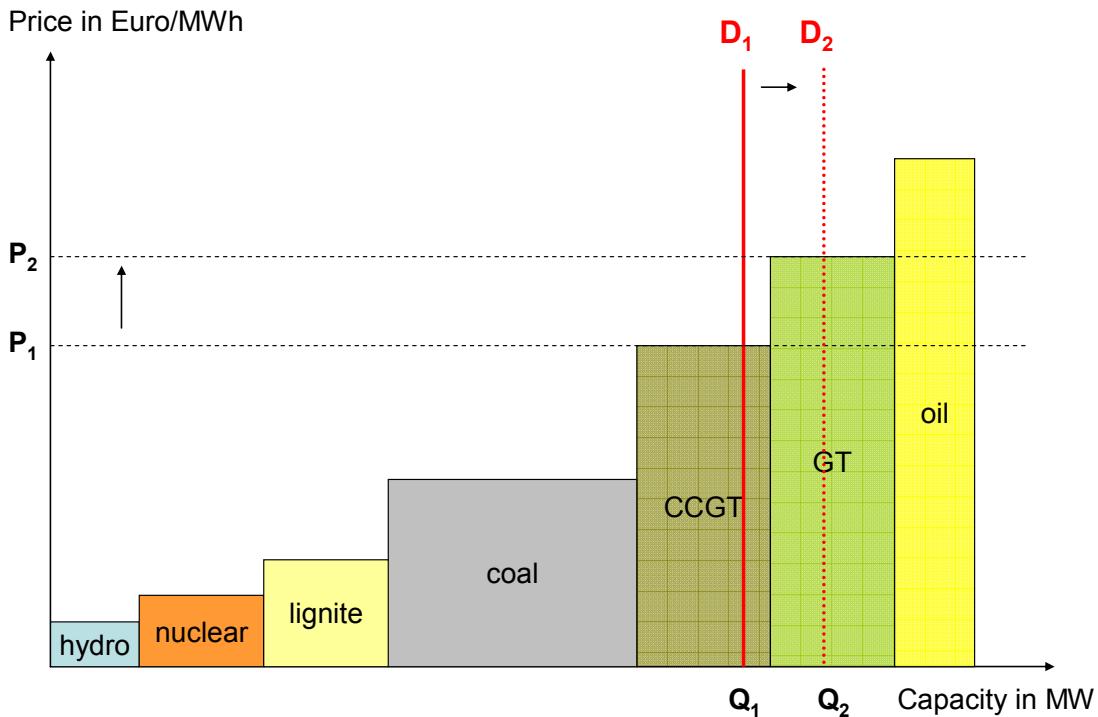
Harnessing antitrust enforcement to pursue liberalisation policy objectives ultimately causes harm to competition policy itself. Once governed by political choices of energy market liberalisation, antitrust rules, bent and stretched beyond their proper limits, slip out of their own systemic framework. Where does competition policy end and liberalisation policy begin? With the Courts' hands-off approach to commitment decisions as demonstrated in the *Alrosa* case, drawing a line between competition policy and liberalisation policy ultimately remains with the Commission.

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<sup>378</sup> AG Kokott's favourable opinion, being the first positive signal from the ECJ, which could increase the Commission's self-confidence in Article 9 proceedings, has been issued much later, in November 2009.

### 3.6. ANNEX 1

Figure 5. Price formation on a short-term competitive electricity market – schematic representation.

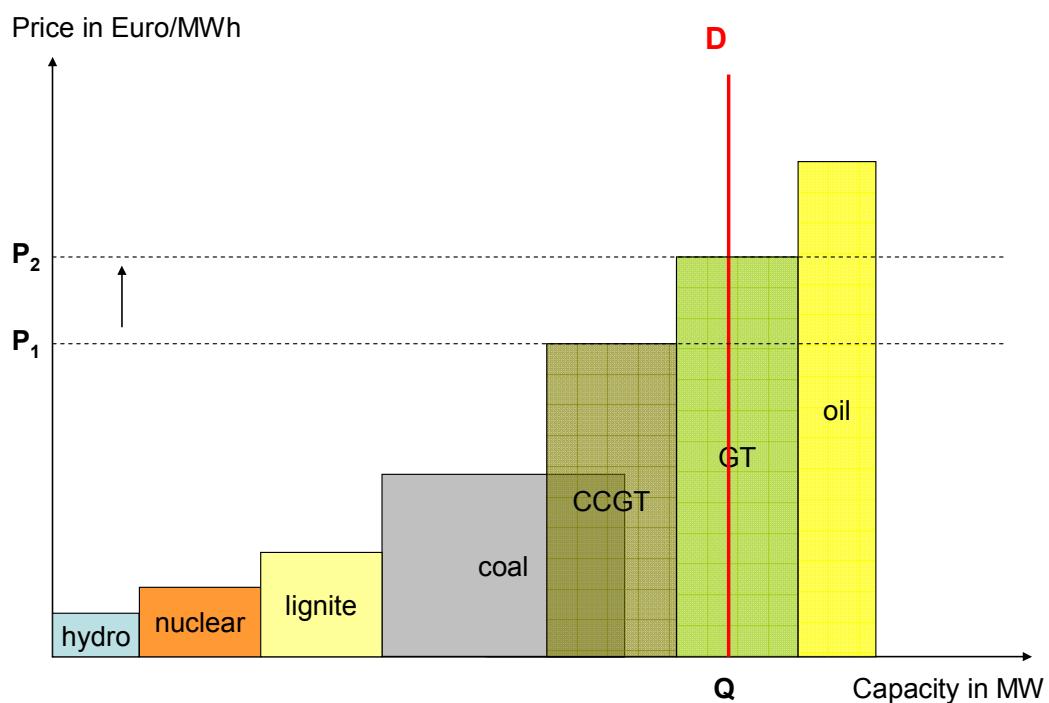
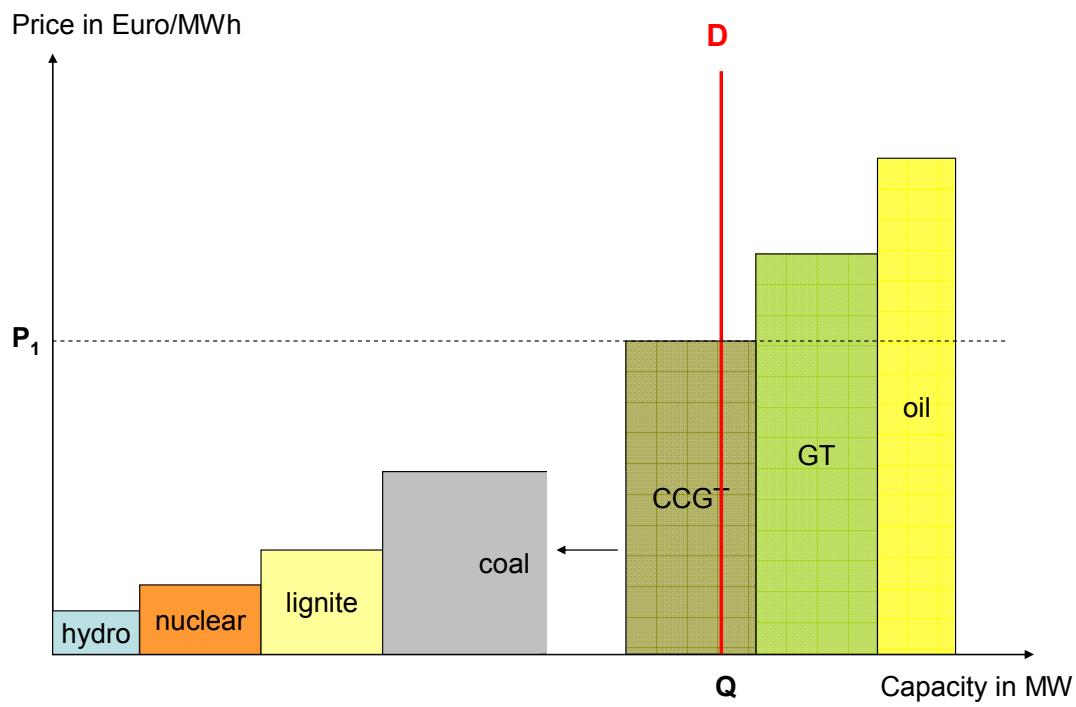


Source: own illustration

Figure 5 illustrates price formation on a competitive short term electricity market with no generation capacity constraints. It demonstrates the basic features of power markets. First of all, the elasticity of demand for electricity is very low. In fact, it comes close to zero in the short run. Hence, to keep things simple, it is depicted as a vertical line at the value of the load forecast for the given time period. Apart from that, demand is volatile over time, raising and falling in daily, weekly and seasonally patterns. Since electricity cannot be stored at a reasonable cost, its supply must be flexible enough to respond to the constant changes in demand. This means that some power plants operate on a constant basis, serving as base-load generation, whereas additional power plants will only go on stream in peak hours.

Electricity can be generated using different production technology. The variety of power generation methods creates substantial discrepancies in production costs. For this reason it is efficient to use the low cost power plants (hydro, nuclear, renewable power) on a permanent basis, covering the base load demand as much as possible. By contrast, high cost plants are brought into production only during the peak hours and subsequently deactivated as soon as demand falls (so called ‘peak plants’). Following this logic, Figure 5 presents the aggregated supply curve in form of a ‘merit order’ curve which ranks plants with respect to their production costs (and the technology they use accordingly). The market price is determined by the crossing point of the supply and demand curves, which equals the level of short run marginal cost (SRMC) of the plant generating the last unit of electricity required to meet demand. In case there is an increase in demand (demand curve shifts to the right) the next most efficient power plant is called to generate and the price rises to the level of its SRMC. Consequently, the price decided by the SRMC of the last plant called to generate determines not only the revenues of the marginal generator but also the revenues of all the electricity producers owning plants on the left hand side of the merit order curve. As can be seen from the chart, the further away to the left the plant is ranked, that is, the lower variable costs it has, the higher is its mark up.

**Figure 6.** The effect of capacity withdrawal on price formation in a competitive short-term electricity market (schematic representation).



Source: own illustration.

An increase in demand raises the market price. Just as decrease in supply. An electricity generator, withdrawing its plant from the market or running it below its full nameplate capacity, creates a shortage in supply which must be filled up with additional units of power provided by the plant standing just behind the marginal plant in the merit order, called to generate as a second-best. In this way, as illustrated by Figure 6, the new plant becomes the marginal one and its marginal costs from now on determine the market price. It goes without saying that the new plant coming on stream does not have to belong to the withdrawing generator. All generators get the higher market price for the volume of electricity they supply, irrespective of who owns the price-setting capacity. Although the new market equilibrium increases the revenues of all producing generators, not all of them would actually opt for output limitation in order to enjoy a higher price. The strategy of capacity withdrawal implies a trade off between the planned, therefore certain, output reduction and the expected, therefore uncertain, increase in price. A generator finds it profitable to withdraw capacity only if the expected mark-up earned from the price increase exceeds the loss linked to the fall in output. Joskow and Kahn (2002)<sup>379</sup> formulate unilateral profit maximisation logic of a withholding generator as follows:

$$\Delta \text{Profit} = [ (Q - \Delta Q) * \Delta P] - (\Delta Q * P) + \Delta c, \text{ where}$$

- $Q$  – generator's capacity sold through the pool
- $\Delta Q$  – capacity withdrawn
- $P$  – price level without withdrawal
- $\Delta P$  – price increase due to withdrawal
- $\Delta c$  – (avoided) operating cost of producing  $\Delta Q$

From the equation it appears that the profitability of capacity withdrawal for a generator depends on several key factors.

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<sup>379</sup> Supra n. 318.

**(i)** First of all, one must consider the generator's market share in the market [Q]. Generators controlling capacity that is small relative to the size of the market have no incentive to limit their output as such withdrawal would be unlikely to materially affect the market price. A generator must account for a significant proportion of total industry generation to allow for a withdrawal that brings about a price increase [Q with respect to  $\Delta Q$ ]. Further, the bigger the generator is, the greater is its incentive to withhold, as the mark-up over its remaining production will more than offset the loss in output. Relating to this, one must remember that Q stands not for the generator's total capacity, but the one sold on the power exchange. If a big share of the generator's total capacity is sold under contracts (therefore already excluded from the pool), the remaining output that can be strategically used by the generator is already limited. In such a case the incentive and the ability to make further withdrawals decreases accordingly.

**(ii)** Secondly, the incentive to withdraw increases with the price rise [ $\Delta P$ ]. A generator would not withhold capacity at any time (at any demand level), but rather in the periods of high demand, when even a small withdrawal results in a substantial price increase. In the periods of low demand, a withdrawal of the same size would result in a modest price increase, due to the flatter slope of the industry's merit order curve. Just for the record, the new market-clearing price is determined by the marginal costs of the next generating unit called on stream. It does not matter whether this unit belongs to the withholding generator or to one of its competitors as even in the latter case the generator is able to forecast the price increase with high accuracy. In peak hours due to capacity or transmission constraints the new marginal generator might be pivotal and set a market-clearing price above its marginal costs, as there will be no other capacities available on the market. Although capacity withdrawal is a unilateral exercise of market power, generators may well collude and reduce their capacities in concert in order to make one of them pivotal, able to explore the capacity constraints.

**(iii)** Third, since low-cost generation enjoys the highest price mark-up  $[(Q - \Delta Q) * \Delta P]$ , the profitability of capacity withdrawal hinges on the generator's asset portfolio,

which must include a sufficient number of low-cost plants. At the same time, having only base-load-oriented portfolio is not enough, since withdrawing low-cost generation would appear too costly. The optimal candidate portfolio for a profitable withdrawal should also include ‘plants to withdraw’, which are more expensive in operation [higher  $\Delta c$ ] and have lower shutdown opportunity costs [ $\Delta Q * P$ ] than the base-load units. These higher-cost plants are not necessary peak plants, since these already operate in a limited period of time. Rather they can be characterised as high-cost inframarginal generation, to limit the cost of withdrawal but at the same time to be sure the strategy actually affects the market price. According to the Commission officials writing in a personal capacity, the optimal asset portfolio for limiting output strategy should, on the one hand, provide incentive to withdraw (a sufficient number of base-load generation units), on the other hand, guarantee the availability to withdraw (higher-cost plants in the middle of the merit-order curve).<sup>380</sup> This grouping of generation assets into ‘incentive assets’ and ‘ability assets’ helps to understand the logic behind the capacity withdrawal but it should not be used in the individual cases, as it oversimplifies the picture and might lead to errors in the assessment. Some plants, especially those in the middle of the merit order curve, might be categorised as ‘incentive assets’ or ‘ability assets’, depending on the generator and the load level.

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<sup>380</sup> P. CHAUVE, M. GODFRIED, K. KOVÁCS, G. LANGUS, K. NAGY and S. SIEBERT, ‘The E.ON electricity cases: an antitrust decision with structural remedies’ (2009) *Competition Policy Newsletter* 1, 51-54, pp. 51-52

## 3.7. ANNEX 2

As discussed in section 1.2.3.2, competition authorities and energy regulators in a number of Member States have become increasingly active in the energy sector. Competition enforcement at the national level reflects the Commission's priorities, that is, its objective of creating an integrated and competitive EU energy market. NCAs launch sector inquiries and follow up with antitrust cases, NRAs conduct their own investigations, and all these actions still focus on competition problems identified by the Commission six years ago in its sector inquiry. To illustrate this trend, the following paragraphs discuss six investigations into market manipulation carried out by NCAs in Spain, Denmark, Germany, the UK, Italy and Belgium. Four of them, launched shortly after the Commission's sector inquiry and the *E.ON* case, focus directly on the problem of capacity withholding.<sup>381</sup>

### 3.7.1. Spain

The Spanish investigation into market manipulation dates back to November 2001, when the Spain's energy regulator observed unusually high electricity prices in the day-ahead electricity market during a very short period of 3 days. Its report, submitted to the Comisión Nacional de la Competencia (CNC), the Spanish Competition Authority, triggered a two-year-long antitrust investigation into generators' bidding strategies. Finally, in 2004, the CNC found that the three major generators (Endesa, Iberdrola and Unión Fenosa) abused their dominant position on the Spanish market for technical restrictions<sup>382</sup> and imposed on them a fine of nearly 3 million EUR (901 519 EUR per firm).<sup>383</sup> According to the CNC, the three firms exploited a weakness in the market design. Namely, they deliberately submitted excessively high bids in the day-ahead market in order to be excluded from the daily merit order, and to be later called

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<sup>381</sup> Country examples discussed here serve only to illustrate the trend, but do not constitute a complete list of NCAs/NRAs investigations into market power abuses on electricity wholesale markets.

<sup>382</sup> This is just another name for a balancing market, where the network operator (in this case REE) has to deal with transmission congestion occurring in the system, and the resulting shortage of energy supply in some areas and excess of energy supply in other areas.

<sup>383</sup> Case 522/02, *Empresas Eléctricas*, CNC decision of 07.07.2004

to produce in the market for technical restrictions at (allegedly excessive) prices, which they submitted in their day-ahead bids.<sup>384</sup> According to the CNC, generators were able to foresee the risk of supply shortage in their respective geographical areas based on available market information. Following an appeal by Unión Fenosa and long court proceedings, the CNC's 2004 decision was eventually set aside by the Spain's Supreme Court (Tribunal Supremo – TS). The Supreme Court found in its ruling from 2012 that generators did not infringe competition rules during the three days in November 2001 because their behaviour was too sporadic and too limited in time to be considered an abuse of a dominant position. The Court also criticised the cost calculation method on the basis of which the CNC established that prices were excessive. According to the Court, in a liberalised market generators can choose whether to generate or not, and their price bids do not always have to correspond to their costs. Further, the CNC failed to take into account the uncertainty faced by generators as to whether or not their bids are eventually selected by the network operator to address technical restrictions.<sup>385</sup> Finally, the Court disapproved that the CNC relied on the NRA's reports, as they could not provide sufficient evidence to establish an abuse of a dominant position.

The *Unión Fenosa* judgment is certainly a landmark case as it puts in question the CNC's decision-making practice regarding the market for technical restrictions. Some decisions adopted by the CNC between 2006 and 2008 are based on similar theories of harm. This period of increased competition enforcement in the Spanish electricity wholesale market coincides with the Commission's sector inquiry. More recently, the CNC investigated nine Spanish electricity generators for similar practices during the 2004-2008 period, i.e. alleged withholding of capacity from the day-ahead market in

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<sup>384</sup> Due to transmission constraints, some areas in Spain might face electricity shortage during certain hours. In such cases, REE buys additional electricity from generators located in the areas with energy shortage, but which have been excluded from the daily merit-order (because their electricity was too expensive). REE pays them the price they initially submitted in their day-ahead bids. For more details on this case and the Spanish electricity market design see a case note by J. GARCIA-NIETO and H. AJOUC, 'Spanish Supreme Court quashes Decision fining major energy companies for abusing their dominant position in the Spanish electricity market for technical restrictions (Unión Fenosa)' (2010) online article, e-Competitions, no. 30709, 03.2010, available at <http://www.whitecase.com/articles-03292010-3> accessed 20.05.2013.

<sup>385</sup> Case ST S 351/2010, *Unión Fenosa*, TS judgment of 27.01.2012, available at <http://www.poderjudicial.es/search/doAction?action=contentpdf&databaseMatch=TS&reference=5048316&links=&optimize=20100225&publicInterface=true> accessed 20.05.2013.

expectation to sell their electricity to the network operator at higher prices in periods of transmission constraint.<sup>386</sup> Eventually, the CNC abandoned this investigation in September 2011, probably in expectation of the Supreme Court's ruling.

### 3.7.2. Denmark

In 2005 and 2007 the Danish Competition Authority (hereinafter 'the Authority') targeted Elsam, the country' electricity generator, for submitting excessive price bids in Nord Pool. In both cases the Authority found that Elsam abused its dominant position by adopting a bidding strategy which resulted in excessive prices in Western Denmark. To determine whether Elsam's prices were excessive, the Authority applied a rather rigid interpretation of the *United Brands*'s test, which still remains the main case-law reference for the application of Article 102 TFEU to unfair prices.<sup>387</sup> The test determines in two stages whether the price charged by an undertaking reasonably relates to the economic value of the product sold. In the first stage, the Authority established that Elsam's prices exceeded the cost actually incurred.<sup>388</sup> In the second stage, it compared Elsam's prices from the the period under investigation with prices submitted during other periods.

In the 2005 case, the Authority found that Elsam's prices were 'unfair' in 900 hours between July 2003 and December 2004, and that Elsam's abuse resulted in losses of approx. 187 million DKK (approx. 25 million EUR). As a remedy, the Authority imposed a price cap on Elsam's bids in Nord Pool.<sup>389</sup> Elsam filed an appeal against this decision and in 2006 the Danish court removed the price cap, but nevertheless confirmed that Elsam abused its dominant position by charging excessive prices.

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<sup>386</sup> Case S/0104/08, *Electricas*. The investigation, opened in October 2009, involved Iberdrola, Endesa, Gas Natural, Hidrocantabrico, E.On, Electrabel, Aceca, Elcogas and Nueva Generadora del Sur.

<sup>387</sup> Supra n. 277, par. 252.

<sup>388</sup> Average total cost (ATC) plus a markup.

<sup>389</sup> Danish Competition Authority, 'Elsam A/S abuse of dominant position by charging unfair prices', press release 3/1120-0204-0150/ISA/LKF/CS, available at <http://www.kfst.dk/en/competition/decisions/decisions-2008-and-earlier/national-decisions-2005/konkurrenceraadets-moede-den-30-november-2005/elsam-as-abuse-of-dominant-position-by-charging-unfair-prices/> accessed 20.05.2013.

In the 2007 case, the Authority followed the same methodology as in the first case and found that Elsam's prices were 'unfair' in 1.484 hours between January 2005 and December 2006. This, according to the Authority, inflicted a loss of 111 million DKK (approx. 15 million EUR).<sup>390</sup> This time no price cap was imposed, but it was announced that Elsam's future pricing will be discussed with the Authority.

In 2010 the Authority once again investigated high electricity prices in Nord Pool, but this time found no infringement of competition rules. The investigation was triggered by a complaint and concerned bidding behaviour of Energy E2 A/S in Eastern Denmark during a period between July 2003 and December 2005.<sup>391</sup> The Authority applied the same economic framework known from the *Elsam* cases. This time, however, the *United Brands* test came out inconclusive, and was then supported by an analysis, hour-by-hour, of the E2's bid curves and their relation to production cost. Given that E2 presented objective, cost-related reasons for its bidding strategy, even during hours of extreme profit, the Authority concluded that the generator did not abuse its dominant position.

### 3.7.3. Germany

A year after the Commission's decision in the *E.ON* case, the Bundeskartellamt (the German Federal Cartel Office – FCO) opened two sector inquiries in the German gas and electricity markets. In the context of electricity, the FCO investigated similar practices to those alleged by the Commission in the *E.ON* case, that is, whether high electricity prices at EEX could have resulted from withholding strategies and collusion between the major power generators – E.ON, RWE, EnBW and

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<sup>390</sup> Danish Competition Authority, 'Elsam', press release 4/0120-0204-0038/ISA/MOL, available at <http://www.kfst.dk/en/competition/decisions/decisions-2008-and-earlier/national-decisions-2007/konkurrenceraadets-moede-den-20-juni-2007/elsam/> accessed 20.05.2013.

<sup>391</sup> Danish Competition Authority, 'Energy E2 did not impose excessive pricing', press release of 22.12.2010, available at <http://www.kfst.dk/en/competition/decisions/decisions-2008-and-earlier/afgoerelser-2010/energy-e2-did-not-impose-excessive-prices/> accessed 20.05.2013.

Vattenfall.<sup>392</sup> The FCO examined the operation of power plants of the four major electricity producers in years 2007-2008. It developed for this a special algorithm in order to detect patterns of capacity withholding in the generators' day-ahead bids. Finally, in 2011, the FCO published a comprehensive report from its inquiry but found no evidence of abusive practices. Even though the analysis of day-ahead bids suggested that a small share of capacities was not put in operation at times when it was profitable, the FCO noted that there are other plausible reasons behind withheld capacities, for instance, trading in other markets. The report concluded that capacity withholding is 'extremely difficult to prove' and, given the amount and complexity of data involved, finding an infringement of competition rules in that respect would be particularly challenging.<sup>393</sup> The report emphasised the importance of continuous market monitoring in order to prevent more sophisticated withholding strategies being deployed.

The German federal law has been adapted in 2012 in order to set up a market transparency office (Markttransparenzstelle) within the Bundeskartellamt.<sup>394</sup> The Office, in operation since January 2013, has as its task to continuously monitor electricity, gas and fuel markets and in particular, to ensure that price formation in electricity and gas at the wholesale level is transparent and competitive. To this aim, the Office is integrated in the new EU market surveillance scheme created under the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT),<sup>395</sup> and closely cooperates with the Bundesnetzagentur, the Federal Network Agency.

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<sup>392</sup> GASSMANN M., 'Angriff auf Stromkonzerne' (2009) online article, Financial Times Deutschland, Düsseldorf, 16.04.2009 <http://www.ftd.de/unternehmen/handel-dienstleister/erste-sektoruntersuchung-angriff-auf-stromkonzerne/501402.html> accessed 20.05.2013

<sup>393</sup> Supra n. 336 and 327.

<sup>394</sup> Bundesministerium für Wirtschaft und Technologie (BMWi), 'Minister Rösler: Market transparency office strengthens competition on fuel and energy markets' press release of 02.05.2012, available at <http://www.bmwi.de/EN/Press/press-releases,did=490210.html> accessed 20.05.2013.

<sup>395</sup> See Article 7 of REMIT, supra n. 102. For more information on REMIT, see infra text accompanying n. 424.

### 3.7.4. The UK

The GB wholesale electricity market is dominated by six market players, including two companies, SP (Scottish Power, owned by Spain's Iberdrola) and SSE (Scottish and Southern Energy).<sup>396</sup> In April 2008, the UK Office of Gas and Electricity Markets (Ofgem) opened an antitrust investigation against the two Scottish generators.<sup>397</sup> The case was based on a formal complaint alleging that SP and SEE abused their dominant position in electricity wholesale market by exploiting their market power arising from transmission constraints between England/Wales and Scotland during a four-week period in 2007. The generators allegedly withheld their power plants when the market was tight, in order to later use these plants to supply balancing power to the network operator (National Grid) at excessively high prices.<sup>398</sup> Finally, in January 2009, the case was suspended.<sup>399</sup> Even though Ofgem had serious concerns regarding the behaviour of the Scottish generators, it found that its powers under the *Competition Act 1998* are not sufficient to capture the problem of capacity withholding / excessive bidding, as it is too difficult to prove an infringement of competition rules.<sup>400</sup> Nevertheless, this case demonstrated a regulatory loophole, which needs to be addressed. Ofgem decided to take a different route to deal with this problem, namely, to modify generators' licences.<sup>401</sup>

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<sup>396</sup> The remaining big market players are EDF Energy, E.ON UK, Centrica and RWE.

<sup>397</sup> Ofgem conducts investigations into the conduct of companies active in the gas and electricity sector for (1) licence breach, (2) Competition Act infringements, and (3) breach of consumer protection law. Under the UK *Competition Act 1998* Ofgem can impose financial penalties of up to 10% of the company's turnover for an infringement of competition rules.

<sup>398</sup> Ofgem, 'Ofgem launches Competition Act investigation into Scottish Power Limited and Scottish and Southern Energy plc', press release R/12 of 8.04.2008, available at <http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem%2012.pdf> accessed 20.05.2013.

<sup>399</sup> Ofgem, 'Ofgem closes Competition Act 1998 case against Scottish Power and Scottish and Southern Energy – Information Note', press release R/4 of 20.01.2009, available at <http://www.ofgem.gov.uk/Media/PressRel/Documents1/ofgem4-190109.pdf> accessed 16.05.2008.

<sup>400</sup> Ofgem argued that it would be too difficult to identify the market in which a company could be found dominant, as the concept of dominance does not capture a situation where a generator has a substantial market power during very short periods of time when the market is tight or where there are local transmission constraints.

<sup>401</sup> In order to be able to generate energy, run transmission/distribution networks or supply energy to customers, companies have to be licenced by Ofgem. A licence includes a list of obligations that a company needs to fulfil (licence conditions). Generally, these conditions should guarantee a reliable energy supply to final customers. Ofgem monitors energy companies to ensure they comply with their licences and can open an investigation if it alleges that a company breaches any of the licence conditions. Ofgem's licensing powers include issuing enforcement orders to make companies comply with their licences and imposing penalties of up to 10% of the

Licence modification requires primary legislation. To trigger this process, Ofgem first published a consultation document on the problem of market power in the GB electricity wholesale market.<sup>402</sup> The document argued there that the existing market structure, coupled with transmission constraints makes the GB electricity wholesale market particularly prone to exploitation of market power. It was estimated that out of 238 million GBP of transmission constraint costs in years 2008-2009, up to 125 million could have potentially resulted from the misuse of market power.<sup>403</sup> To tackle the problem, the Office proposed to impose a new condition in generators' licences, limiting their ability to manipulate markets when transmission bottlenecks occur.<sup>404</sup><sup>405</sup> Such a new licence condition strengthens Ofgem's *ex-post* investigatory powers and allow it to impose fines and/or sanctions also in cases of market power abuses specified under this condition.<sup>406</sup>

Ofgem's suggestions were incorporated in the new *Energy Act 2010*. The so-called Transmission Constraint Licence Condition (TCLC), which is in force since the end of 2012, allows Ofgem to use its existing licensing powers to monitor and act on two types of conduct which are specified therein, covering instances of capacity

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company's turnover. In some cases Ofgem also accepts commitments from the investigated companies to take steps to ensure compliance with the licence.

<sup>402</sup> Ofgem, *Addressing Market Power Concerns in the Electricity Wholesale Sector—Initial Policy Proposals* (2009) Consultation Document, Ref. 30/09, 30.03.2009, available at <http://www.ofgem.gov.uk/Markets/WhlMkts/CompanEff/Documents1/Market%20Power%20Concerns-%20Initial%20Policy%20Proposals.pdf> accessed 20.05.2013.

<sup>403</sup> *Ibid.*, paras. 1.14 and 1.15.

<sup>404</sup> Supra n. 401.

<sup>405</sup> Ofgem proposed several alternative policy approaches to deal with the problem of undue exploitation of market power, but introducing a licence condition was its preferred solution. (1) The first proposal related to changes to existing market arrangements and included, for instance, alignment of the incentives of the System Operator (SO) and Transmission Owners (TOs) as to minimising the frequency of transmission constraints. The Office recognised the limitations of this approach, as it would mostly target market power issues in relation to transmission constraints. (2) The second proposal concerned changes to existing assets and/or ownership of assets, like divestments of power plants. Also in this case, according to Ofgem, sale of assets does not sufficiently address all relevant market power concerns. (3) The third proposal was to develop specific mechanisms for addressing market power issues. This could be an *ex-post* control mechanism (licence condition suggested by Ofgem), or, for instance, some sort of *ex-ante* screening mechanism to identify regions and time periods where market power was likely to occur, and where price caps could be introduced.

<sup>406</sup> TCLC aims to cover two types of conduct: (1) excessive bidding in the balancing market in the event of a transmission constraint, when the options available to National Grid during this periods; (2) potential market manipulation by generators (by e.g. by taking uneconomic dispatch/withhold decisions in expectation of charging higher prices to correct the situation through the balancing mechanism) which creates or exacerbates a transmission constraint.

withholding and excessive bidding at times of transmission constraint.<sup>407</sup> Ofgem has powers to impose a fine up to 10% of the generator's turnover for the breach of this condition.<sup>408</sup> TCLC expires after 5 years, but can be extended by 2 years upon review.

### 3.7.5. Italy

Italian day-ahead electricity market is split into 22 price zones, and Sicily, badly interconnected with mainland Italy, forms one of them. For the most of hours, electricity wholesale prices are set by the local generators, making Sicily an ‘electric island’. Enel Produzione (EP) and Edipower, a group of power plants managed by a tolling agreement between four companies,<sup>409</sup> enjoy there significant market power.

The Italian Regulatory Agency for Electricity and Gas (AEEG) observed that between November 2008 and January 2009 electricity wholesale price in Sicily were significantly higher than in the rest of the country, and this could not be explained by structural factors such as equipment failure or routine maintenance. AEEG’s report, published in 2009, drew attention of the Italian Competition Authority (AGCM), which then launched two separate antitrust investigations, one against Enel and EP for an abuse of a dominant position, and the other one against Edipower’s shareholders and their parent companies, for collusion.<sup>410</sup> AGCM alleged that Enel withheld generation capacity from the day-ahead market in order to create supply shortage and raise the clearing price to the detriment of all Italian consumers.<sup>411</sup> Edipower ‘toller’

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<sup>407</sup> For an interesting comment, see P. WILLIS, ‘DECC announces decision on Transmission Constraint Licence Condition’ (2012) online article, Bird and Bird Energy News, 06.2012, available at [http://www.twobirds.com/English/News/Documents/Transmission\\_Constraint\\_Licence\\_Condition.htm](http://www.twobirds.com/English/News/Documents/Transmission_Constraint_Licence_Condition.htm) accessed 20.05.2013.

<sup>408</sup> Ofgem’s decision can be appealed to the Competition Appeal Tribunal, which has to review it on the merits.

<sup>409</sup> Edipower’s shareholders include Edison Trading (50%), A2A Trading (20%), Alpiq Energia Italia (20%) and Iride Mercato (10%). The shareholder companies (tollers) pay a fee and supply pro-rate the fuel necessary to produce electricity. The volumes produced by Edipower’s power plants are taken and sold by the tollers to the final clients. In that way, industrial risks of the producer remain with Edipower, and market risks deriving from the fuel procurement and the sale of electricity are the responsibility of the toller companies.

<sup>410</sup> AGCM, ‘Electricity market: Enel, Edison and other companies from the sector under investigation’, press release of 02.02.2010, available at

<http://www.agcm.it/en/newsroom/press-releases/1873-electricity-market-enel-edison-and-other-companies-from-the-sector-under-investigation.html> accessed 20.05.2013.

<sup>411</sup> Despite market splitting in Italy, final consumers still face a single electricity price (PUN), which is calculated from the weighted average of all zonal sale prices. See infra n. 528.

companies were accused of coordinating their supply strategies in order to exploit the pivotal position of the Sicily-based power plant of San Filippo del Mela at times of peak demand, and to keep high prices both on the day-ahead market and on the balancing market.

Both cases were closed when the investigated companies offered commitments.<sup>412</sup> Enel introduced a bid cap of 190 EUR/MWh for years 2011-2013, until the new interconnection with mainland is developed. Edipower's tollers agreed to exclude the San Filipo del Mela plant from the tolling agreement, entrusting its management solely to Edipower and thereby reducing the risk of coordinated practices. Moreover, Edipower agreed to run this power plant under a special regulatory regime for plants which are considered indispensable by the TSO. This basically allows the latter to take key decisions on plant management.<sup>413</sup>

### *3.7.6. Belgium*

In 2009 CREG, the Belgian energy regulator issued a study on price formation at Belpex, the Belgian power exchange, pointing out abnormal price spikes in 2007 and the beginning of 2008. CREG suspected price manipulation by Electrabel and submitted its study to the Belgian Competition Authority (hereinafter ‘the Authority’). In September 2009 the Authority carried out dawn raids on the premises of Electrabel and several other companies active in the wholesale electricity market in search of evidence of price manipulation in form of capacity withholding and excessive bidding

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<sup>412</sup> AGCM, decisions no. 21960 and 21962 of 22.12.2010, Enel – Dinamiche formazioni prezzi mercato energia electrica in Sicilia / Tolling Edipower, available at <http://www.agcm.it/concorrenza/intese-e-abusi.html> accessed 20.05.2013.

<sup>413</sup> AGCM, ‘I721 – A423 – Edipower Tolling and Enel – Dynamics in the Setting of Electricity Market Prices in Sicily (Closure of Investigation)’, press release of 10.01.2011, available at <http://www.agcm.it/en/newsroom/press-releases/1924-i721-a423-edipower-tolling-and-enel-dynamics-in-the-setting-of-electricity-market-prices-in-sicily-closure-of-investigation.html> accessed 20.05.2013. See also a case study by F. SALERNO, ‘Debate on “market vs. regulation”: insights from selected national competition law cases’ in J.-M. GLACHANT, N. AHNER and A. DE HAUTECLOCQUE (eds.), *EU Energy Law & Policy Yearbook 2012. The Priorities of the European Commission – Vol. V*, 3<sup>rd</sup> ed., Claeys & Casteels, Deventer 2013, pp. 169-171.

and/or capacity manipulation.<sup>414</sup> CREG actively participated in this follow-up investigation. In February 2013, the Authority formally accused Electrabel of an abuse of a dominant position by, among others, withholding capacity on the Belgian market for generation, wholesale and trading of electricity from 2007 to 2010.<sup>415</sup> According to its estimations, Electrabel's capacity withholding might have costed Belgian customers between 33 and 49 million EUR. The case is currently examined by the Authority's decision-making panel where Electrabel has a possibility to exercise its defence rights.<sup>416</sup> Given the difficulty in finding evidence of capacity withholding, the Belgian case against Electrabel is followed with much interest by the competition community.<sup>417</sup>

### 3.7.7. Discussion

Price formation in electricity wholesale markets and possible market manipulation has recently received much more scrutiny at the Member State level than anytime before. The activation of national competition enforcement in this area is, to a certain extent, encouraged by the findings of the Commission's sector inquiry and the *E.ON* case. It is interesting that earlier national cases (prior to the Commission's sector inquiry and the *E.ON* case) refer to excessive bidding or market manipulation in general terms. Concerns about withholding strategies appeared only after the Commission's sector

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<sup>414</sup> Conseil de la concurrence, 'Perquisitions au sein d'entreprises actives dans le secteur de la vente en gros d'électricité en Belgique', press release of 22.09.2009, available at [http://economie.fgov.be/fr/binaries/Communiqu%C3%A9%20de%20presse%20Autorit%C3%A9%20belge%20de%20la%20concurrence%202009%2009\\_tcm326-74612.pdf](http://economie.fgov.be/fr/binaries/Communiqu%C3%A9%20de%20presse%20Autorit%C3%A9%20belge%20de%20la%20concurrence%202009%2009_tcm326-74612.pdf) accessed 20.05.2013.

<sup>415</sup> Conseil de la concurrence, 'The College of Competition Prosecutors of the Belgian Competition Council found that Electrabel (GDF Suez) abused its dominant position on the Belgian market for generation, wholesale and trading of electricity as well as on the Belgian market for supply of tertiary reserve services', press release of 07.02.2013, available at [http://economie.fgov.be/en/binaries/20130207\\_Pressrelease\\_F\\_tcm327-211835.pdf](http://economie.fgov.be/en/binaries/20130207_Pressrelease_F_tcm327-211835.pdf) accessed 20.05.2013.

<sup>416</sup> At the time of writing this section (05.2013).

<sup>417</sup> See, for instance, P. WILLIS, 'Belgian competition authority prosecutor accuses Electrabel of abuse of dominance' (2013) online article, Bird & Bird, 13.02.2013, available at [http://www.twobirds.com/english/news/articles/pages/belgian\\_competition\\_accuses\\_electrabel\\_abuse\\_dominance0213.aspx](http://www.twobirds.com/english/news/articles/pages/belgian_competition_accuses_electrabel_abuse_dominance0213.aspx) accessed 20.05.2013; S. BERRA, 'Belgium threatens Electrabel with abuse fine' (2013) online article, Global Competition Review, 11.02.2013, available at <http://www.globalcompetitionreview.com/news/article/33039/belgium-threatens-electrabel-abuse-fine/> accessed 20.05.2013.

inquiry and the *E.ON* case. These national cases share certain characteristics, which puts them in stark contrast to the *E.ON* case.

The first difference lies in the level of case complexity and thoroughness. The Commission's theory of harm in the *E.ON* case is general and not very clear, combining simple logic behind a profitable unilateral withholding<sup>418</sup> with allegations of coordinated behaviour. The relevant market is broad in scope, defined as the German wholesale market for electricity. The Commission's allegations stem from the sector inquiry, which found that some German plants operated less frequently than they would in a perfectly competitive world. Nevertheless, the sector inquiry reached no conclusive findings as to whether strategic withholding indeed took place.

In contrast to that, investigations at the national level are much more thoroughgoing and complex. Theories of harm are based on more sophisticated withholding strategies which take account of specific characteristics of these markets (transmission constraints, regulatory arrangements in place). As a result, markets are defined narrowly, both in terms of products and the geographical scope (e.g. market for technical restrictions, Sicily, Eastern Denmark). Lastly, NCAs often analyse vast amounts of data on plant operation and price bids, and develop complex econometric methods and models to find evidence of market manipulation.

The second difference concerns the outcome of the case. The Commission's energy cases are usually closed under Article 9 without concluding on the existence of a market abuse. To the contrary, NCAs rather abandon investigations, when they cannot prove an infringement of competition rules (Germany,<sup>419</sup> the UK, Denmark, Spain), or pursue the investigation until they actually find one (Denmark, Spain). Only Enel offered voluntarily commitments.<sup>420</sup>

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<sup>418</sup> Supra section 3.6.

<sup>419</sup> Given negative results from the Bundeskartellamt's sector inquiry, no individual antitrust investigations followed.

<sup>420</sup> But see the Italian case, where Enel offered commitments.

The third difference relates to remedies. At the EU level, the Commission extracts far-reaching divestments, changing the structure and competitive dynamics of national markets. NCAs' cases of market manipulation, on the other hand, result in high fines (Spain) and/or behavioural remedies of regulatory nature, mostly temporary price caps (Denmark, Italy, Spain), but also other forms of price control (the 2005 *Elsam* case) or special regulatory restrictions on plant management (the *Edipower* case). In none of these cases generators were required to divest assets.

These three common characteristics of national investigations reflect increasing involvement of NRAs in competition cases. Antitrust proceedings in Spain, Italy, the UK<sup>421</sup> and Belgium were triggered by NRAs' investigations and conducted in close cooperation with the latter. NCAs' allegations built on NRAs' data and findings. The NCAs and NRAs exchange information on a regular basis and often undertake joint initiatives. For instance, since 2011 the German FCO and the Bundesnetzagentur carry out joint market monitoring in electricity wholesale markets. This involves cooperation in data collection and joint reporting activities.<sup>422</sup> Similarly, the Italian AGCM has recently signed a protocol of cooperation with AEEG which provides for an exchange of information and findings from market investigations and taking up joint initiatives in market surveillance.<sup>423</sup> Cooperation with NRAs, either case-specific or more general, provides competition authorities with sector-specific expertise allowing them to undertake more and more complex investigations on technical issues, as well as to impose behavioural remedies requiring continuous regulatory supervision.

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<sup>421</sup> Ofgem is the UK regulator for energy with competition law powers.

<sup>422</sup> See, for instance, Bundeskartellamt, 'Joint Energy Monitoring 2013 of the Bundeskartellamt and the Bundesnetzagentur – Data survey', press release available at [http://www.bundeskartellamt.de/wEnglish/News/2013\\_04\\_22\\_Joint\\_Energy\\_Monitoring\\_2013.php](http://www.bundeskartellamt.de/wEnglish/News/2013_04_22_Joint_Energy_Monitoring_2013.php) accessed 20.05.2013. The first joint Monitoring Report was issued in 2012 and documents developments in the German energy markets in 2011.

<sup>423</sup> AGCM, 'Antitrust e Autorità per l'energia insieme per tutelare il funzionamento dei mercati e i consumatori', press release of 17.09.2012, available at <http://www.agcm.it/stampa/news/6193-antitrust-e-autorita-per-lenergia-firmato-protocollo-di-intesa-per-rafforzare-la-collaborazione.html> accessed 20.05.2013.

Much of the stimulus for NCA/NRA cooperation, especially in market surveillance, has been provided by REMIT.<sup>424</sup> The *E.ON* case exposed difficulties in addressing market manipulation by ad-hoc antitrust actions, and made a strong case for a more systematic market monitoring and alternative enforcement instruments. REMIT came into force in December 2011 and introduced an explicit prohibition of market manipulation, attempted market manipulation and insider trading.<sup>425</sup> Member States are now required under REMIT to endow their NRAs with sufficient investigatory and prosecutorial powers to act upon these prohibitions,<sup>426</sup> and may also establish joint NCAs/NRAs market monitoring.<sup>427</sup> Further, NRAs are obliged under REMIT to inform national competition authorities in their respective countries in case they suspect breaches of competition rules on wholesale energy markets.<sup>428</sup> NRAs, together with NCAs may establish appropriate forms of cooperation in carrying out market investigations and enforcing REMIT.<sup>429</sup>

NRAs actively participated in NCAs' antitrust interventions in the electricity sector also before REMIT came into force and this might have been triggered by the lack of guidance at the EU level on how to address market manipulation under competition rules. Namely, the Commission's sector inquiry signaled that market manipulation might occur, but has not provided any clear guidance on how to deal with it. Nor had the Commission's decision in the *E.ON* case. Quite on the contrary, the *E.ON* commitment decision might have left a sense of ambiguity which activated NCAs/NRAs in this area. This is because the Commission formulated specific concerns about E.ON's capacity withholding in its preliminary assessment, but eventually left the issue open. The *E.ON* decision only means that in the light of the commitments, 'there are no longer grounds for action by the Commission'. It is not clear whether this means that E.ON's divestments eliminated all risks of alleged abusive behaviour, or whether they only reduced the Commission's concerns to such

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<sup>424</sup> REMIT, *supra* n. 102.

<sup>425</sup> Articles 3 and 5 of REMIT, *supra* n. 102.

<sup>426</sup> By 29.06.2013. *Ibid.*, Article 13.

<sup>427</sup> *Ibid.*, Article 7.

<sup>428</sup> *Ibid.*, Article 16 (3) (d).

<sup>429</sup> *Ibid.*, Article 16 (1).

an extent that the case is no longer a priority in the EU competition enforcement.<sup>430</sup> The wording of Article 9, according to which commitment decisions are without prejudice to the powers of NCAs and national courts to make a finding of an infringement and decide upon a case, seems to support the latter interpretation. In other words, the *E.ON* case might have invited the Bundeskartellamt to launch its own sector inquiry in the wake of the Commission's intervention. More generally, 'incomplete' commitment cases might provide a plank for NCAs/NRAs' actions.

Two further observations can be drawn from these national cases. Firstly, this lack of clear guidance at the EU level in dealing with market manipulation resulted in a range of national approaches and very different outcomes. The German sector inquiry exposed difficulties in finding evidence of capacity withholding and no individual cases followed. Similar problems made Ofgem close the case against the Scottish generators. The Danish Authority found only limited evidence of excessive pricing in the recent *E2* case, insufficient to prove infringement.<sup>431</sup> In contrast, investigations in Spain and Denmark resulted in decisions finding an infringement and imposing fines or price controls. The Italian AGCM accepted commitments of a similar type. These inconsistencies in application of competition law to market manipulation across Member States diminish legal certainty and trust of the industry in competition intervention.

Secondly, these cases demonstrate that Article 102 does not provide a suitable legal framework to capture capacity withholding and/or excessive bidding strategies and NCAs face serious difficulties in applying national competition rules to these types of abuses. In half of the cases reported here<sup>432</sup> NCAs failed to prove competition law infringements. The Bundeskartellamt could not find any evidence of withholding and decided not to follow this route at all. In few other cases NCAs either gave it up after costly and time-consuming investigations (the UK, Spain) or their decisions were

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<sup>430</sup> See supra text accompanying n. 214-215.

<sup>431</sup> *E2*'s prices were not corresponding to its costs in only 0.25% of hours during the period under investigation.

<sup>432</sup> Spain (the 2009 investigation), Germany, the UK.

quashed by national courts (Spain,<sup>433</sup> Denmark<sup>434</sup>). In particular, the *Electricas* case against practically *all* Spanish generators suggests that making improvements in the regulatory framework might be more effective in reducing the risk of market manipulation rather than launching ad-hoc antitrust investigations against individual generators, which, if successful, result in a serious regulatory intervention in form of price controls. However, correcting the market design requires legislative changes and might take some time. In the meantime, alternative enforcement tools are now provided under REMIT. Acting on market abuses prohibited by REMIT does not require an establishment of competition law infringement, that is, neither a dominant position nor an abuse needs to be proved.

In sum, given the deficiencies of the competition law framework in dealing with market manipulation and the possibility to prosecute these types of abuses under REMIT, NCAs/NRAs might soon move away from antitrust investigations towards these new enforcement tools. Introduction of TCLC in the UK, creation of the market transparency office within the German FCO, and the AGCM/AEEG cooperation protocol are indicative of this trend.

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<sup>433</sup> The TS found that there was no dominance, because the generators' behaviour was too sporadic and limited in time. The *Unión Fenosa* ruling suggests that generators with market power over very short periods of time (3 days) would not be considered dominant under Spanish competition rules.

<sup>434</sup> The Danish court did not approve behavioural remedies imposed in the 2005 *Elsam* case and removed the price cap.

## 4. MARKET INTEGRATION AND ECONOMIC EFFICIENCY AT CONFLICT? COMMITMENTS IN THE SWEDISH INTERCONNECTORS CASE<sup>435</sup>

**Co-authored with Bert Willems**

### 4.1. ABSTRACT

According to the European Commission, Svenska Kraftnät, the Swedish network operator, might have violated competition rules by limiting cross-border transmission capacity to relieve congestion within Sweden. Eventually, the case was settled under Article 9 and Svenska Kraftnät offered commitments to address the Commission's concerns. As an interim remedy, it committed to reduce transmission flow of electricity on internal network bottlenecks primarily by introducing national measures and by not reducing interconnection capacity. As a final remedy, Svenska Kraftnät agreed to split the Swedish market into multiple price zones. Congestion within Sweden would then be solved by adjusting the prices of those zones.

We analyse the economic effects of the alleged abuse and the remedy package. We make three observations. Firstly, it might be socially optimal to reduce cross-border capacity in response to internal congestion. Hence, without an in-depth economic analysis the Commission risked preventing efficient behaviour. Secondly, the interim remedy of handling internal congestion primarily by national measures is not socially optimal, and it cannot be ruled out that it reduces overall welfare. Thirdly, even though splitting the market into price zones may improve allocative efficiency within Sweden, it does not prevent Svenska Kraftnät from potential manipulation of cross-border transmission capacity.

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## 4.2. INTRODUCTION

Congestion often occurs in the Swedish electricity network. It is mainly caused by the lack of network capacity to transport cheap energy from hydropower plants in North Sweden to high consumption areas in South Sweden and, via the Øresund interconnector,<sup>436</sup> to Eastern Denmark.<sup>437</sup> Svenska Kraftnät (SvK), the Swedish electricity network operator, identifies several transmission bottlenecks in the Swedish grid, where demand for transmission capacity exceeds network capacity.<sup>438</sup> SvK used to solve this internal congestion by limiting export to the neighbouring countries, especially to Denmark on the Øresund interconnector. Export limits reduced demand for cheap hydropower from North Sweden and therefore relieved congestion in the Swedish grid.

We analyse a competition law case brought by the European Commission against SvK for a potential abuse of a dominant position on the electricity transmission market in Sweden (Article 102 TFEU).<sup>439</sup> According to the Commission, SvK might have violated competition rules by limiting cross-border transmission capacity in order to relieve internal congestion in the Swedish network. In other words, it ‘shifted’ congestion from the internal bottlenecks to the interconnectors. The case arose from a complaint filed by Dansk Energi (DaE), a trade association for Danish energy companies. DaE alleged that SvK’s recurring export limitations on the Øresund-

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<sup>436</sup> By ‘interconnector’ we mean a transmission line which crosses or spans a border between Member States and which connects the national transmission systems of the Member States, as set out in Article 2(1) of Regulation 714/2009, *supra* n. 91.

<sup>437</sup> Denmark is divided into two separate price areas (DK1 for Western Denmark and DK2 for Eastern Denmark) because there is no direct electric connection between the two country’s regions. Whenever we refer to Denmark in chapters 4-5, we mean Eastern Denmark only.

<sup>438</sup> There are four transmission bottlenecks in the Swedish grid, where demand for electricity transmission frequently exceeds the physical capacity of the network. Three of them (called ‘cuts’: cut 1, cut 2 and cut 4) occur due to the excessive flow of electricity from the North to the South of Sweden. The fourth bottleneck, the west-coast corridor, results from increased transport of electricity from Denmark and the rest of Europe to the western coast of Sweden and further up to Norway. On the characteristics of the Swedish electricity market see e.g. NordREG, *Congestion Management in the Nordic Region. A common regulatory opinion on congestion management*, Report 2/2007, pp. 16-18.

<sup>439</sup> Commission Decision of 14.04.2010 in case *Swedish Interconnectors* (Case COMP/39.351).

connection caused economic losses to Danish consumers.<sup>440</sup> Deprived of hydropower imports from Sweden, Denmark was forced to use its more expensive thermal power plants to meet its demand. Recourse to thermal generation resulted in higher day-ahead prices and price volatility. The Danish allegations were supported by an empirical study of Copenhagen Economics, estimating losses for Danish consumers from SvK's capacity shifting and the simultaneous gains for Swedish consumers, due to lower electricity day-ahead prices in Sweden.<sup>441</sup> DaE claimed that SvK's actions were detrimental to competition and trade within the internal market, and violated EU competition rules.<sup>442</sup>

In 2009, following negotiations with the Commission, SvK offered a set of commitments. Firstly, as an interim remedy, SvK committed to reduce congestion on internal bottlenecks primarily by counter-trading. This is a type of congestion management where the network operator makes deals with individual generators to eliminate congestion. It pays generators in export-constrained areas to reduce production, and pays generators in import-constrained areas to increase production. Secondly, SvK agreed to split the Swedish market into multiple price zones by November 2011, so-called market splitting.<sup>443</sup> Congestion between zones is now solved by adjusting zonal prices, affecting zonal supply and demand within Sweden,

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<sup>440</sup> DaE's complaint concerned only the Øresund interconnector. However, the Commission broadened the scope of its investigation, including all interconnectors managed by SvK. Commission Decision, *supra* n. 439, paras. 38-40.

<sup>441</sup> See Copenhagen Economics, *The economic consequences of capacity limitations on the Øresund connection*, Report commissioned by Energinet.dk (the Danish network operator), Copenhagen 2006. From 10.2000 till 06.2006, losses for consumers in East Denmark were estimated to be 725 million DKK (ca. 100 million EUR) and gains for consumers in Sweden between 215 and 265 million DKK (29 to 36 million EUR).

<sup>442</sup> DaE challenged the SvK's policy on several legal bases, namely the internal market rules on free movement of goods (Articles 34 and 35 TFEU), the provisions of the 2<sup>nd</sup> Energy Package (Regulation 1228/2003, *supra* n. 73, Directive 2003/54/EC, *supra* n. 73) and finally, also the EU competition rules (Article 102 TFEU). See Dansk Energi, *Complaint concerning Svenska Kraftnät's regulation of transmission capacity on 'Øresundsforbindelsen'*, Kromann Reumert, Document Ref. ERB/jol/169978/535450-5, 20.07.2006, available at [http://www.danskenergi.dk/Aktuelt/Indblik/Svenska\\_Kraftnaet.aspx](http://www.danskenergi.dk/Aktuelt/Indblik/Svenska_Kraftnaet.aspx) accessed 20.05.2013.

<sup>443</sup> According to the initial commitments offered to the Commission, the exact number of price zones and their configuration was supposed to be kept flexible, depending on the flow patterns in the Swedish electricity network. In the end, SvK decided to split the market into four price zones. Market splitting does not apply to the west-coast corridor, due to the lack of sufficient suitable generation resources for setting a separate market price in that area. For the same technical reasons counter-trading cannot be performed there. Instead, SvK undertook to reinforce the west-coast corridor by building and operating a new 400kV transmission line by the end of 11.2011. See Commission Decision, *supra* n. 439, par. 48.

and not by reducing interconnector capacities.<sup>444</sup> Market splitting has been used, for instance, in the Norwegian energy market.

We analyse the economic effects of SvK's behaviour, in the situation that existed before the investigation, and then in the context of the interim and final remedies respectively. These effects are illustrated on the basis of a simplified market model which represents the main features of the Swedish and the Danish electricity markets. We make three observations. Firstly, shifting some congestion to the borders might make economic sense. Without an in-depth economic analysis, the Commission risks going after socially optimal behaviour. Secondly, the interim remedy of solving internal congestion primarily by counter-trading, and not by shifting congestion to the border, is not socially optimal either, and it cannot be ruled out that it reduces overall welfare. Thirdly, even though market splitting may improve allocative efficiency within Sweden, it does not prevent potential manipulation of cross-border transmission capacity by SvK.

This chapter is written with a legal and policy audience in mind. It explains the main lessons of an economic analysis of the case to non-economists and lacks therefore some of the modelling rigor of a pure economic paper. We chose to present our results graphically, give numerical illustrations and limit the use of analytical expressions to situations where they could provide some additional insights. In chapter 5 we take a closer look at some of the legal aspects of this case.

## 4.3. MODEL

### 4.3.1. *Set-up*

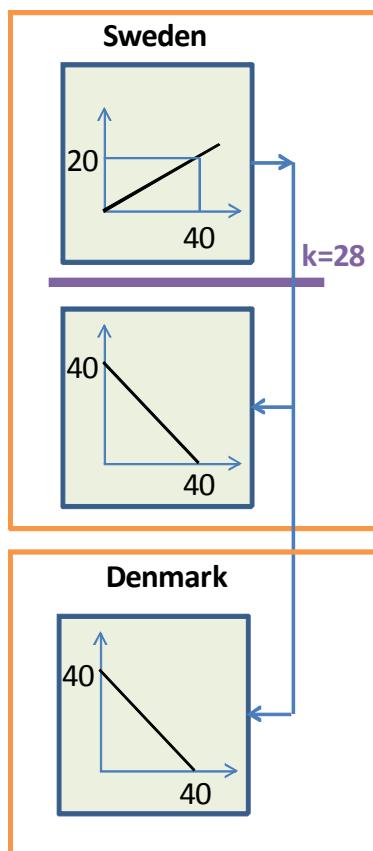
We use a simplified market model to illustrate the economic effects of congestion in the Swedish grid. See Figure 7. This model explains the main economic insights, but

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<sup>444</sup> In cases where internal congestion occurs within a price zone, SvK committed not to reduce capacity on the interconnectors but to carry out counter-trading within these zones to relieve it.

is not intended to reflect the market in detail.<sup>445</sup> The numbers were chosen for illustrative purpose. To ensure that calculations can be checked without relying on numerical simulations, this section provides some equations for readers that are familiar with economic models, although we hope that they are not necessary to understand the main arguments set forth in this chapter.

**Figure 7.** Set-up of the model.



Source: own illustration.<sup>446</sup>

Cheap hydroelectricity is produced in North Sweden and transported to South Sweden and further to Denmark via an interconnector, but transportation is limited by a transmission constraint within Sweden. North Sweden, South Sweden and Denmark are indicated with the letters  $N$ ,  $S$  and  $D$ . We assume that production cost in North

<sup>445</sup> The model has a simple radial network with one bottleneck, covering three regions. It neglects the fact that networks are meshed and that electricity flows distribute themselves on the network over multiple parallel paths depending on technical characteristics of the transmission lines (so called ‘loop flows’). We do not consider the effects on other neighbouring regions (e.g. Norway). Also, we do not investigate the case of several bottlenecks within Sweden.

<sup>446</sup> All figures and tables in chapter 4 are our own.

Sweden  $C_N(q)$  and the utility functions in South Sweden and Denmark,  $U_S(q)$  and  $U_D(q)$  can be represented by quadratic functions. The resulting competitive demand for energy in South Sweden and Denmark is represented by demand functions  $D_S(p)$  and  $D_D(p)$ , while supply in North Sweden is given by  $S_N(p)$ .<sup>447</sup> The physical transmission limit is  $k$ . Table 6 provides the data of our numerical illustration.<sup>448</sup>

Table 6. Data for the numerical illustration.

PARAMETERS	DESCRIPTION
$C_N(q) = \frac{q^2}{4}$	Total production cost in North Sweden (N)
$S_N(p) = 2p$	Supply in North Sweden (N)
$U_S(q) = U_D(q) = 40q - \frac{q^2}{2}$	Utility in South Sweden (S) and Denmark (D)
$D_S(p) = D_D(p) = 40 - p$	Demand in South Sweden (S) and Denmark (D)
$k = 28$	Physical transmission limit between North Sweden (N) and South Sweden (S)

#### 4.3.2. First-best

Before analysing any scenario, we use an efficient outcome as a benchmark. In order to find it, we maximise total surplus<sup>449</sup>, which is equal to the utility of South Swedish

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<sup>447</sup> The demand function in South Sweden and Denmark should be thought of as *net* demand, *i.e.* for a given price level how much would the region import to satisfy demand, given local production at that price level. Similarly, supply in North Sweden should be considered as *net* supply. Note that electricity producers and consumers are price takers, hence we assume that there is no market power in the generation market.

<sup>448</sup> The demand function and the utility function are linked such that  $D(p) = q \Leftrightarrow U(q) = p$ , in other words, the demand function is the inverse of the marginal utility function. Similarly, the supply function is the inverse of the marginal cost function.

<sup>449</sup> Total surplus is a measure of the society's economic well-being. It is equal to the amount consumer are willing to pay for electricity that they receive minus the total production cost for producing this electricity. It can also be expressed as the sum of consumer surplus, producer surplus, and TSO surplus. Consumer surplus is the amount a consumer is willing to pay for electricity minus the amount the consumer actually pays for it. Producer surplus is the amount a generator is paid for electricity minus his production costs. In other words, consumer surplus is a benefit that consumers receive from participating in the electricity market and producer surplus is a benefit that generators receive from selling their electricity. TSO surplus is equal to amount the TSO is paid for transporting electricity, as we assume in our model that there are no transportation costs in the short run. See also N.G. MANKIW, *Principles of Economics*, 2<sup>nd</sup> ed., South-Western College Publishing, Boston (MA) 2000, p. 152.

and Danish consumers minus the production cost of North Swedish producers, subject to the transmission constraint. Hence, the following optimisation problem has to be solved:

$$\begin{aligned} & \max_{q_S, q_D} U_S(q_S) + U_D(q_D) - C_N(q_S + q_D) \\ & \text{s.t.} \quad q_S + q_D \leq k \quad (l) \end{aligned}$$

The first order conditions of this optimisation problem are the following equalities:

$$U_S'(q) = U_D'(q) = C_N'(q) + l$$

with  $l$  being the Lagrange multiplier of the transmission constraints.<sup>450</sup> This equation shows that in order to achieve efficient allocation, the marginal utility of energy in South Sweden should be equal to the marginal utility in Denmark. As consumers in S and D have the same marginal utility for energy, reallocation of cheap energy from North Sweden between those two regions cannot improve total surplus. The allocation is thus Pareto optimal.<sup>451</sup> If cheap energy in the North is abundant and transmission capacity is relatively small, then the transmission constraint will be binding and the Lagrange multiplier will be positive:  $l > 0$ . The positive multiplier reflects the scarcity of transmission capacity, which makes the marginal utility of consumption in S and D larger than the marginal cost of production in N. If transmission capacity is abundant, and cheap production capacity is limited, then the Lagrange multiplier is zero, and the marginal utility in S and D should be equal to the marginal production cost in N.

With the parameters of our model (see Table 6), cheap energy in North Sweden is abundant, and the transmission line is used at full capacity to export cheap energy

<sup>450</sup> The first order conditions are a set of mathematically necessary conditions for an optimum. They roughly impose that around the optimum the objective function is flat. Lagrange multipliers are used to describe the first order conditions of maximum of a function subject to constraints. The Lagrange multiplier has an economic interpretation as it represents the marginal surplus that would be created by relaxing the constraint. It is therefore often also called the shadow price of a constraint.

<sup>451</sup> In a Pareto optimal allocation, no one can be made better off without making at least one individual worse off.

from North Sweden to South Sweden and Denmark, i.e.  $q_S + q_D = k = 28$ . This cheap energy should then be allocated efficiently between South Sweden and Denmark. This requires that  $U_S'(q_S) = 40 - q_S = U_D'(q_D) = 40 - q_D$ , which simplifies to  $q_S = q_D$ . This is intuitive. As consumers in S and D have the same utility function, they should both receive 50% of the energy which can be transported from the North. North Sweden exports 28 units, and South Sweden and Denmark each consume 14 units (Figure 8). Under the efficient allocation, the marginal utility for electricity in South Sweden and Denmark ( $U_S'(14) = U_D'(14)$ ) is 26 and the marginal cost of production in North Sweden  $C_N'(28)$  is 14. The difference between the marginal valuation for energy in S and D, and the marginal production cost in N, is the scarcity price of transmission, i.e. the Lagrange multiplier ( $\lambda = 26 - 14 = 12$ ).

Figure 8. First-best outcome: Marginal valuation and marginal costs are presented inside the squares. Each square represents a region. Energy flows are represented by arrows.

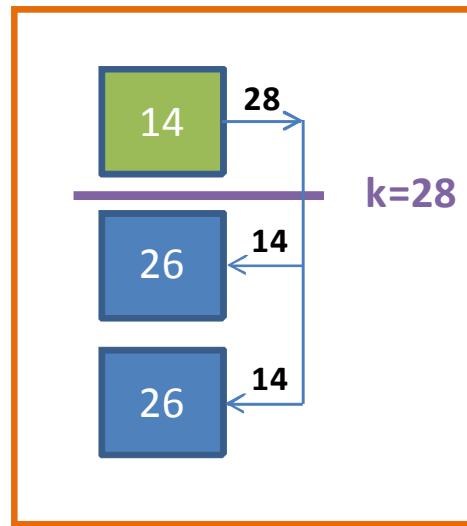
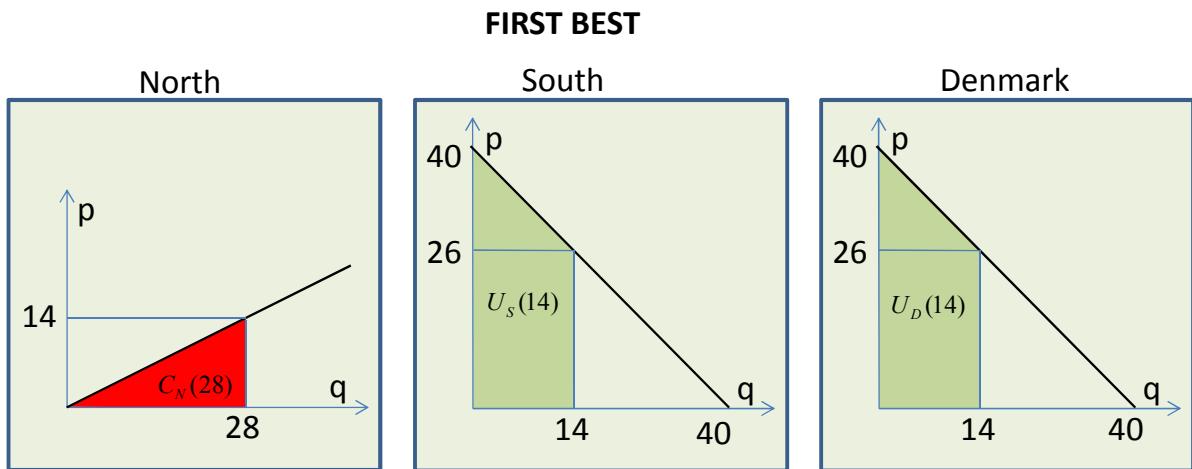


Figure 9 shows the total surplus obtained in the market in the first-best situation. Consumers in South Sweden and Denmark enjoy the benefit of consuming electricity, while there is a cost of producing electricity in North Sweden. Utility in South

Sweden is illustrated by the green area in the middle graph of Figure 9. This area is equal to  $U_s(14) = 462$ . Danish utility is identical (right graph). The red triangle shows production costs in North Sweden, which are equal to  $C_N(28) = 196$ . Total surplus in the first-best amounts to 728.

Note that in the first best outcome we determine a Pareto optimal *allocation* of transmission capacity and energy. We do not specify how the total surplus is divided between the different actors in the model, or the mechanism that was used to achieve this outcome. In particular we do not assume a specific pricing structure.

Figure 9. First-best: gross consumer surplus and production costs.



#### 4.3.3. Scenarios

SvK's key task as a Transmission System Operator (TSO) is the transmission of power on the national grid and to ensure that the system remains balanced, i.e. that electricity production and consumption for Sweden match at all times.<sup>452</sup> To avoid line overload, SvK needs to relieve congestion on bottlenecks. There are at least three methods of congestion management commonly used by network operators: 1) market

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<sup>452</sup> So called 'overall system reliability', *The Swedish Electricity Act*, SFS 1997:857, 20.11.1997, Article 8(1). See also <http://www.svk.se/Start/English/About-us/> accessed 20.05.2012.

splitting, 2) congestion shifting and 3) counter-trading.<sup>453</sup> These methods can, and in practice often are, combined.

First of all, in the day-ahead market,<sup>454</sup> a network operator can *split the market* into two different price areas with the bottleneck as a ‘border’ between them. Thus, the day-ahead price is set for each area separately, in order to influence demand and supply curves, and consequently ensure that transmission remains within the limits of the physical capability of the bottleneck. This price is higher than the system price<sup>455</sup> on one side of the bottleneck, in the import-constrained area (deficit area), and lower on the other side of the bottleneck, in the export-constrained area (surplus area). Thus, the flows of electricity between the two areas are adjusted. This market-clearing mechanism eliminates congestion.<sup>456</sup> Transmission of electricity from the surplus area to the deficit area generates extra revenue, equal to price difference between the two zones multiplied by the volume of electricity transmitted between these zones. This revenue, called congestion rents, goes to the network operator. Under the current EU regime, it can only be used for guaranteeing capacity, building infrastructure or lowering the network tariff.<sup>457</sup> When no congestion occurs between the two zones, they will have the same price<sup>458</sup> and no congestion rent arises.

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<sup>453</sup> Investment in the network (new transmission lines) would increase its physical transmission capability and hence, relieve congestion in the long run. In the short run, another method to deal with congestion is to perform an intended power outage in area of high consumption (rolling blackout or load shedding). Since this method leaves some customers without electricity, it should be considered a measure of last resort. In fact, TSOs allow for load shedding only in emergency situations to avoid total system blackout. See Nordic Competition Authorities, *Capacity for Competition. Investing for an Efficient Nordic Electricity Market*, Report 1/2007, pp. 35-37.

<sup>454</sup> Elspot, the main platform for trading electricity in the Nordic region, is organised as a day-ahead auction. Elspot is the market for electricity to be delivered the following day, or, to be more specific, the auction for electricity 24 hours in advance of actual delivery in a given time in any day. Power generators offer electricity on this auction based on their ability to produce energy for a specific period on the following day.

<sup>455</sup> The electricity reference price for all the Nordic region (the system price) is calculated based on all the supply and demand bids for electricity that will be delivered the following day disregarding transmission network constraints between or within the Nordic countries. If there is no congestion, electricity prices in all the Nordic countries equal the system price. If, however, congestion occurs on the network, the Nordic region subdivides into separate price areas (price zones), whereby some countries constitute one price area each and other countries (Denmark, Norway and from 11.2011 – also Sweden) are further subdivided into smaller price zones.

<sup>456</sup> Elspot market closes (in other words, ‘clears’) after all the day-ahead supply and demand bids have been collected and the system price (market-clearing price) is set at a level, at which quantity of electricity supplied equals the quantity of electricity demanded. Energy firms do not only trade in the centralised power market Elspot, but can also trade bilaterally within a price zone.

<sup>457</sup> As required by Article 16(6) of Regulation 714/2009, *supra* n. 91. This provision was already in force at the time of the case (see Article 6(6) of Regulation 1228/2003, *supra* n. 73) In line with this regulation, SvK,

Secondly, still in the day-ahead market, a network operator can *reduce trading capacities with other price zones; in our case with neighbouring countries*. By declaring lower cross-border capacities, it limits export out of the country and reduces demand for transmission capacity within the country. However, it creates congestion at the national borders. In other words, it ‘shifts’ internal congestion to interconnectors. Cross-border congestion splits the regional market into different price zones along national borders, but preserves a single price within a country. Given that the interconnector is now congested and the prices in the two interconnected countries differ, any cross-border transmission of electricity between these countries generates congestion rents as well. These cross-border congestion rents are shared between the network operators of the two interconnected countries.

Finally, a network operator can manage congestion by influencing production levels of market players on both sides of the bottleneck once the day-ahead market has closed, that is, *by counter-trading* in real-time.<sup>459</sup> This is done by, for instance, buying expensive electricity from generators on the deficit side of the bottleneck and selling it at a loss on the surplus side. The generators in the import-constrained area are thus paid to generate more than they initially committed to in the day-ahead market. On the other side of the bottleneck, in the export-constrained area, generators are paid to generate less. Therefore the generation system is re-dispatched, but the electricity price, at which consumers bought electricity in the day-ahead market, remains unchanged and is equal for *all customers* on both sides of the bottleneck.<sup>460</sup> Only the re-dispatched volumes are priced differently. As the TSO buys expensive energy and

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together with other Nordic TSOs, decided to use congestion rents for investments to strengthen the grid and interconnectors. This also refers to congestion rents collected from internal bottlenecks, once market splitting is implemented. See Energy Markets Inspectorate, *The Swedish electricity and natural gas markets 2010*, Report No. EI R2011:09, CM Gruppen, Bromma 2011, p. 20.

<sup>458</sup> It must be noted that ‘bidding zones’ is a more precise term than ‘price zones’, as sometimes prices are the same across all zones, even if market splitting is in place. Such situations occur when there is no congestion in the network. However, for simplicity, we use the term ‘price zone’ throughout this chapter.

<sup>459</sup> Electricity is mainly traded on the day-ahead market. However, in case imbalances occur after the day-ahead market clears, the TSO can buy or sell electricity in real-time, that is, close to delivery time, to bring the market back in balance. This is known as the regulating market, where the network operator collects upward and downward regulating bids from the balance providers (flexible generators). Since 1999 there is an additional market in Sweden (Elbas) which operates after day-ahead market.

<sup>460</sup> In practice, a very small number of large industrial consumers might also be able to reduce or increase demand in real-time. In that case, those consumers will also receive some extra revenue.

sells it cheaply, counter-trading is costly for the TSO. This cost is then passed on to the Swedish grid users through a higher transmission network tariff. Counter-trading creates extra revenue for generators. In surplus regions they get paid to produce less. In deficit areas they receive a higher price to produce additional amounts. The net effect is a transfer from consumers to generators. It must be noted that TSO not only incurs costs due to counter-trading, but also has no congestion rents, as neither the internal transmission lines nor the interconnectors are congested in the day-ahead market. In this chapter we look at four scenarios resulting from the SvK case. Each scenario involves an application of one or more of the above mentioned congestion management methods. First, we consider a scenario of counter-trading with full congestion shifting (1<sup>st</sup> scenario), which corresponds to SvK's alleged abuse. Then we turn to the analysis of commitments. In the context of the interim remedy, we compare two cases: counter-trading without congestion shifting (2<sup>nd</sup> scenario) and counter-trading with partial congestion shifting (3<sup>rd</sup> scenario). With regard to the final remedy, we study the impact of market splitting (4<sup>th</sup> scenario). The scenarios are summarised in Table 7. In the next section we present each scenario separately and explain how those scenarios are linked with the case. Each scenario makes particular assumptions about the behaviour of SvK, i.e. it specifies the actions SvK would take. We discuss whether such actions are consistent with the likely objectives of SvK in section 4.4.5, where we also talk about the regulatory context.

Table 7. Four scenarios.

	1. CT with full CS	2. CT without CS	3. CT with some CS	4. Market Splitting
Congestion management used within Sweden	CT is in place, but not used	CT is used	CT is used	market splitting
Available capacity between Sweden and Denmark in the day-ahead market	2 units	unlimited	14 units	unlimited
Link with the case	alleged abuse	interim remedy as implemented	optimal interim remedy	final remedy

Note: CT – counter-trading. CS – congestion shifting.

## 4.4. RESULTS

### 4.4.1. Counter-trading with full congestion shifting (alleged abuse)

Sweden used to be a single price area in the Nordic power market.<sup>461</sup> Since the country was not subdivided into separate price zones, SvK dealt with internal congestion using the two remaining congestion methods: 1) shifting congestion to the borders and 2) counter-trading. However, SvK relied mainly on the first method. Capacity limits for the Øresund interconnector were set both by SvK as well as the Danish network operator. If the numbers were different from each other, the lower capacity applied. Declared capacity limitations were made public before the day-ahead market closed. Where capacity reduction at the borders was insufficient to eliminate all internal congestion, SvK counter-traded in real-time between the southern areas of high energy consumption, and the northern areas with a surplus of generation.<sup>462</sup> SvK argued in the case that counter-trading should not be (and, in fact, was not) employed excessively, for the following reasons. Firstly, SvK claimed that it is not always technically feasible. It depends on the availability of suitable generating units in a given hour and in a given location.<sup>463</sup> <sup>464</sup> Secondly, according to SvK, counter-trading conceals locational signals from market players.<sup>465</sup> Lastly, SvK complained that the cost of counter-trading is borne only by the Swedish grid users

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<sup>461</sup> According to SvK, market splitting has not been yet introduced in Sweden due to the lack of sufficient liquidity and competition both in the day-ahead market as well as in intraday and balancing markets (real-time). See the explanations of SvK's Director General, Mikael Odenberg, to the Commission in a letter of 22.05.2008, *Case No 39351 – Øresund interconnector*, 356/2006/MA30, available at [http://www.svk.se/Global/02\\_Press\\_Info/Pdf/remissvar/080522\\_KOM.pdf](http://www.svk.se/Global/02_Press_Info/Pdf/remissvar/080522_KOM.pdf) accessed 20.05.2013. However, the introduction of market splitting has been much debated in the Swedish and in the Nordic market in the recent years and the Commission's antitrust intervention played an important role in this debate. We elaborate on this in chapter 5.

<sup>462</sup> Energy Markets Inspectorate, *The Swedish electricity and natural gas markets 2009*, Report No. EI R2010:12, Åtta45, Eskilstuna 2010, p. 14. See also Svenska Kraftnät, *Swedish Interconnectors – COMP CASE NO 39351: Background explanations submitted by Svenska Kraftnät regarding the offered commitments for this case*, 356/2006/MA30, 01.10.2009, available at [http://www.svk.se/Global/02\\_Press\\_Info/091001\\_Background\\_document.pdf](http://www.svk.se/Global/02_Press_Info/091001_Background_document.pdf) accessed 20.05.2013, p. 10, 12 and 24.

<sup>463</sup> Suitable generation units are referred to as regulating resources, which are generation units that can increase or decrease production or consumption of electricity at short notice, and which can therefore be used for regulation. See Svenska Kraftnät, *Background explanations*, supra n. 462, p. 5.

<sup>464</sup> Svenska Kraftnät, *Background explanations*, supra n. 462, p. 27.

<sup>465</sup> See letter of M. Odenberg, supra n. 461.

(via a higher network tariff), and not, for instance, Danish grid users, who also benefit from it.<sup>466</sup> <sup>467</sup>

However, faced with Swedish export restrictions, Denmark needed to increase its domestic production, having recourse to more expensive thermal generation. Therefore, SvK's actions may have contributed to higher and more volatile electricity prices in Denmark.

In this section we analyse congestion shifting, which is designed to relieve all internal congestion and to remove the need for counter-trading.<sup>468</sup> How would such a congestion shift affect prices, and total welfare, in our simplified model? In this scenario, illustrated by Figure 10, transmission capacity is fully used to transport cheap electricity from North Sweden,  $C_N(p) = k$ . North Sweden produces as much electricity as the physical transmission allows (28 units). At this production level, the price in North Sweden is 14 (see Figure 10). Since, in the final outcome, there must be a uniform price within the country, the price in South Sweden must also equal 14. At this price level, South Sweden imports  $D_S(14) = 26$  units from North Sweden.

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<sup>466</sup> See Svenska Kraftnät, *The Complaint from Dansk Energi regarding the effects on the Danish electricity market of Svenska Kraftnät's congestion management methods*, Document Ref. SvK200 v 1 0 2006-07-24, 13.11.2006.

[http://www.svk.se/global/01\\_om\\_oss/pdf/nattjanst/svar\\_danskarna2006.pdf](http://www.svk.se/global/01_om_oss/pdf/nattjanst/svar_danskarna2006.pdf) accessed 20.05.2013, pp. 8-9.

<sup>467</sup> We do not believe that giving locational signals is a clear argument in favour of congestion shifting in comparison with counter-trading. If the network operator counter-trades, some generators in South Sweden will be paid a high price to relieve congestion. This should give them an investment incentive. In case the network operator shifts congestion to the borders, those generators face a low and country-wide uniform price and will not invest in additional capacity. However, for North Sweden the results are opposite. In case of counter-trading, generators can benefit from high energy prices, even if transmission capacity is unavailable to transport energy. So we might see too many investments. In case of congestion shifting, prices will be lower in North Sweden.

<sup>468</sup> SvK claims to have carried out counter-trading to some extent. See Svenska Kraftnät, *Background explanations*, supra n. 462, p. 24. This is a common practice in the Nordic market. The Nordic network operators use counter-trading to handle temporary and non-structural bottlenecks within their price areas. Sweden experiences recurrent bottlenecks of a structural nature. In such cases, day-ahead methods like market splitting and congestion shifting often eliminate the need for counter-trading in real-time. See Nordic Competition Authorities, *Capacity for Competition*, supra n. 453, p. 35 and 37. Accordingly, the model does not take account of instances, where some counter-trading takes place. Rather it reflects an extreme case where the network operator shifts all congestion to the border and hence, no counter-trading needs to be carried out. This reflects also the Commission's preliminary assessment: Between 01.2002 and 04.2008, SvK used to relieve the congestion in the grid by reducing export capacity on several interconnectors, thereby reducing the cost of counter-trading and keeping low day-ahead prices in Sweden. The initial complaint of the DaE concerned only the Øresund interconnector. However, the Commission broadened the scope of its investigation, including all interconnectors managed by SvK. Commission Decision, supra n. 439, paras. 38-40.

This leaves only 2 units of transmission capacity that can be used for transporting cheap energy from North Sweden to Denmark ( $k - D_S(14) = 2$ ) Thus, the Swedish network operator declares that only 2 units of capacity are available at the border with Denmark. In the day-ahead market, Danish consumers import 2 units from Sweden, and the price in Denmark is 38 ( $D_D(2) = 38$ ). Given the production level in North Sweden (28 units), there is no congestion within the country, and the network operator does not need to counter-trade.

Figure 10. Counter-trading with full congestion shifting: regional prices, import and export quantities (left: day-ahead market, right: counter-trading).

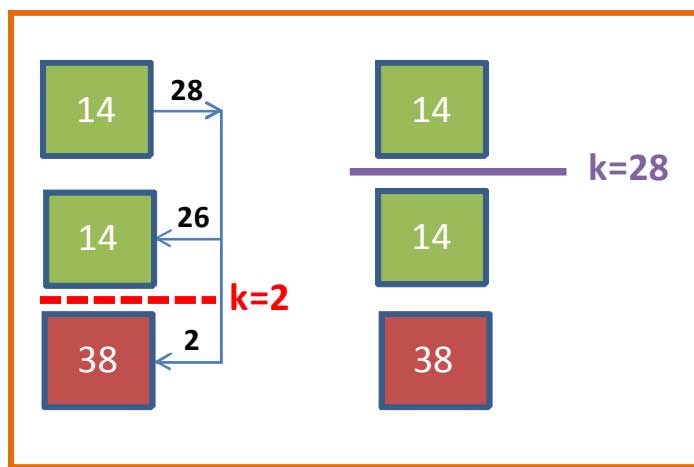


Figure 11 presents surpluses in each of the three regions.<sup>469</sup> These results are summarised in the first column of Table 8, which serves as a reference for all scenarios. The upper half of the table presents producer surplus in North Sweden, consumer surplus in South Sweden and Denmark, and the surplus of the network operator. Note that we only look at the effect of price levels on consumer surplus and producer surplus. Congestion shifting might affect price volatility, which, if firms are risk averse, will reduce overall welfare. As a matter of fact, Danish energy traders claimed to have incurred losses due to unexpected price swings, which increased the

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<sup>469</sup> Producer surplus in North Sweden is  $\frac{1}{2} \times 14 \times 28 = 196$ . Consumer surplus in South Sweden equals  $\frac{1}{2} \times 26 \times 26 = 338$  and in Denmark  $\frac{1}{2} \times 2 \times 2 = 2$ . The network operator receives congestion rents on the interconnector equal to the price difference times the quantity transported:  $(38 - 14) \times 2 = 48$ .

cost of insuring against price uncertainty.<sup>470</sup> This is neglected in our simple presentation. We only illustrate that, due to import restrictions, prices in Denmark are high, and consumer surplus is low. In addition, somewhat counter-intuitively, Danish energy producers also complained about congestion shifting, because the actions of the Swedish TSO decreased market transparency.<sup>471</sup>

In order to better understand the possible incentives of the actors, the second part of Table 8 presents total surplus of all Swedish network users (aggregated), consumer surplus of the Danes and the revenue of each network operator. We assume that cross-border congestion rents are shared equally between the Swedish and the Danish TSOs, while the congestion rents from the internal bottleneck go to the Swedish network operator only.<sup>472</sup> Similarly, the cost of counter-trading is allocated to the Swedish TSO. We neglect the fact that, in the long run, the Swedish network operator will pass on higher costs to the grid users by increasing transmission tariffs.

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<sup>470</sup> Copenhagen Economics estimates that the (within-day) volatility of prices in eastern Denmark has been 150% larger in congested hours compared to non-congested hours. See Copenhagen Economics, *supra* n. 441, pp. 55-61.

<sup>471</sup> One could rather expect that Danish energy producers benefit from the Swedish exports limits as they receive a higher day-ahead price for their electricity in Denmark. See DaE's complaint, *supra* n. 442, p. 1.

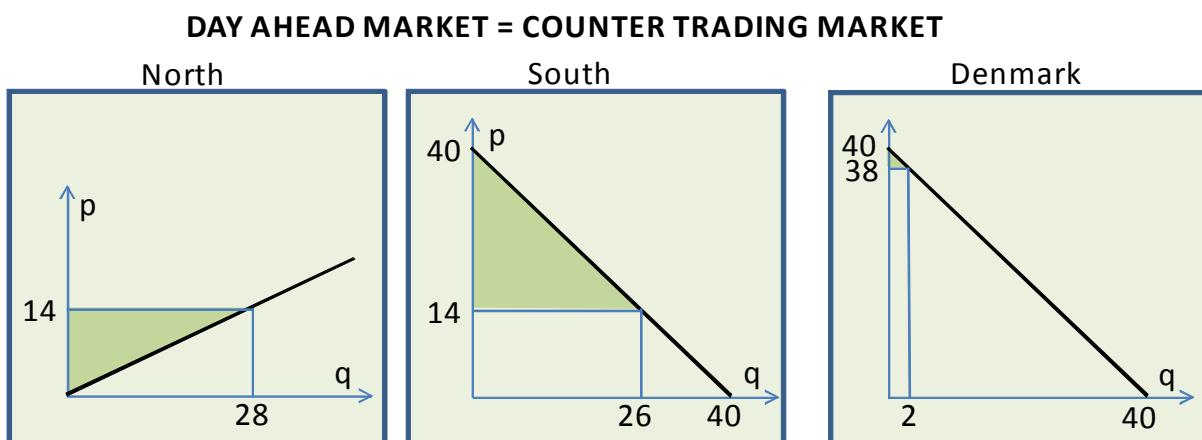
<sup>472</sup> In practice, Nord Pool Spot collects all congestion rents (also generated by the internal bottlenecks) and redistributes them among the TSOs. Under the new regime (in force since 2012) congestion rents from an interconnector are shared equally between the two TSOs affected, that is, co-owners of the interconnector. Congestion rents from internal bottlenecks in Norway and Sweden are paid to Statnett and SvK, respectively. The old rules on congestion rent-sharing were more complex, but in principle they do not go against our assumptions. According to a common agreement between the Nordic TSOs for years 2006-2011, the system of cost-sharing was based on two formulas. Under the first formula, bottleneck income was divided between all Nordic TSOs according to their expected investment costs related to five prioritised grid investments. Under the second formula, bottleneck income was shared equally between two affected TSOs. Both formulas were applied during the contract period, with a stepwise changeover from formula 1 to formula 2. More details can be found at <http://www.nordpoolspot.com> accessed 20.05.2013.

Table 8. Numerical results for 4 scenarios. Note that total surplus in first-best is 728.

	<b>1. CT with full CS</b>	<b>2. CT without CS</b>	<b>3. CT with some CS</b>	<b>4. MS</b>
PS North Sweden	196	436	340	196
CS South Sweden	338	272	274	98
CS Denmark	2	200	98	98
Revenue Swedish + Danish TSO	48	-216	16	336
<hr/>				
Sweden (CS + PS)	534	708	614	294
Swedish TSO	24	- 216	- 40	336
Sweden TOTAL	558	492	574	630
Denmark CS	2	200	98	98
Danish TSO	24	0	56	0
Denmark TOTAL	26	200	154	98
<hr/>				
<b>TOTAL SURPLUS</b>	<b>584</b>	<b>692</b>	<b>728</b>	<b>728</b>
TSO, consumers and producers				
<b>Efficiency?</b>	<i>Inefficient</i>	<i>Inefficient</i>	<i>Efficient</i>	<i>Efficient</i>

Note: CT – counter-trading; CS – consumer surplus; MS – market splitting; PS – producer surplus

Figure 11. Counter-trading with full congestion shifting: producer surplus and consumer surplus.



It becomes clear that this scenario is not optimal, once we juxtapose it with the first-best (compare Figure 8 with Figure 10, and Figure 9 with Figure 11). The level of total market surplus in the first-best scenario is equal to 728, while the surplus here is only 584. Even though the transmission line between North Sweden and South Sweden is used at full capacity, transferred electricity is not allocated efficiently

between South Sweden and Denmark. Congestion at the border with Denmark results in an inefficient use of resources, as Denmark has to use more expensive domestic generation to meet the country's electricity demand. Danish consumption is smaller than in the first-best scenario, and the electricity price in Denmark is high. Contrary to this, Swedish consumers benefit from a relatively low price. The Swedish network operator receives congestion rents at the border and does not have to counter-trade, which reduces its costs.<sup>473</sup> In the long run, Swedish grid users will pay a low network tariff. Nevertheless, the network is used inefficiently. The source of the inefficiency is that consumers in South Sweden do not internalise the negative consequences of reducing the available transmission capacity for Danish consumers, if they consume more. Hence, their consumption creates a negative externality.<sup>474</sup>

#### *4.4.2. Counter-trading without congestion shifting (the interim remedy as implemented)*

Since full congestion shifting resulted in an inefficient outcome, we will now consider the other extreme: counter-trading without congestion shifting. This scenario corresponds to the interim remedy offered by SvK to the Commission. Between April 2010 and November 2011, that is, in the period preceding the introduction of market splitting, SvK committed to reduce transmission flow on internal bottlenecks primarily by counter-trading, subject to availability of regulating resources.<sup>475</sup> In practice, in the day-ahead market, whenever SvK anticipated internal congestion in the grid, it was first supposed to calculate the corresponding amount for cross-border reduction necessary to relieve it. Then, instead of shifting congestion to the borders, SvK committed to counter-trade, using regulating resources located both in Sweden,

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<sup>473</sup> Note that congestion shifting gives considerable revenues also to the Danish network operator, as capacity at the border is relatively scarce.

<sup>474</sup> A negative externality is a negative side effect of the consumption of a product on a third party. Negative externalities are common in an environmental context (pollution). When economic agents do not take into account the negative externality of their consumption of a product, the level of consumption of this product will be larger than the social optimum. In order to achieve a socially efficient outcome, those agents need to internalise the externality, so that they take into account the effect of their actions on third parties. This could be done for instance by imposing a tax on the good ('the polluter pays principle') or by the creation of clear property rights.

<sup>475</sup> Note 463 above.

as well as in neighbouring countries. Cross-border capacity reduction was allowed only in case no suitable generation was available for counter-trading. In this section, we analyse the scenario in which there are sufficient regulating resources on the one hand and no congestion shifting on the other, as preferred by the Commission. In practice, however, these factors may not always be in place.<sup>476</sup>

Figure 12 depicts this scenario. In the day-ahead market there is only one clearing price for Sweden and Denmark, as there is no congestion in the network. As supply equals total demand,  $D_S(p) + D_D(p) = S(p)$ , the uniform day-ahead price is equal to 20.<sup>477</sup> South Sweden and Denmark each imports 20 units of energy, and North Sweden produces 40 units of energy. However, the transfer of 40 units to the southern areas is physically unfeasible, as total transmission capacity between North and South Sweden is only  $k = 28$  units. In order to deal with congestion, the network operator needs to rely on counter-trading in real-time. It buys 12 units of energy in South Sweden and sells it in North Sweden at a loss (Figure 12, right graph). The price of counter-traded energy in South Sweden will be higher as energy becomes scarcer, and lower in North Sweden as energy becomes more abundant.<sup>478</sup>

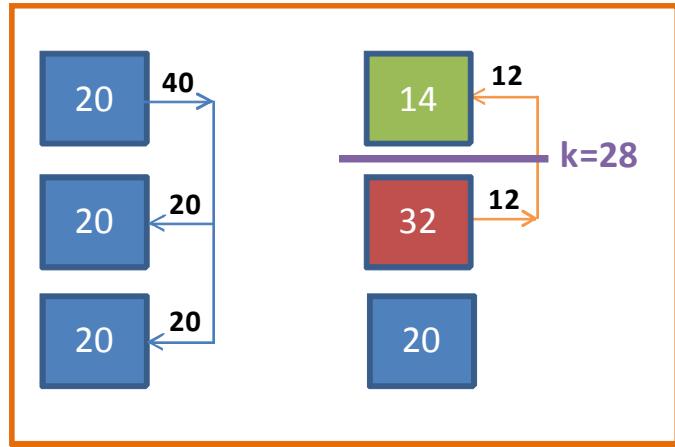
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<sup>476</sup> Even though SvK committed to deal with internal congestion primarily through counter-trading, it made a reservation that there may still remain an amount of reduction on interconnectors. See Commission Decision, *supra* n. 439, par. 49. The model, however, assumes that all internal congestion is relieved through counter-trading within Sweden and capacity reductions do not occur at the borders. In practice, throughout the interim phase, SvK did shift congestion to the borders, whereas counter-trading could not be carried out, most often due to unavailability of suitable regulating resources in a given area. See Svenska Kraftnät, *Swedish Interconnectors – COMP Case No 39.351, Monitoring Reports, 1-7, 2009/481*, available at <http://www.svk.se/Start/English/Energy-Market/Electricity/Bakgrund/> accessed 20.05.2013.

<sup>477</sup> For this discussion we assume that generators in South Sweden are myopic when they offer energy in the day-ahead market. They could realise that the value of energy in the counter-trading market is 32, and they should therefore be unwilling to sell their volumes in the day-ahead market at a price of 20. We also assume that generators in North Sweden do not behave strategically. They could pretend to have an even lower cost and produce more than 40 units, as in the counter-trading market they would be compensated for reducing their production.

<sup>478</sup> Note that demand function  $D_S(p)$  in South Sweden presents net demand, i.e. local demand minus local production at a certain price level. Hence, if the network operator buys energy in South Sweden, this could mean in practice that some consumers forgo consumption, or equivalently, that local production has increased.

Figure 12. Counter-trading without congestion shifting: regional prices, import and export quantities (left: day-ahead market, right: counter-trading).



In South Sweden demand needs to be reduced from 20 units to 8. In order to do so, the network operator offers a price  $p$  to all consumers who are willing to resell their energy. This price should be such that the marginal consumer is just willing to resell its energy, hence  $D_s(p) = 8$ , and the price  $p = 32$ . At this price, consumers sell 12 units of energy to the network operator. Those consumers, who bought energy at a price of 20 and then resell it to the network operator at a price of 32, make a resale profit which is indicated by the orange square in the bottom middle graph of Figure 13. After counter-trading has taken place, consumers in South Sweden with a valuation larger than 32 will consume 8 units. They bought this energy at a day-ahead price of 20, and their consumer surplus is indicated by the trapezoid in the blue dotted line.<sup>479</sup>

In North Sweden the network operator sells 12 units of energy at a price of 14. Instead of producing energy themselves, some generators shut down production and buy the energy from the TSO. In this way, they save on production costs. Those producers buy 12 units of energy from the network operator at a price of 14, but already have sold these units at a price of 20. Thus, they make a profit which is indicated by the orange

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<sup>479</sup> Total consumer surplus equals 272, and is the sum of resale profit ( $12 \times (32 - 20) = 144$ ) and net consumer surplus ( $\frac{1}{2} \times 8 \times 8 + 12 \times 8 = 128$ ).

rectangle in the bottom left graph of Figure 13. Total production in North Sweden is reduced to 28 units. Producers have sold this energy at a price of 20 in the day-ahead market. Their surplus from producing energy is equal to the surface of the trapezoid with the blue dotted line. Total producer surplus in North Sweden is the sum of production surplus and trading surplus.<sup>480</sup>

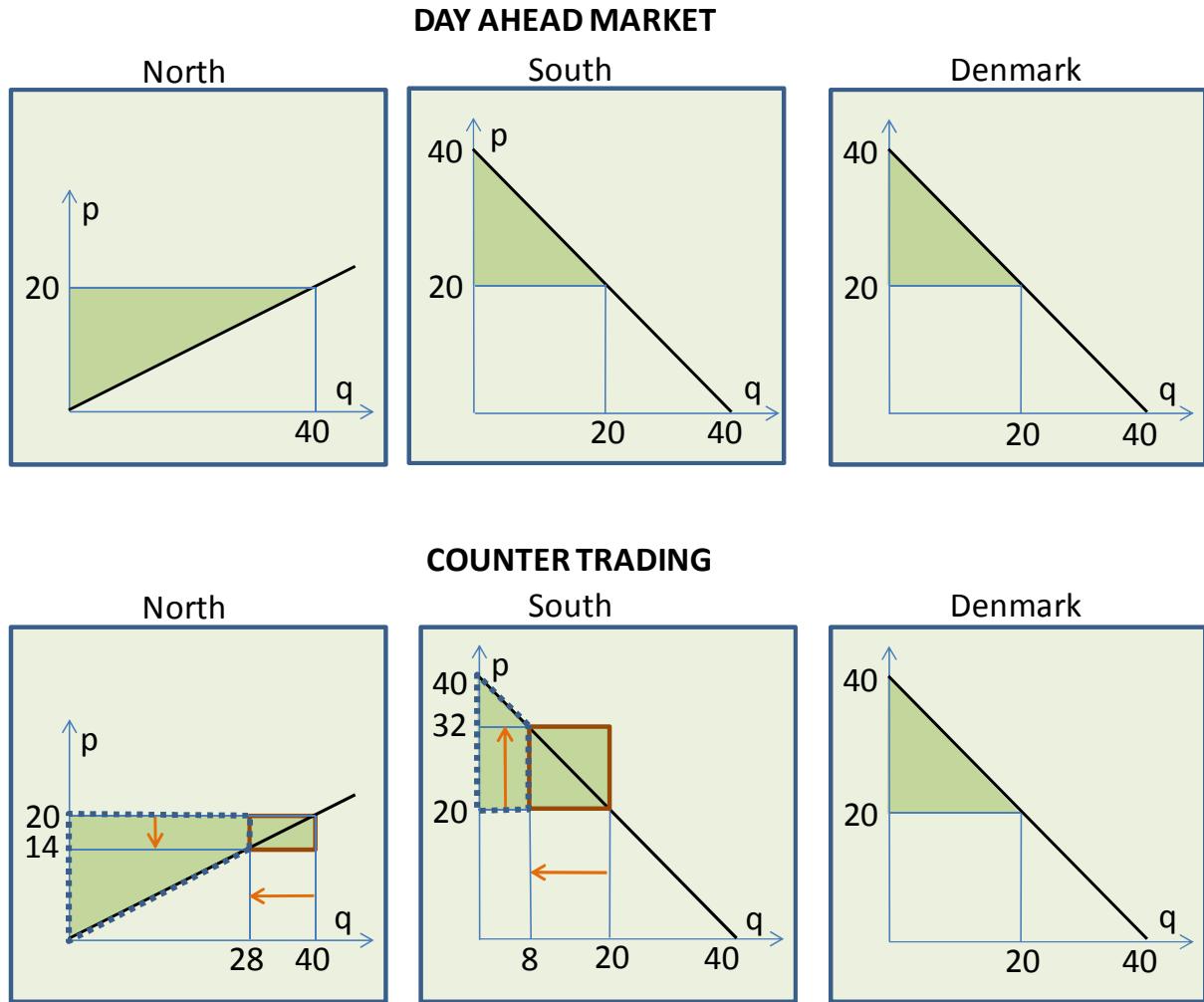
However, the network operator makes a loss, as it buys 12 units of energy in South Sweden at a price of 32 and sells them in North Sweden at a price of 14. On the top of that, it does not receive any rents from the cross-border trade with Denmark, since the interconnector is not congested. Consumer surplus of the Danes is not affected by the Swedish counter-trading and remains equal to the green triangle in the bottom right figure. The calculations for the second scenario are summed up in Table 8, second column.<sup>481</sup>

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<sup>480</sup> Total producers surplus (436) is the sum of trading surplus ( $12 \times (20 - 14) = 72$ ) and net producers surplus ( $\frac{1}{2} \times 14 \times 28 + 6 \times 28 = 364$ ).

<sup>481</sup> Danish consumer surplus is equal to  $\frac{1}{2} \times 20 \times 20 = 200$ , and the counter-trading losses for the network operator are equal to  $12 \times (32 - 14) = 216$ .

Figure 13. Counter-trading without congestion shifting: producer surplus and consumer surplus.



In this scenario, Danish consumers benefit from a low energy price (20). Also consumers in South Sweden can buy electricity at a relatively low price (20), and some of them are subsidised for reducing their consumption. Energy exporters in North Sweden receive a relatively high price (20) for their production, while some firms are subsidised in order not to produce. The network operator incurs a loss as counter-trading is costly. In practice, the losses of the network operator are passed on to network users through higher network tariffs. As we are unable to identify the incidence of this higher network tariffs, we assume that the cost of counter trading is borne by the network operator.

However, relieving internal congestion solely through counter-trading does not result in an efficient outcome. Even though the interconnector between Denmark and Sweden is not congested, the price in Denmark is lower than the counter-trading price in South Sweden. In our simple simulation exercise, the total market surplus under this scenario (692) is higher than in the case of full congestion shifting described above (584). But it does not necessarily mean that this will always be the case. Overall welfare may also be reduced.<sup>482</sup> The basic efficiency problem is the opposite of the previous scenario. If the network operator does not shift congestion to the border, Danish consumers will not internalise the fact that they create congestion within Sweden, and will therefore consume too much energy.

#### *4.4.3. Counter-trading with partial congestion shifting (the optimal interim remedy)*

Neither of the two extremes (congestion shifting vs. counter-trading) is socially optimal. However, these two congestion methods, once combined, may result in an efficient allocation. In this section, we present an optimal interim remedy that the Commission did not go for.

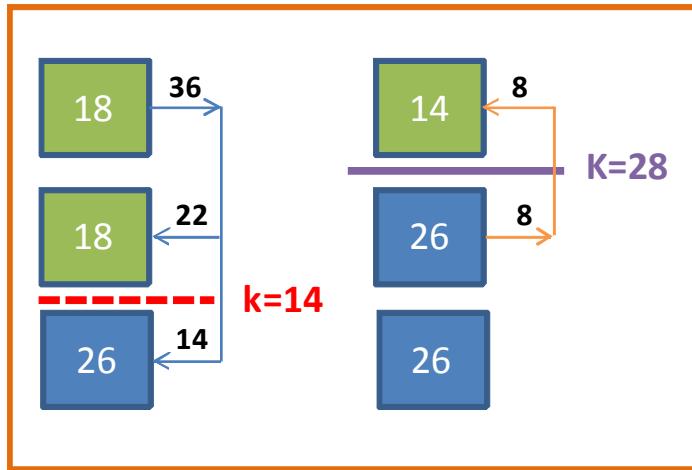
For the desirable outcome to take place, the Swedish network operator has to shift *some* internal congestion to the border with Denmark. As Figure 14 demonstrates, in the efficient scenario, the TSO declares that only 14 units of capacity are available at the border with Denmark, i.e. the same amount as Denmark would import in the first best scenario (Figure 8). Any other level of available capacity ( $k \neq 14$ ) would reduce total welfare. If the network operator declared a smaller capacity ( $k < 14$ ), the price in Denmark would be higher than the counter-trading price in South Sweden, which would be inefficient. If it declared more available capacities ( $k > 14$ ), then the price in Denmark would be lower than the counter-trading price in South Sweden, which would be inefficient as well.

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<sup>482</sup> This will vary depending on, for instance, the precise shape of the demand functions in South Sweden and Denmark, and the relative size of the markets.

Once the Swedish TSO declares  $k = 14$ , Denmark imports 14 units from Sweden, and the day-ahead price in Denmark is 26, as  $D_D(26) = 14$ . In the day-ahead market, it is assumed that there is no congestion within Sweden, and therefore there is a uniform energy price in Sweden. The day-ahead price is found by equaling supply and demand, while taking into account that demand by Danish consumers is equal to the available cross-border capacity  $S_N(p) = D_S(p) + 14$  (= Danish Demand). This results in a Swedish day-ahead price of  $p=18$ . With this price, total production in North Sweden is  $s(18)= 36$  and demand in South Sweden is  $D_S(18)= 22$ . See Figure 14, left graph.

Figure 14. Counter-trading with partial congestion shifting: regional prices, import and export quantities (left: day-ahead market, right: counter-trading).



South Sweden and Denmark together import 36 units from North Sweden, that is, 8 units above the transmission limit. In order to deal with this congestion, the network operator again resorts to counter-trading. It buys 8 units of energy in South Sweden and sells it in North Sweden at a loss (Figure 14, right graph). Counter-trading prices differ within Sweden: in the South they go up and in the North they go down. Some consumers in South Sweden, who bought energy at a price of 18 in the day-ahead market, agree to resell it at a price of 26 in counter-trading. They make a trading profit, equal to the orange rectangle in the bottom middle graph of Figure 15. The

surplus of consumers from consuming energy in South Sweden is equal to the trapezoid in the blue dotted line. Total consumer surplus is the sum of both areas.<sup>483</sup>

Some generators in North Sweden shut down their power plants and buy 8 units of electricity from the network operator at a price of 14. Since they have already sold these units at a day-ahead price of 18, they make a profit, indicated by an orange rectangle in the bottom left graph of Figure 15. The producer surplus from producing electricity in North Sweden is equal to the trapezoid in the blue dotted line. Total surplus is the sum of both areas.<sup>484</sup>

The network operator buys 8 units of energy in South Sweden at a price of 26 and sells them in North Sweden at a loss for a price of 14. However, it earns congestion rents in the day-ahead market from the cross-border trade with Denmark. It gets the price difference for each capacity unit that it exports. Counter-trading costs are born completely by the Swedish network operator, while the cross-border congestion revenues are shared equally between the Danish and the Swedish TSO. Consumer surplus in Denmark remains the same as in the day-ahead market, and is equal to the green rectangle in the bottom right figure.<sup>485</sup>

As the transmission line is used at full capacity and the South Swedish and Danish consumers consume identical amounts, this outcome is efficient. The total market surplus is therefore equal to the one in the first-best allocation. Table 8, third column, presents the results for this scenario.

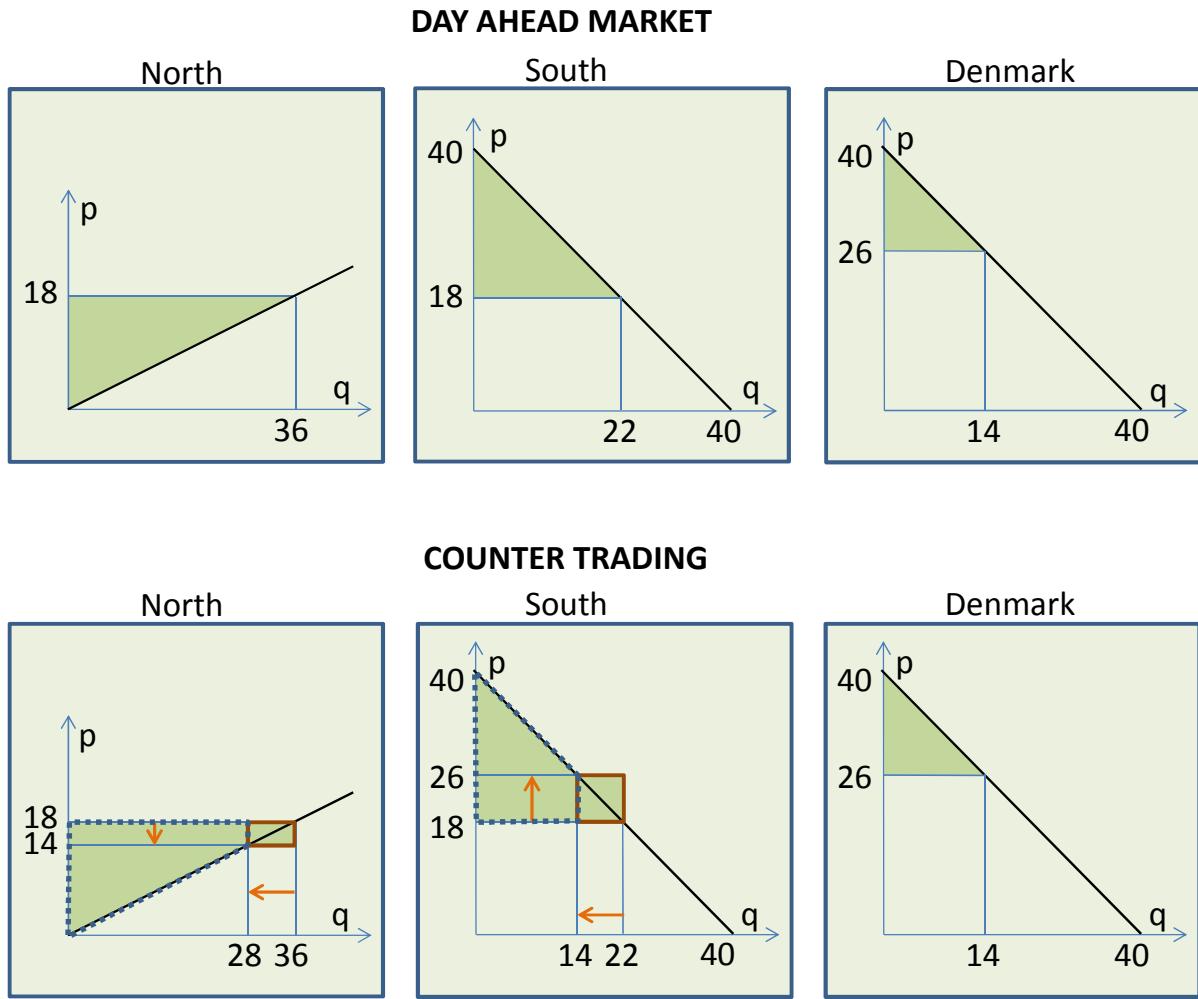
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<sup>483</sup> Total consumer surplus (274) is the sum of trading surplus ( $8 \times (26 - 18)$ ) and net consumer surplus ( $\frac{1}{2} \times 14 \times 14 + 8 \times 14$ ).

<sup>484</sup> Under the same assumptions. See note 477 above. Total surplus in North Sweden (340) is the sum of trading surplus ( $8 \times (18 - 14)$ ) and net producer surplus ( $\frac{1}{2} \times 14 \times 28 + 4 \times 28$ ).

<sup>485</sup> Overall, the network operator makes a surplus of 16, which is the sum of cross-border congestion rents ( $14 \times (26 - 18)$ ) minus counter-trading losses ( $12 \times (26 - 14)$ ). Danish consumer surplus is  $\frac{1}{2} \times 14 \times 14 = 98$ .

Figure 15. Counter-trading with partial congestion shifting: producer surplus and consumer surplus.



This result shows that a combination of congestion shifting and counter-trading does not necessarily lead to inefficient use of network resources. In order to obtain an efficient outcome, the Swedish network operator *has to* shift part of its internal congestion to the border with Denmark. By reducing available cross-border capacity, the Swedish TSO can ensure that the Danes internalise the cost of congestion they create inside Sweden. In order to know how much congestion the network operator should shift to the border to achieve the social optimum, it needs to invest in collecting information on the demand functions in South Sweden and in Denmark. The network operator should therefore only declare available capacity, once it has collected information about the demand levels in the market.

Note that the efficient outcome implies that Swedish and Danish consumers have non-discriminatory access to the transmission capacity. The counter-trading price in S is 26, which is equal to the day-ahead price in D. However, Swedish network users pay a price of 18 which is lower than the Danish price 26. This is the consequence of the Swedish policy of having a uniform price. Hence, this outcome might suggest discrimination between Danish and Swedish consumers. However, in order to achieve a uniform price, the Swedish network operator incurs counter-trading losses, which it recovers in the long run from the Swedish network users by charging them higher transmission tariffs. Hence overall, consumers in South Sweden are not necessarily better off than their Danish counterparts.

#### *4.4.4. Market splitting (final remedy)*

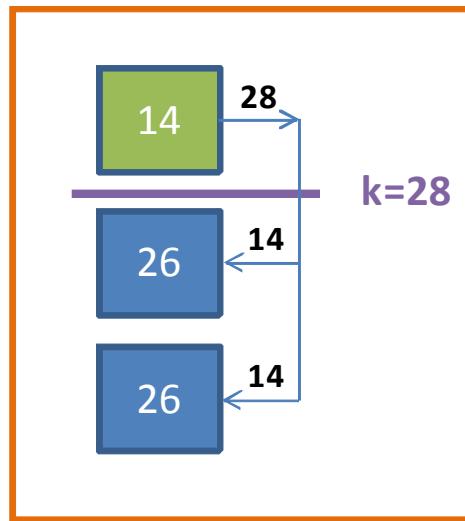
Our fourth and last scenario is market splitting, the final remedy accepted by the Commission in the SvK case. As a result of negotiations with the Commission, SvK agreed to subdivide the Swedish electricity market into several price zones, and to manage domestic congestion without limiting trading capacity on interconnectors. This new market system, according to which Sweden was split into four price areas, was introduced in November 2011.<sup>486</sup> In cases where internal congestion occurs within a price zone, SvK committed not to reduce capacity on the interconnectors, but to carry out counter-trading within these zones to relieve it.

Market splitting results in an efficient allocation, in the same way that the optimal combination of congestion shifting and counter-trading does. Whenever there is congestion on the line between North Sweden and South Sweden, the network operator splits the market into two price areas, as presented in Figure 16. As a result, there is a uniform price of 26 in South Sweden and Denmark, while the price in North Sweden is 14. North Sweden exports a surplus of 28 units, which is imported in South Sweden (14 units) and Denmark (14 units).

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<sup>486</sup> The four price areas from north to south are SE1 (Luleå), SE2 (Sundsvall), SE3 (Stockholm) and SE4 (Malmö).

Figure 16. Market splitting: regional prices, import and export quantities.

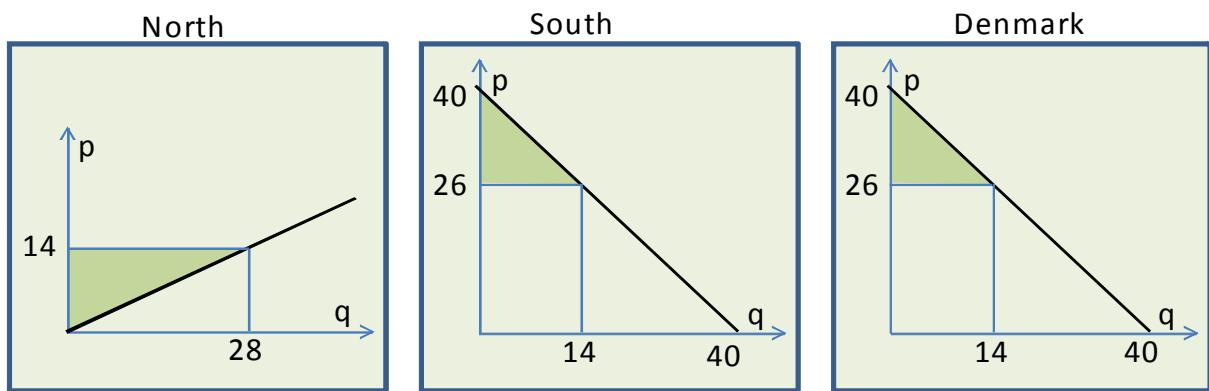


Producer surplus in North Sweden and consumer surplus in South Sweden and Denmark is given by green triangles in Figure 17. The network operator receives congestion rents on the transmission line equal to the price difference times the quantity transported. As those rents are internal to the Swedish network, they accrue fully to the Swedish network operator and not to the Danish one. The allocation of transmission capacity is efficient and total market surplus is equal to the first best outcome (728).<sup>487</sup> The last column in Table 8 shows these results.

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<sup>487</sup> The total market surplus (728) is the sum of producer surplus ( $\frac{1}{2} \times 14 \times 28$ ), South Swedish and Danish consumer surplus (both equal to  $\frac{1}{2} \times 14 \times 14$ ) and internal congestion revenue for the TSO ( $(26 - 14) \times 28$ ).

Figure 17. Market splitting: producer surplus and consumer surplus.



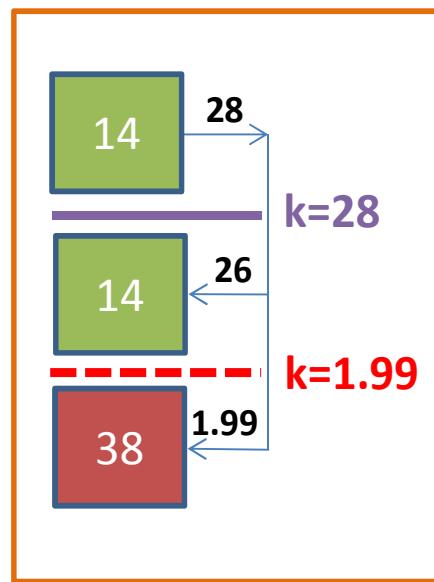
The Swedish TSO agreed to split the market into price zones, so that it no longer needs to reduce capacity on the interconnectors to other countries or any other line.<sup>488</sup> However, it may still do it, even if the new system of price zones is in place. In this section, we show that market splitting does not prevent the Swedish network operator from capacity manipulation at the border with Denmark. Figure 18 shows day-ahead prices in case the Swedish network operator sets available capacity at the interconnector with Denmark equal to 1.99.<sup>489</sup> In equilibrium,<sup>490</sup> congestion occurs only at the border with Denmark, and not on the transmission line between North and South Sweden. The price in South Sweden drops to 14 and evens up with the price in North Sweden. In turn, the price rises to 38 in Denmark. In this way, the Swedish network operator can achieve the same price levels as in our first ‘abusive’ scenario.

<sup>488</sup> Commission Decision, *supra* n. 439, paras. 79-80.

<sup>489</sup> If the network operator sets the quantity exactly equal to 2 units, then two constraints are binding at the same time: the internal constraint of 28 units and the cross-border constraint of 2 units. In that case, prices within Sweden are not uniquely defined. By setting a cross-border capacity just below 2 (in our example equal to 1.99), the network operator can guarantee that the internal constraint within Sweden is not binding, and that there is one unique price for Sweden.

<sup>490</sup> Market is in equilibrium, when supply of electricity equals the quantity demanded.

Figure 18. Market splitting with strategic congestion: regional prices, import and export quantities.



Splitting the Swedish market into separate price zones does not make it impossible for the Swedish network operator to manipulate the available cross-border capacity. Hence, a change in the market architecture alone is insufficient to prevent SvK from congestion shifting in the future. Monitoring of the Swedish TSO's behaviour remains necessary. But while separate price zones do not effectively prevent congestion shifting, they do improve market transparency, making it easier for the regulators and market participants to determine whether available capacity is set at the right level. In this way, congestion shifting can be easier to detect.

#### *4.4.5. Comparison of 4 scenarios*

Table 8 collects results from all the four scenarios, and enables a cross-scenario comparison of regional and total market surplus. Overall, scenarios 3 and 4 are efficient and therefore maximise total market surplus, while inefficient allocation of

network capacity in scenarios 1 and 2 leads to welfare losses and a reduction of total market surplus.<sup>491</sup>

Danish customers lose out on congestion shifting, because cross-border capacity reductions increase high-cost domestic energy production in Denmark, and lead to high day-ahead prices. This might explain why SvK's behaviour raised protests in Denmark. Danish consumer surplus is the highest when the interconnector is used to the largest extent, that is, when no congestion shifting takes place. Hence, the most advantageous scenario for Danish consumers is clearly full counter-trading. However, in situations where the interconnector is congested, the Danish TSO may earn some additional congestion rents. The current regulatory regime requires that these congestion rents are paid back, in the long run, to the network users through grid investments or lower transmission tariffs.<sup>492</sup>

Producers in North Sweden benefit from counter-trading. If the network operator does not shift congestion to the borders, some producers in North Sweden receive the highest price for their energy ( $p = 20$ ). In addition, other producers in North Sweden are subsidised for not producing (counter-trading). Consumers in South Sweden, on the other hand, benefit from congestion shifting to the Danish border, as this keeps their price low. Market splitting increases their price. Taken together, Swedish grid users are better off when SvK performs counter-trading (scenario 2, interim remedy as implemented) or a mix of counter-trading and congestion shifting (scenario 3, optimal interim remedy) rather than shifting all congestion to the borders (scenario 1, alleged abuse). If it was up to the Swedish grid users, market splitting would not be chosen in the short term. This might be reflected in their initial strong opposition against the

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<sup>491</sup> Counter-trading and market splitting might have different welfare aspects in a richer model than the one we use here. For example, it is well-known that counter-trading gives inefficient long-term signals for generation investment and can lead to strategic behaviour by generators. However, these long term issues and problems are not captured by our simple model.

<sup>492</sup> Note that we do not formally model how the costs and benefits of the TSO are allocated. In practice, the EU regulation forbids cross-border congestion rents to be transferred as dividend to shareholders. Congestion income can only be used for guaranteeing capacity, building infrastructure or lowering the network tariff. Supra n. 457.

introduction of price areas in Sweden.<sup>493</sup> However, once we compare total surpluses for Sweden in each scenario, it is clear that market splitting results in the highest market surplus, because it is efficient and keeps all congestion revenues within Sweden.<sup>494</sup>

In the long term, Swedish grid users pay not only direct energy and congestion costs through their transmission tariffs, but also the counter-trading costs that the TSO incurs. These tariffs are likely to be lower under market splitting as the TSO has an additional source of income, the congestion rents. Given current regulation, these rents will be used to improve the TSO's network operations, so that, ultimately, they will be returned to the network users.<sup>495</sup> Hence, in the long run, the Swedish grid users should prefer the scenario that gives the highest surplus to Sweden, which is market splitting, and not optimal congestion shifting. In the aggregate, patient forward-looking network users should not oppose market splitting.

The Swedish network operator's revenue is maximised under market splitting, as it receives congestion rents on the internal bottleneck.<sup>496</sup> If SvK shifts all internal congestion to the borders, it also receives some congestion revenues from the cross-border bottleneck. However, we assume that they are shared with the Danish TSO.<sup>497</sup> Further, due to low capacity of the cross-border interconnector (2 units are available on the market), these revenues are relatively small. On the plus side is the fact that SvK does not bear the cost of counter-trading. Thus, it appears that the Swedish network operator would clearly favour market splitting if its objective would be to maximise its own revenue. If market splitting would be impossible to implement, a profit-maximising network operator would prefer to shift all congestion to the border, as this reduces the cost of counter-trading.

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<sup>493</sup> See, for instance, Svenska Kraftnät, *Annual Report 2010*, Director General's Statement, p. 5. We discuss this at length in chapter 5.

<sup>494</sup> Under the current congestion rent-sharing regime. Supra n. 472.

<sup>495</sup> Supra n. 492.

<sup>496</sup> Supra section 4.4.4.

<sup>497</sup> Supra n. 472.

Having said that, we cannot just assume that SvK is merely trying to maximise its own profits and ignore the regulatory environment in which it operates. Looking at the regulation is necessary to understand SvK's incentives. It is a state-owned public utility that faces several complex incentive structures. As with all European TSOs, SvK is subject to economic regulation, which typically tries to align the TSO's incentives with the social optimum, i.e. to limit the network operator's profits, while simultaneously ensuring an efficient operation and investment in the network.<sup>498</sup> In order to prevent network operators from intentionally declaring low transmission capacities as a way to earn congestion rents, those rents are earmarked for grid reinforcement or to lower transmission tariffs and cannot be used to generate additional profits for shareholders.<sup>499</sup> Thus, there is no obvious direct link between SvK's profits and the amount of congestion in the network.

If the Swedish regulator was able to align SvK's incentives with total market surplus, then, according to our model, SvK would still opt for market splitting, just as if it was an unregulated profit-maximising firm. Market splitting leads to an efficient allocation of network capacities and maximises total surplus. It keeps congestion revenue in Sweden, and on top of that, it might also provide more detailed information as to where congestion occurs and how severe it is. With this information SvK could target and direct its investments more efficiently.

There might be many reasons, why SvK delayed the introduction of market splitting for such a long time. SvK's objectives are stipulated in the Instruction from the Swedish Government, the national regulation governing SvK.<sup>500</sup> One of those objectives is promotion of competition in the Swedish wholesale and retail electricity markets.<sup>501</sup> Maintaining one price in Sweden reflects this goal, as it simplifies life for

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<sup>498</sup> See, for instance, NordREG, *Regulation of the Nordic TSOs – with focus on Market Efficiency and Harmonisation*, Report 7/2007, pp. 13-14.

<sup>499</sup> Article 16(6) of Regulation 714/2009, *supra* n. 91.

<sup>500</sup> Government Ordinance with Instruction for Svenska Kraftnät 2007:1119 (*Förordning med instruktion för Affärsvetket svenska kraftnät*), 29.11.2007.

<sup>501</sup> In our model we assume that energy markets are perfectly competitive, that is, we do not take into account market power effects. However, we believe that obtaining a uniform price by means of, for instance, counter-trading will not always be pro-competitive. It leads to strategic bidding for counter-trading payments in export-

retail competitors. For instance, retailers can offer a single product to all Swedish consumers and they do not face the risk of regional price differences when they procure energy from producers. Moreover, SvK mentioned that there were serious concerns that the introduction of market splitting would have adverse effect on South Sweden, as it would create a sub-market with insufficient competition.<sup>502</sup> Lastly, as already mentioned, Swedish stakeholders, headed by the trade association Swedenergy, were initially rather skeptical towards market splitting. They might have influenced Swedish regulators and government agencies to keep the status quo, and as a regulated state-owned company, SvK might have been interested in pleasing its sole shareholder and regulator, the Swedish state.

There might be further reasons why SvK prefers to shift congestion to the borders, instead of counter-trading. The Instruction from the Swedish Government names cost-efficiency as one of the SvK's objectives, which suggests that SvK ought to avoid costly counter-trading as an option. Furthermore, the cost of counter-trading is passed on to the Swedish grid users through transmission tariffs.<sup>503</sup> By avoiding counter-trading SvK would keep these tariffs low for the Swedish consumers, which is an obvious preference of the Swedish government. Lastly, from the security of supply's perspective, congestion shifting might be seen as a safer method to deal with congestion than counter-trading. Congestion shifting reduces flows over the Swedish network in the day-ahead market, whereas counter-trading is carried out in real-time and relies on regulating resources, which are not always at hand. Thus, where these regulating resources are not sufficiently available, counter-trading raises the risk of black-outs.<sup>504</sup>

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constrained areas and higher day-ahead bids in import-constrained areas, as forward-looking firms take into account the opportunity cost of the counter-trading market. See also J. DIJK and B. WILLEMS, 'The effect of counter-trading on competition in electricity markets' (2011) 39 *Energy Policy* 3, 1764-1773. Obtaining a uniform price with congestion shifting might somewhat improve competition between North and South Sweden, but likely reduces competition between Sweden and Denmark. See also the recent report of Energy Markets Inspectorate, which finds no evidence that retail competition decreased in the first months after introducing market splitting in Sweden. See Energy Markets Inspectorate, *Elområden i Sverige. Analys av utvecklingen och konsekvenserna på marknaden*, Report No. EI R2012:06, CM Gruppen, Bromma 2012. In Swedish only.

<sup>502</sup> See Svenska Kraftnät, *The Complaint from Dansk Energi*, supra n. 466, p. 4.

<sup>503</sup> *The Swedish Electricity Act*, supra n. 452, stipulates that tariffs must be cost-reflective.

<sup>504</sup> We could also speculate about the objectives of managers at SvK. They could, for instance, try to maximise total European surplus, and would like to collaborate with their peers, the managers of TSOs. They might also

#### 4.5. CONCLUSIONS

We now contrast the results of our economic analysis with the Commission's anticompetitive concerns expressed in its antitrust investigation against SvK.<sup>505</sup>

According to the Commission, SvK's congestion shifting results in *de facto* discrimination between Swedish customers and foreign customers that import electricity from Sweden. Once congestion occurred in the Swedish grid, SvK discriminated between domestic and cross-border transmission services. In order to relieve internal bottlenecks, it first satisfied domestic demand and then reduced transmission of electricity intended for export.

In our view, the Commission's initial anticompetitive assessment, which points at discrimination between domestic and cross-border transmission services, goes in the right direction. Discrimination based on transmission services can be given a sound economic interpretation. Local trade (from North Sweden to South Sweden) and international trade (from North Sweden to Denmark) would be treated in a non-discriminatory manner if the price in Denmark and the counter-trading price in South Sweden were equal. This would lead to an efficient allocation of all transmission capacity. Note that the counter-trading price in South Sweden is typically higher than the price consumers pay in South Sweden. In order to determine whether discrimination took place, the Commission should study the prices that arose in the day-ahead market and in the counter-trading market. A correct focus on discrimination can thus improve social welfare. However, this economic interpretation is not taken by the Commission in its reasoning. Instead, the Commission notices price differences between Sweden and Denmark in the day-ahead market and argues that SvK's practices resulted in a segmentation of markets between Member States, with a lower electricity price in Sweden and a higher price abroad.<sup>506</sup> Against this backdrop, the

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want to maximise the turnover of the company, to receive a private benefit of managing larger projects and having better job opportunities in the future.

<sup>505</sup> Commission Decision, *supra* n. 439, para. 27 and paras. 42-44.

<sup>506</sup> Commission Decision, *supra* n. 439, para. 41.

Commission recalls the European Court of Justice's case law, according to which discrimination between the customers based on residence constitutes an abuse of a dominant position in violation of Article 102 TFEU.<sup>507</sup> It refers also to Article 18 TFEU, prohibiting discrimination on the basis of nationality. In other words, the Commission seems to define discrimination based on differences in day-ahead prices in Sweden and in Denmark. We show that under efficient congestion shifting (3<sup>rd</sup> scenario, optimal interim remedy, see Figure 14), energy prices for consumers in Sweden and Denmark will be different.<sup>508</sup> Hence, if the Commission's goal was economic efficiency, it should not define discrimination between domestic and cross-border transmission services based on differences in *day-ahead prices*, but should take both *day-ahead and counter-trading prices* into account.

In the commitment decision, the Commission does not directly mention economic efficiency as its objective, and relies mainly on market integration rhetoric. According to the Commission, SvK's behaviour thwarts the benefits of the single market in electricity, and goes against the objective of European integration.<sup>509</sup> Interestingly, the Commission even explicitly refers to Treaty provisions outside the area of competition policy, in particular the rules governing free movement of goods. It cites Article 35 TFEU, which forbids quantitative restrictions on exports and measures having equivalent effect.<sup>510</sup>

Invoking Article 35 TFEU seems to suggest that SvK's conduct is abusive just by the mere fact that restricts exports. Apparently, in the Commission's view, behaviour of a dominant undertaking impeding cross-border trade should be prohibited under Article 102 TFEU, just as state protectionist measures are prohibited under Article 35

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<sup>507</sup> Commission Decision, *supra* n. 439, at note 39. The European Courts apply Article 102 to discriminatory practices and the Commission invoked this line of cases to back the SvK decision. All these cases concern practices that are, in the first place, harmful to the internal market. Some legal scholars consider them a third category of Article 102 abuses, next to exploitative and anti-competitive abuses. See, for instance, R. WHISH (2005), *supra* n. 16, p. 195 and 679. A. JONES and B. SUFRIN, *supra* n. 61, p. 520.

<sup>508</sup> As we mentioned before, consumers in South Sweden might face higher network tariffs in the long-run to finance the implicit subsidy that is paid by the network operator while counter-trading.

<sup>509</sup> Commission Decision, *supra* n. 439, paras. 27 and 44.

<sup>510</sup> Commission Decision, *supra* n. 439, para. 43.

TFEU.<sup>511</sup> In this chapter we show that forbidding all congestion shifting can only be justified if the Commission's main objective is market integration, and not economic efficiency.<sup>512</sup> Efficiency requires that some cross-border capacity is reduced. To the contrary, the Commission's interpretation of discrimination, based on *electricity day-ahead prices* comparison, seems to imply that international consumers should get priority access to national bottlenecks as compared to national consumers. The Commission's approach seems to favour reverse discrimination, and may have a negative effect on competition in the internal market just as any other kind of discriminatory treatment.

The interim remedy accepted by the Commission, which requires SvK to solve internal bottleneck problems primarily by counter-trading and thus maximise utilisation of cross-border links, might have resulted from this flawed argumentation, according to which international (in this case Danish) consumers should obtain priority access to transmission on congested lines within Sweden. In the counter-trading scenario, which represents the implemented remedy, the Danes do not internalise congestion they create within Sweden, which leads to inefficiencies. The ill-designed interim remedy (from an economic efficiency viewpoint) might have been avoided, if the Commission formulated its anticompetitive concerns in the preliminary assessment in a different way. Congestion shifting as such should not constitute an alleged abuse in the SvK case. Rather, the fact that the amount of shifting was suboptimal should raise anticompetitive concerns. The Commission, by relying in its argumentation on internal market rules (Article 35 TFEU), created the false

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<sup>511</sup> Commission Decision, *supra* n. 439, para. 43: 'Moreover, Article 35 TFEU expressly prohibits quantitative restrictions on exports and all measures having equivalent effect. It is thus clear that a Member State would not be entitled to restrict exports of electricity so as to reserve such electricity for domestic consumption. Similarly, a dominant undertaking cannot seek to achieve the same objective through its conduct on the market without falling foul of Union competition rules. Practices that do so are generally considered to have as their object the restriction of competition.' Note that this prohibition is addressed to the Member States, not the individual undertakings. However, the Commission drew a parallel here in terms of objectives. That is, given that Member States are not allowed to restrict cross-border trade under Article 35 TFEU, also a dominant undertaking, which seeks to achieve the same objective through its market behaviour, should not escape competition rules. We discuss this point in more detail in chapter 5.

<sup>512</sup> It is not the first time in the history of the EU competition enforcement that the single market imperative takes precedence over efficiency considerations. M. MOTTA, *supra* n. 61, p. 23. R. WHISH (2005), *supra* n. 16, p. 21. G. MONTI (2007), *supra* n. 72, p. 40. J. BAQUERO CRUZ, *Between Competition and Free Movement. The Economic Constitutional Law of the European Community*, Hart Publishing, Oxford 2002, pp. 98-100.

impression that complete elimination of congestion shifting would be an efficient solution, because it would maximise cross-border flows and thus best serve the overriding goal of market integration.

However, the negative effect resulting from the imperfect interim remedy (efficiency loss) might not have been that substantial in the end. First of all, counter-trading has been applied only over a short period of time, between April 2010 and November 2011. Secondly, the interim remedy has not even achieved the Commission's goals. As SvK reported, this remedy turned out to be rather ineffective. At times when congestion occurred within the network and SvK tried to counter-trade according to the interim procedure, it either did not increase cross-border capacities,<sup>513</sup> or the increase was insignificant.<sup>514</sup> The most common reason for not performing counter-trading was the lack of suitable generation in a given area, that is, with short enough start-up times.<sup>515</sup> Note also that in our simulation the second scenario, representing the interim remedy as implemented, is more efficient than the first 'abusive' scenario, where all congestion is shifted to the border. Hence, our simulation model suggests that the interim remedy could have actually improved total surplus.

Our analysis shows that the final remedy, market splitting, is an optimal market design, as it can address internal congestion efficiently. Nevertheless, even though market splitting results in an efficient allocation of declared capacity, it does not address the anticompetitive concerns regarding SvK's (alleged) abuse. SvK can still manipulate declared cross-border capacities in order to maintain a single low price within Sweden. Further monitoring is necessary to ensure that cross-border capacity is not unduly limited.<sup>516</sup>

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<sup>513</sup> Svenska Kraftnät, *Monitoring Reports*, supra n. 476: Report No. 2 of 13.07.2010, pp. 18-22, Report No. 3 of 14.10.2011, pp. 19-22 and Report No. 6 of 14.07.2011, pp. 15-17.

<sup>514</sup> Svenska Kraftnät, *Monitoring Reports*, supra n. 476: Report No. 4 of 12.01.2011, pp. 19-21, Report No. 5 of 13.04.2011, pp. 17-21 and Report No. 7 of 12.10.2011, pp. 16-19.

<sup>515</sup> Usually area 4, south to CUT 4, where the congestion often occurred. See Reports No. 2, 3 and 6, supra n. 513.

<sup>516</sup> In the same line CONSENTEC and Frontier Economics, *Analysis of Cross-Border Congestion Management Methods for the EU Internal Electricity Market*, a study commissioned by the European Commission, Final Report, 2004, Executive Summary, p. 88.

We believe that our economic analysis is not only relevant for the Swedish interconnector case, but also for the ongoing discussion on the regulation of cross-border capacity allocation and congestion management (CACM).<sup>517</sup> Current regulations forbid congestion shifting unless it is justified for reasons of operational security, cost-effectiveness, and minimisation of negative impacts on the internal electricity market.<sup>518</sup> In practice, network operators are not transparent in how they determine cross-border transmission capacities, where they often implicitly give priority to national consumers<sup>519</sup>, and are likely to shift too much congestion to borders.<sup>520</sup> Our case study shows that some congestion shifting is efficient, and discusses exactly how much congestion should be shifted. Determination of optimal congestion shifting requires an economic analysis on top of a physical and engineering description of the electricity network.

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<sup>517</sup> Congestion Management Guidelines 770/2006/EC (CM Guidelines) appended to Regulation 714/2009, supra n. 91. See also ACER, *Framework Guidelines on Capacity Allocation and Congestion Management for Electricity* (CACM FG), FG-2011-E-002, 29.07.2011. On the basis of the CACM FG, the European Network for TSOs for Electricity (ENTSO-E) is currently developing the Network Code on Capacity Allocation and Congestion Management for Electricity (CACM network code), which then needs to be applied by the TSOs. The CACM network code is currently being revised by ACER.

<sup>518</sup> Point 1.7 of CM Guidelines, supra n. 517.

<sup>519</sup> See ERGEG, *Draft Framework Guidelines on Capacity Allocation and Congestion Management for Electricity. Initial Impact Assessment*, Ref:E10-ENM-20-04, 2010, p. 37. In practice, TSOs first determine the network flows nationally, using historical data and neglecting cross-border trade (base-line scenario). They then determine how much capacity is available on the network for cross-border trade. In this way, national transactions are given priority.

<sup>520</sup> Congestion shifting is still a common practice among TSOs in Europe. See ERGEG, *Draft Framework Guidelines*, supra n. 519, p. 35 and 42. Energy Markets Inspectorate, *Price Formation and Competition in the Swedish Electricity Market*, Main findings of ER 2006:13, EMIR 2006:02, non-authorised translation, Eskilstuna 2006, p. 15. G. SQUICCIARINI, G. CERVIGNI, D. PEREKHODTSEV and C. POLETTI, ‘The integration of the European electricity markets at a turning point: from the regional model to the Third Legislative Package’ (2010) European University Institute, RSCAS Working Paper 2010/56, p. 2.



## 5. POWER MARKETS SHAPED BY ANTITRUST<sup>521</sup>

Co-authored with Bert Willems

### 5.1. ABSTRACT

In November 2011 Sweden abolished the uniform national electricity price and introduced separate price zones. This was the result of an antitrust deal between the Commission and the Swedish network operator, which was accused of discriminating between domestic and export electricity transmission services and segmenting the internal market. Based on this case, we show how the Commission uses competition law enforcement to foster market integration in the energy sector. We find that, even though the Commission's action under competition rules was contrived and lacked economic depth, the commitment package provides an economically sound, long-term solution to network access and congestion management in Sweden. Such a quick and far-reaching change of Swedish congestion management could not have been achieved by Swedish policymakers or enforcement of the EU sector-specific regulation.

### 5.2. INTRODUCTION

Electricity transmission networks can transport only a certain volume of electricity within the system security limits. This is referred to as the transmission capacity of the network. In Sweden, the national power grid lacks capacity to transmit cheap hydro electricity from the northern part of Sweden to the southern areas where there is high energy usage. In order to keep electricity flows within the system security limits, Svenska Kraftnät (SvK), the Swedish network operator, needs to take actions to relieve congestion on the internal bottlenecks.<sup>522</sup> Congestion management can be

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<sup>522</sup> Supra n. 438.

defined as actions taken by a network operator to avoid or relieve transmission congestion. In November 2011, the Swedish electricity market was split into separate price areas, which is one of the possible actions to relieve congestion in the Swedish transmission network (so-called market splitting). Interestingly, in spite of an almost decade-long, multi-level debate on handling congestion in the Nordic market, the change in the Swedish market design came neither from the Swedish government, nor from the Swedish or Nordic regulatory bodies. Nor was it prompted by the EU regulations, promoting efficient and transparent congestion management. Instead, it was an outcome of an antitrust investigation launched by the European Commission (the Commission) against the Swedish network operator. Seen from this perspective, EU competition rules can be considered a complementary tool to achieve wider policy objectives,<sup>523</sup> in addition to political debate and regulation. In this chapter, we look at the consequences of using competition rules to solve the problem of the Swedish transmission congestion, and more broadly, to promote EU market integration, against the backdrop of other two tools – political debate and regulation.

First of all, we observe that the commitment procedure greatly facilitates the use of competition enforcement to achieve a primarily internal market objective, that is, to foster cross-border trade in electricity. However, in promoting inter-State trade at all costs, the Commission seems to lose sight of a wider economic and regulatory context of congestion management.

Secondly, this case not only intensifies the Nordic debate on market splitting, but also accelerates the introduction of price zones in Sweden. Lastly, the remedies offered by SvK go beyond what could have been achieved by merely applying the EU sector specific regulation. While existing EU law regulates cross-border congestion management, without prescribing any specific congestion management method to deal

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<sup>523</sup> EU competition policy is driven by many, sometimes clashing, objectives such as economic welfare, promoting market integration, economic freedom, fairness and other public policy considerations. For a comprehensive debate on the EU competition policy objectives, see e.g. M. MOTTA, *supra* n. 61, pp. 17-30. A. JONES and B. SUFRIN, *supra* n. 61, pp. 3-18. R. WHISH (2005), *supra* n. 16, pp. 17-23.

with internal congestion, the Commission, by means of competition enforcement, actually pushed through market splitting.

Overall, even though the Commission's action under competition rules is contrived and lacks economic depth, the final commitment to split the market into separate price zones provides an economically sound, long-run solution to Swedish congestion. We conclude that neither a political debate nor regulation would have changed the Swedish congestion management as quickly and to such an extent as an ad-hoc antitrust case.

The chapter is structured as follows. In section 5.3 we introduce the reader to the existing methods of congestion management. This is followed by a brief description of the main facts of the *SvK* case. Then, in section 5.4, we take a closer look at the antitrust investigation itself, particularly at the choice of the legal basis and the procedure. We explain how the Commission employs competition rules to promote market integration and what impact may it have on the outcome of the case. We turn to the other tools in section 5.5, where we discuss the Nordic debate on market splitting, and in section 5.6, we cover the EU sector-specific regulation of congestion management. Section 5.7 draws certain conclusions.

### 5.3. THE CASE AND ITS CONTEXT

Network operators handle transmission congestion on their national power grids generally in three ways, that is, by 1) market splitting, 2) congestion shifting and 3) counter-trading.<sup>524</sup> These three common congestion management methods can be combined.

Firstly, in the day-ahead market<sup>525</sup>, a network operator can *split the market* at the network bottleneck point and create one price zone (price area) on each side of the

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<sup>524</sup> Supra n. 453.

<sup>525</sup> Supra n. 454.

bottleneck. Once the day-ahead market closes, day-ahead prices differ in both areas.<sup>526</sup> The area of abundant electricity supply (surplus area) gets a lower electricity price than the area on the other side of the bottleneck (deficit area), where electricity is expensive. In this way, congestion between the two zones is resolved by adjusting zonal prices, influencing zonal supply and demand. Zonal day-ahead price differences vary over time, depending on the local electricity demand and supply conditions. At times without congestion, prices in both areas even up, so that there is only one common day-ahead price for all the market.<sup>527</sup> Until recently, only Italy, Denmark, Norway and the UK had multiple price zones to deal with national congestion.<sup>528</sup> Most European countries constitute single price areas, that is, the country's borders coincide with those of a price zone.<sup>529</sup>

Secondly, still in the day-ahead market, the network operator can *reduce trading capacities with neighbouring countries*. For instance, it can reduce export from a deficit area within a country, as this will reduce demand for transmission capacity on the national transmission network. In our case, reduced export of electricity from South Sweden to Denmark would relieve congestion on the internal bottlenecks within Sweden. This practice, however, creates congestion at interconnectors, that is, cross-border transmission lines.<sup>530</sup> In other words, the network operator “shifts” internal congestion to the borders (congestion shifting). This mechanism divides the market

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<sup>526</sup> Day-ahead market closes (or ‘clears’) after all the day-ahead supply and demand bids have been collected and a common day-ahead electricity price has been calculated for all the market on the basis of all supply and demand bids. This price is called market-clearing price (or ‘system price’). If, due to congestion, market is split into price zones, market-clearing price is set for each zone separately, based on the supply and demand bids in that zone only.

<sup>527</sup> Note that two adjacent price zones might have identical prices if the line connecting the zones is not congested. Therefore, price zones are sometimes also called ‘bidding zones’ which reflects more accurately the situation where prices are equal.

<sup>528</sup> Denmark has 2 price areas since there is no direct electricity connection between Denmark West and Denmark East. Norway splits into 2 to 4 price areas, depending on the need. Italian day-ahead market is zonal too, structured in 22 zones. However, while generators are paid at zonal prices, final consumers still face a single electricity price, which is an average of all zonal sale prices weighted by the zonal consumptions (so-called ‘prezzo unico nazionale’, PUN). As of November 2011, Sweden has introduced four price zones as a result of the Swedish Interconnectors case.

<sup>529</sup> There are 3 cases where price zones extend across national borders: Germany forms one price zone together with Austria, the Czech Republic with Slovakia, and the whole island of Ireland also forms one price zone.

<sup>530</sup> Supra n. 436.

into separate price zones along national borders in order to maintain a single price within a country.

Thirdly, this time in real-time,<sup>531</sup> the network operator can affect production and consumption patterns of market participants on both sides of the congested line by taking actions on the so-called balancing market, that is, by *counter-trading*. It makes deals with individual generators and large energy consumers. For instance, it pays generators on the surplus side of the bottleneck to reduce their production. At the same time, generators on the other side of the bottleneck, in the deficit area, are paid to generate more. Alternatively, the network operator can also pay industry consumers to change their consumption patterns. The generation system is re-dispatched<sup>532</sup>, but the electricity price that consumers face does not change. They pay a uniform price within a country, no matter on which side of the bottleneck they consume electricity. Prices are only different for the counter-traded volumes. The cost of re-dispatching is born by the TSO. In Sweden, it is then passed on to the grid users through the transmission network tariff.

From the early days of the Swedish electricity market liberalisation in 1996, keeping one single electricity price within the country was seen as a tool to promote (national) competition and market liquidity.<sup>533</sup> The single price policy excluded market splitting as a method of congestion management. Instead, SvK used to solve internal congestion using the two remaining methods, whereby it mainly shifted congestion to the borders and resorted to counter-trading sporadically, only if congestion shifting alone was not sufficient to relieve internal bottlenecks.<sup>534</sup> SvK's congestion

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<sup>531</sup> Most electricity in the Nordic region is traded on the day-ahead market. However, in case imbalances occur after the day-ahead market closes, the TSO can buy or sell electricity in real-time, that is, close to delivery time, to bring the market back in balance. This is called regulating market, where TSO collects upward and downward regulating bids from the balance providers (flexible generators). Since 1999 there is an additional market in Sweden (Elbas) which operates after day-ahead market.

<sup>532</sup> The dispatch is a set of start-up, shutdown and production decisions of all individual generating plants in order to meet total demand. The dispatch is submitted to the network operator after the closure of the day-ahead market. When the production decisions are changed in real-time, then the system is re-dispatched.

<sup>533</sup> See section 5.4.4.3 below.

<sup>534</sup> According to SvK, counter-trading could not be relied upon all the time, as it required flexibility in generation and some areas lacked such suitable power plants to adjust production levels at a later stage. On the top of that, the Swedish TSO argued that counter-trading was not a suitable method to deal with congestion

management based on recurring export reductions triggered protests in the neighbouring countries, in particular in Denmark.<sup>535</sup> In 2006, Dansk Energi (DaE), a trade association for Danish energy companies, filed a complaint to the Commission, claiming that SvK's capacity reductions at the Øresund interconnector, the line between Sweden and Denmark, caused economic losses to Danish consumers. SvK restricted export of cheap hydro power and Denmark needed to dispatch its own more expensive thermal generation units instead. Electricity day-ahead prices in Denmark increased and became more volatile. In support of its case, the trade association cited an empirical study of Copenhagen Economics. The consultants estimated the loss for the Danes from SvK's cross-border capacity reductions and gains for the Swedes resulting from the lower domestic prices.<sup>536</sup> According to DaE, the Swedish congestion shifting was detrimental to competition and trade within the internal market and violated EU competition rules.<sup>537</sup> The complaint was backed by EBL, the Norwegian Electricity Industry Association, due to effects of SvK's likewise reduction of interconnector capacity at the Swedish-Norwegian border.

In April 2009, the Commission opened proceedings against SvK for an abuse of a dominant position on the electricity transmission market in Sweden (Article 102 TFEU).<sup>538</sup> According to the Commission, SvK might have violated competition rules by limiting cross-border transmission capacity in order to relieve internal congestion

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because its cost was borne by the Swedish grid users, and not by those who benefit from counter-trading, for instance Denmark. For these reasons, counter-trading was considered a complementary method in the Swedish congestion management. SvK used it merely to correct the flow of electricity, so that it does not exceed security limits, rather than to deal with internal congestion (for instance, when there was still some internal congestion which could not be entirely relieved by capacity reductions at the borders or, in case of unexpected outages or forecast errors, to guarantee capacities declared before the market clearing). Svenska Kraftnät, *Background explanations*, supra n. 462, p. 24 and 27. See also Energy Markets Inspectorate (2010), supra n. 462, p. 14, and Energy Markets Inspectorate (2011), supra n. 457, p. 18.

<sup>535</sup> Complaints came also from Norway. See the letter from the Norwegian Electricity Industry Association to the Commission of 27.10.2006, *Congestion management – Dansk Energi's complaint regarding Swedish TSO practice*, Document Ref. 05/078, 742/HOW/SL.

<sup>536</sup> According to their estimations, Danish consumers suffered a loss of DKK 725 million (EUR 97.3 million) arising from higher spot prices (the cost of price volatility has not been quantified). The gain (avoided costs) passed on to Swedish consumers was DKK 215-265 million (EUR 29-35 million). See Copenhagen Economics, supra n. 441.

<sup>537</sup> Supra n. 442.

<sup>538</sup> *Swedish Interconnectors* (Case COMP/39.351). See Commission Decision, supra n. 439.

in the Swedish network.<sup>539</sup> A few months later in September, as a result of negotiations with the Commission, SvK voluntarily offered a set of commitments. Most importantly, SvK agreed to split the Swedish market into four price zones by November 2011.<sup>540</sup> SvK committed to solve internal congestion by adjusting zonal prices, affecting zonal supply and demand within Sweden, and not by shifting congestion to the borders. In cases, where internal congestion occurs within a price zone, SvK offered not to reduce capacity on the interconnectors, but carry out counter-trading within these zones to relieve it. Secondly, as an interim remedy, before the system of separate price areas becomes operative (within 18 months), SvK agreed to reduce the transmission flow on internal bottlenecks primarily by counter-trading, and not, as far as possible, by shifting it to the national borders.<sup>541</sup>

#### 5.4. INTERNAL MARKET OBJECTIVE REACHED WITH COMPETITION POLICY

In this section we argue that the *SvK* case is marked with two conflicting goals of EU competition policy: promotion of market integration (which we label “internal market objective”) and improving economic welfare (the “market efficiency objective”).<sup>542</sup> On the one hand, the market integration objective implies that any obstacle to cross-border trade should be removed. On the other hand, the market efficiency objective requires that congestion should be solved efficiently, so that it does not deteriorate economic welfare. This means that cross-border trade should be increased only if social benefits of such a policy outweigh social costs.

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<sup>539</sup> DaE’s complaint concerned only the Øresund interconnector. However, the Commission broadened the scope of its investigation, including all interconnectors managed by SvK. Commission Decision, *supra* n. 439, paras. 38-40.

<sup>540</sup> Initially, it was agreed with the Commission that the exact number of price zones and their configuration was flexible, depending on the flow patterns in the Swedish electricity network. SvK decided to introduce four new zones.

<sup>541</sup> Market splitting does not apply to the west-coast corridor, due to the lack of sufficient suitable generation resources for setting a market price in that area. For the same technical reasons counter-trading cannot be performed there. Instead, SvK undertook to reinforce the west-coast corridor by building and operating a new 400kV transmission line by the end of 11.2011. See Commission Decision, *supra* n. 439, para. 48.

<sup>542</sup> We would not like to enter into a discussion of the possible goals of the EU competition policy, nor subscribe to any of them. See *supra* n. 523.

In our view, the Commission does not distinguish between these two conflicting goals in the *SvK* case. Its arguments are mainly based on internal market rhetoric and neglect a substantial economic analysis. The focus on the internal market objective rules out, from the outset, any possible objective justification of *SvK*'s approach to congestion management before the Commission's investigation. We deal with these issues in detail in sections 5.4.3 and 5.4.4 and follow up with a discussion on proportionality of *SvK*'s commitments in section 5.4.5. However, before doing this, we make the reader familiar with the political climate and legal concerns, which the Commission might have faced when launching this case (5.4.1), and the specific procedure it opted for (5.4.2).

#### *5.4.1. Political climate and legal concerns likely delayed the case*

The Commission opened antitrust proceedings against *SvK* almost three years after the Danish complaint. This might reflect the initial reluctance of the Commission's Directorate-General for Competition (DG COMP) to take up this case.<sup>543</sup> We can only speculate on the political and legal reasons for this delay.

##### 5.4.1.1. Political climate

One of the main objectives of the Commission in 2006-2008 was to push for further unbundling of the transmission network operators. This was a core element of the Commission's legislative proposal for internal gas and electricity markets (the 3<sup>rd</sup> Energy Package).<sup>544</sup> The Commission argued that a complete separation of transmission business would eliminate all anticompetitive concerns regarding the

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<sup>543</sup> DaE submitted its complaint on *SvK*'s congestion management in July 2006. A competition case was opened in April 2009. The Commission's inaction is not unusual but it stands in stark contrast to the principle of good administration. According to the case law, the Commission must adopt a decision regarding the action it intends to take within a reasonable time (Judgment of the Court of 18.03.1997 in case C-282/95 P, *Guérin Automobiles v. Commission* [1997] ECR I-1503, para. 37). For instance, an indicative time limit for informing the complaint of the Commission's proposed action is four months. See Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty, 27.04.2004, OJ C101/65, paras. 60-63.

<sup>544</sup> Supra, section 1.2.3.3. The package consists of two Directives and three Regulations. Electricity markets are regulated by Directive 2009/72/EC, supra n. 90, and Regulation 714/2009, supra n. 91. Corresponding acts have been adopted with regard to gas markets. In addition, the Package includes Regulation 713/2009, supra n. 92, establishing ACER. The package was adopted in July 2009 and is applicable since 2011.

transmission segment. In line with the Commission's unbundling policy, DG COMP mostly took on cases against vertically integrated companies, which owned both transmission and supply businesses.<sup>545</sup> Launching a competition case against SvK, an already unbundled network operator, would not necessarily be consistent with the Commission's rhetoric set out during the adoption of the 3<sup>rd</sup> Energy Package. Once the 3<sup>rd</sup> Package was adopted in spring 2009, the Commission immediately went ahead to open formal proceedings against SvK.<sup>546</sup> In fact, the Commission clearly saw an opportunity in the case to send a clear message to newly unbundled network operators to respect common market goals when managing congestion on their national grids.<sup>547</sup>

Moreover, there might have been concerns that this case would bring competition law into the realm of energy policy and sector-specific regulation, since SvK is a state-owned and regulated public utility. This might have signalled a substantial erosion of the competencies of the Swedish state. However, if such concerns ever did exist, then they lost importance in 2008, when the European Courts ruled in two important Article 102 cases. Both cases concerned regulated sectors, telecommunications and pharmaceuticals. In the first case, the General Court upheld a fine imposed by the Commission on Deutsche Telekom (DT) for margin squeeze. The German case was widely contested because the Commission intervened under competition rules even though the DT's pricing policy was permitted by the national regulator.<sup>548</sup> The second

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<sup>545</sup> See cases *German electricity balancing market* (Case COMP/39.389), *RWE gas foreclosure* (Case COMP/39.402), *GDF Suez gas foreclosure* (Case COMP/39.316), *E.ON gas foreclosure* (Case COMP/39.317) and *ENI* (Case COMP/39.315). See also A. DE HAUTECLOCQUE, F. MARTY and J. PILLOT, 'The Essential Facilities Doctrine in European Competition Policy: The Case of Energy Sector', in J.-M. GLACHANT, D. FINON and A. DE HAUTECLOCQUE (eds.), *Competition, Contracts and Electricity Markets: A New Perspective*, Edward Elgar, Northampton 2011, 259-293.

<sup>546</sup> The 3<sup>rd</sup> Energy Package received a formal approval from the European Parliament in April 2009 (see IP/09/622 of 22.04.2009). In the same month the Commission formally launched investigation in the SvK case.

<sup>547</sup> P. CHAUVE, E. GLOWICKA, M. GODFRIED, E. LEDUC, S. SIEBERT, 'Swedish Interconnector case. Improving electricity cross-border trade' (2010) *Competition Policy Newsletter* 2, 3-5, p. 3 and 5 *in fine*. See also comments of Commissioner Joaquín Almunia, press release IP/10/425 of 14.04. 2011. Using cross-border capacity limitations to relieve internal bottlenecks is a common practice of all national TSOs, even to a much larger degree than SvK. See, for instance, Copenhagen Economics, *supra* n. 441.

<sup>548</sup> Case T-271/03, *Deutsche Telekom AG v. Commission* [2008] ECR II-477, paras. 85-89. Deutsche Telekom's appeal to the ECJ was dismissed in 2010. The ECJ upheld the General Court's judgment and confirmed that Article 101 and 102 TFEU do not apply to undertakings in cases when the national regulatory framework requires them to engage in an anti-competitive conduct or when it eliminates any possibility for the undertakings to comply with competition rules. However, if national legislation merely encourages or makes it easier for undertakings to act autonomously in an abusive manner, but leaves open the possibility of complying with

case, known as *Syfait II* case, concerned a Greek subsidiary of GlaxoSmithKline (GSK). The European Court of Justice (ECJ) took the stance that GSK's refusal to supply with the clear intention to restrict export from Greece violated Article 102 TFEU. The Court found no objective considerations that could justify this behaviour, and ignored the fact that both prices and distribution of pharmaceuticals are subject to extensive regulation in all Member States.<sup>549</sup> Taken together, in 2008 the Courts not only gave a clear nod for the Commission's antitrust activity in the regulated markets (*DT* case, *Syfait II* case), but also endorsed the Commission's pursuing of an internal market objective through competition rules (*Syfait II* case).

The fact that Sweden took over the EU presidency in 2009 might have contributed to the quick implementation of the case as well. It is believed that Sweden did not want the case lingering around much longer, as it could undermine the success of its presidency. Lastly, given the already vigorous EU antitrust enforcement in the energy sector, the case seemed to fit well with Commissioner Kroes' priorities.

#### 5.4.1.2. Legal concerns

The SvK case could have been tackled under competition rules, internal market rules or sector-specific energy rules. Depending on that, the case could have been allocated either to DG COMP, DG MARKT or DG ENER.<sup>550</sup> The Commission's inaction at the outset might reflect the indecision as to which DG should take this case. As for DG COMP, it might have been unclear whether Article 102 TFEU could constitute a correct legal basis to deal with this case. The Swedish network operator is an integral

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competition rules, this does not absolve them from responsibility under Article 101 and 102 TFEU. See case C-280/08 P, *Deutsche Telekom AG v. Commission* [2010] ECR I-9555, paras. 80-82.

<sup>549</sup> This case was a follow-up to *Syfait I* case, where AG Jacobs considered in his opinion that GSK's refusal to supply can be objectively justified given, among others, 'the pervasive regulation of price and distribution in the European pharmaceuticals sector.' Despite that, the Court in 2008 found no justification to GSK's anticompetitive practices. The outcome of this case was hotly debated. See joined cases C-468/06 to C-478/06, *Sot. Lélos kai Sia EE and Others v. GlaxoSmithKline AEVE (Syfait II)* [2008] ECR I-7139. Opinion of AG Jacobs delivered on 28.10.2004 in case C-53/03, *Syfait and Others v. GlaxoSmithKline plc*.

<sup>550</sup> DG COMP – Directorate General for Competition; DG MARKT – The Internal Market and Services Directorate-General; DG ENER – The Directorate-General for Energy. As a matter of fact, DaE complained both to DG ENER and DG COMP, arguing that SvK's practices violated internal market rules as well as competition rules. Given the possibility of various legal routes, discussions on case allocation might have involved DG COMP, DG ENER and DG MARKT.

part of the public administration and has no legal personality on its own. It therefore remains under the state's control to some extent. Such close links with the state raise a question of liability: should SvK be responsible for the choice of congestion management method (and be subject to competition rules) or should it be the Swedish state (which failed to comply with the EU law)? Apart of an action under competition rules, the Commission could have also started proceedings against Sweden under Article 258 TFEU for failing to comply with the EU law (action for non-compliance).<sup>551</sup> The Treaty offers a range of provisions which could serve here as a legal basis for the Commission's action through DG MARKT. These could be the internal market provisions on free movement of goods (Article 35 TFEU), the principle of non-discrimination (Article 18 TFEU), or even antitrust rules (Article 4(3) TFEU in combination with Article 102 TFEU). Action for non-compliance can also be based on secondary, sector-specific EU regulation, which would allocate the case to DG ENER. Cross-border trade in electricity was at that time regulated in a directly applicable legislative act – Regulation 1228/2003.<sup>552</sup> Rules on congestion management were appended to the regulation, taking the form of binding guidelines.<sup>553</sup> In fact, the Commission (2007) was plainspoken about its plans to start infringement procedures against Member States for not complying with the internal market rules on congestion management.<sup>554</sup> The first wave of infringement proceedings started almost in parallel to the SvK investigation and focused on the lack of transparent access to interconnectors in all Member States.<sup>555</sup> The Commission closed proceedings in six cases within one year, but the remaining 19 Member States (incl. Sweden) have been again requested in 2010 to comply with the EU internal

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<sup>551</sup> Supra section 1.2.3.4.

<sup>552</sup> Supra n. 73. Now it is regulated in Regulation 714/2009, supra n. 91, which repealed Regulation 1228/2003.

<sup>553</sup> Guidelines on the Management and Allocation of Available Transfer Capacity on Interconnectors between National Systems, annexed to Regulation 1228/2003, supra n. 73, and now replaced by Congestion Management Guidelines 770/2006/EC (CM Guidelines), supra n. 517. These were binding guidelines adopted by the Commission on the basis of Article 8 of Regulation 1228/2003, supra n. 73.

<sup>554</sup> See European Commission, *Report on the experience gained in the application of the Regulation (EC) No 1228/2003: Regulation on Cross-border Exchanges in Electricity*, Communication from the Commission, COM(2007) 250 final, Brussels, 15.05.2007, p. 5.

<sup>555</sup> MEMO/09/296 and 297 of 25.06.2009. Malta and Cyprus were out of scope of the Commission's proceedings, as they are electrically not connected with other Member States.

market rules, also in the area of congestion management.<sup>556</sup> Alternatively, the Commission could have adopted an Article 106 (1) TFEU decision (in combination with Article 102 TFEU) for maintaining in force measures which allow or facilitate congestion shifting by SvK. The Commission relied on a combined application of Article 106 in 2008, when it took an action in the energy sector against Greece.<sup>557</sup> Since the Greek case also involved an abuse of a dominant position (Article 106 (1) TFEU read in conjunction with Article 102 TFEU) the assessment of SvK's behaviour under antitrust rules would seem to be less of an experiment.

However, after investigating the case, the Commission established that SvK acts independently from the Swedish state in the area of congestion management.<sup>558</sup> SvK itself underlined its decisional autonomy as a completely unbundled TSO.<sup>559</sup> Nor did it ever argue that its conduct was required by state regulation.<sup>560</sup> In sum, SvK's statements endorsed the Commission's approach. This eventually might have excluded an action against Sweden under Article 258 TFEU, or an eventual Article 106 (1) decision, and might have prompted the Commission to fall back on antitrust rules as a legal basis.

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<sup>556</sup> The Commission opened infringement procedures against Sweden for non-transposition of the 2nd Package in June 2009, only two months after launching the SvK investigation. Allegations against the Swedish government included, among other concerns, SvK's congestion management which is not in line with Regulation 1228/2003, *supra* n. 73, at that time in force. Sweden had no intraday congestion management mechanism at all interconnections and no common coordinated congestion management method (see IP/09/1035 of 25.06.2009 and IP/10/836 and MEMO/10/275 of 24.06.2010). The Commission pointed out that it was for the Swedish energy regulator to take necessary steps to enforce compliance with EU law, in particular to introduce a system of penalties for EU energy law violations. This infringement case against Sweden has been running in parallel to negotiations with SvK and is still pending at the time of writing this chapter (01.2013). See Commission Staff Working Document, *supra* n. 96, Part IV. The two Swedish cases on congestion management opened on the basis of different Treaty provisions demonstrate the Commission's pragmatism in using various procedural routes to achieve a desirable market outcome.

<sup>557</sup> *Greek lignite* (Case COMP/B-1/38.700). The Greek case also involved a public undertaking vested with legal monopoly for access to lignite exploration. The Commission used Article 102 in conjunction with Article 106(3) TFEU to induce Greece to remove the existing barriers to the lignite market and lignite-fueled electricity production. *Supra*, Table 2.

<sup>558</sup> Commission Decision, *supra* n. 439, para. 22.

<sup>559</sup> Svenska Kraftnät, *Background explanations*, *supra* n. 462, pp. 6-7.

<sup>560</sup> So-called 'regulated conduct defence'. This concept describes a specific type of defence, which excludes the intervention under competition rules in cases when an abuse of dominance by an undertaking is required by national legislation and the undertaking in question has no discretion to act differently. The mere existence of regulation which encourages or facilitates abusive conduct does not exempt from the application of competition rules, but in some cases can be considered a mitigating circumstance. See case T-271/03, *Deutsche Telekom AG v. Commission* [2008] ECR II-477, paras. 85-89 and 311. A. DE STREEL, 'Background Paper' (2011), Competition Policy Roundtable on Regulated Conduct Defence, OECD, DAF/COMP(2011)3. See also submission from the European Union.

#### *5.4.2. Commitment procedure simplifies the case*

In contrast to these initial obstacles, formal proceedings against SvK, once opened, advanced quite quickly and the Commission closed the case within one year. As in most of its previous antitrust actions in the energy sector, the Commission decided to close the case under the *commitment procedure*, set forth in Article 9 of Regulation 1/2003.<sup>561</sup> This is a simplified procedure by which the Commission formulates its *concerns* about an alleged breach of antitrust rules in a document called *preliminary assessment*. The investigation is much quicker than one done under the standard infringement procedure (Article 7 of Regulation 1/2003). However, this administrative efficiency comes at the expense of analytical depth. For the purpose of a commitment decision, the Commission is not required to find an infringement of competition rules. Neither a dominant position, nor its abuse needs to be established. In turn, much more attention is paid to the remedies. The undertaking in question offers a package of remedies (i.e. commitments) to address the Commission's concerns formulated in the preliminary assessment. If the Commission considers them sufficient to remedy the anticompetitive behaviour, it makes them binding upon the undertaking in a commitment decision and closes the case without concluding on whether there was (or still is) a breach of competition rules. Instead, it concludes that there are no longer grounds for its action. In practice, the final commitment package is the outcome of negotiations between the Commission and the undertaking.

We observe that commitment procedure greatly facilitate the use of competition rules as an EU energy policy tool. The Commission pursues policies of economic liberalisation and integration of markets, which often interfere with national protectionism or interests of local industrial lobby groups. Where political negotiations collapse due to irreconcilable national or industrial aims, direct negotiations with firms under competition rules allow the Commission to achieve its policy goals while keeping national governments and interest groups out of the picture. The loose concept of *concerns* in Article 9 allows the Commission to extend

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<sup>561</sup> Supra n. 14. For cases, see Table 2.

the scope of competition policy to catch practices, which may hamper European integration, but where antitrust aspects may not always be that obvious. Moreover, because an infringement of competition rules does not need to be established in a commitment decision, the Commission does not really need to come up with a robust theory of anticompetitive harm based on sound economic principles.<sup>562</sup> It appears that, in the process of modernisation of EU competition rules, where *a more economic approach* displaces formalism and requires an effect-based assessment of anticompetitive behaviour, commitment procedure provides an escape hatch, where the Commission can drop economic welfare standards and pursue other policy objectives. In the following sections, using the *SvK* case as an example, we explain how the Commission employs competition rules to promote market integration, and ignores possible efficiencies of *SvK*'s actions as well as the regulatory context of electricity transmission services.

#### *5.4.3. Promotion of market integration as a key objective in the *SvK* case*

According to the Commission, *SvK* may have abused its dominant position on the market for electricity transmission in Sweden, and thus infringed Article 102 TFEU, by limiting export capacity on the interconnectors in order to relieve congestion on the national grid. To breach Article 102 TFEU, *SvK* would have to meet the following five cumulative conditions set forth therein: it would have to be (1) an undertaking (2) which abuses its (3) dominant position (4) held within the internal market or a substantial part of it, and (5) this behaviour would have to affect inter-State trade.<sup>563</sup> For the purpose of adopting a commitment decision, a breach of Article 102 TFEU does not need to be established, which allows the Commission to only briefly discuss the five-step infringement test.

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<sup>562</sup> Commitment decisions might also have clear advantages for the firms involved. They will be able to avoid a lengthy and costly process, they might avoid paying a fine, and legally their abuse has not been established, so subsequent private claims are less likely to follow. See discussion, *supra* section 1.2.1.1.

<sup>563</sup> A. JONES and B. SUFRIN, *supra* n. 61, p. 261.

As already mentioned,<sup>564</sup> it was debatable whether SvK could be considered an undertaking for the purpose of Article 102 TFEU (the first element). The classification of SvK as an undertaking in the meaning of EU competition rules is of key importance as it determines whether Article 102 TFEU can be applied here in the first place. The Commission establishes in the decision that SvK is subject to competition laws. The discussion concerning criteria (3), (4) and (5) seems to be more of a formality. Finding a dominant position within a substantial part of the internal market (3 and 4) is in any case evident, as SvK enjoys a legal monopoly for the transmission services in Sweden.<sup>565</sup> Similarly, since the case concerns cross-border trade in energy, the inter-State effect (5) is beyond dispute.<sup>566</sup>

The core of the Commission's assessment is the (alleged) abuse itself (2). The Commission develops a theory of harm which intertwines anticompetitive concerns (discrimination) with an internal market interest. Firstly, one source of anticompetitive concern is that SvK's practices led to *de facto* discrimination between different network users. SvK discriminated on the basis of nationality, since at times of congestion it only refused to satisfy external demand, whereas transmission of electricity reserved for national consumption has never been limited in order to relieve internal bottlenecks. The Commission explicitly refers to the general principle of non-discrimination enshrined in the Treaty,<sup>567</sup> and recalls that nationality-based discrimination can constitute an abuse of a dominant position in violation of Article 102 TFEU. In fact, the European Courts used to apply Article 102 TFEU to discriminatory practices in the past and the Commission invokes this line of cases to back the *SvK* decision.<sup>568</sup>

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<sup>564</sup> Supra, section 5.4.1.2.

<sup>565</sup> Commission Decision, supra n. 439, paras. 24-26.

<sup>566</sup> Commission Decision, supra n. 439, para. 46.

<sup>567</sup> Article 18 TFEU.

<sup>568</sup> Case C-82/01, *Aéroports de Paris v. Commission* [2002] ECR I-9297, case C-163/99, *Portuguese Republic v. Commission* [2001] ECR I-2613, case T-139/98, *AAMS v. Commission* [2001] ECR II-3413, case C-18/93, *Corsica Ferries Italia* [1994] ECR I-1783, case 7/82, *GVL v. Commission* [1983] ECR 483 and case 27/76, *United Brands v. Commission* [1978] ECR 207. See Commission Decision, supra n. 439, at note 39. All these cases are concerned with practices that were either directly or indirectly discriminatory on the grounds of nationality and, more importantly, they were seen as harmful to the internal market. Some legal scholars consider them a third category of Article 102 abuses, next to exploitative and anti-competitive abuses. See, for instance, R. WHISH (2005), supra n. 16, p. 195 and 679. A. JONES and B. SUFRIN, supra n. 61, p. 520.

Secondly, and this is where the internal market rules come into picture, the Commission reasons that SvK's practices contributed to a re-segmentation of the European market along national borders, with artificially low prices in Sweden and higher prices abroad. Hence, the non-Swedish customers could not fully benefit from the internal market.<sup>569</sup> SvK's policy constituted an obstacle to trade within the internal market. The Commission recalls that Article 35 TFEU prohibits quantitative restrictions on exports and measures having equivalent effect.<sup>570</sup> It refers to the ECJ case law dating all the way back to the 1966 *Consten and Grundig* judgment<sup>571</sup> and draws an analogy between SvK's conduct and state measures restricting cross-border trade. According to the Commission, since export restrictions are prohibited under the Treaty, so should be a unilateral conduct of a dominant undertaking with the same objective of restricting cross-border trade.<sup>572</sup>

The Commission's theory of harm heavily relies on the general prohibition of nationality-based discrimination and Article 35 TFEU. These are provisions contextually beyond the scope of competition policy,<sup>573</sup> but the Commission has invoked them directly or indirectly in competition cases whenever it sought to protect the internal market or promote further market integration.<sup>574</sup> The case law recalled by the Commission considers market-partitioning practices as *per se* abuses, because they

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<sup>569</sup> Commission Decision, *supra* n. 439, paras. 27 and 42-44.

<sup>570</sup> Commission Decision, *supra* n. 439, para. 43.

<sup>571</sup> Joined cases 56/64 and 58/64, *Établissements Consten and Grundig v. Commission* [1966] ECR 299, paras. 342-343.

<sup>572</sup> The *Consten and Grundig* case was decided in the early days of the European integration. At that time, the Commission's antitrust enforcement, supported by the Courts, was particularly driven by common market considerations.

<sup>573</sup> Considering the context of the provisions, neither Article 18 TFEU nor Article 35 TFEU is listed under the chapter on competition rules (Title VII, Chapter 1). However, the link between Article 18 TFEU and Article 102 TFEU is comprehensible, given the wording of Article 102, which names discriminatory practices as a potential abuse of a dominant position (Article 102(2)(c) TFEU). There is no such textual link, however, between Article 102 TFEU and Article 35 TFEU, apart from the fact that a breach of Article 102 TFEU requires a cross-border effect.

<sup>574</sup> For competition cases involving discrimination based on nationality, see *supra* n. 568. For competition cases involving export bans and conduct hindering cross-border trade, see e.g. joined cases 56/64 and 58/64, *Établissements Consten and Grundig v. Commission* [1966] ECR 299, case 41/69, *ACF Chemiefarma v. Commission* [1970] ECR 661, case 27/76, *United Brands v. Commission* [1978] ECR 207, case 226/84, *British Leyland v. Commission* [1986] ECR 3263, case T-62/98, *Volkswagen v. Commission* [2000] ECR II-2707, case T-139/98, *AAMS v. Commission* [2001] ECR-II 3413.

frustrate “the most fundamental objections of the Union”<sup>575</sup>, and because they have the same objective as protectionist measures by Member States, which are captured by internal market rules. The Commission does not depart from this argumentation in the *SvK* case. Its approach remains very formalistic. First, it emphasises discriminatory nature of *SvK*’s practices, based solely on price comparisons in the day-ahead market. As discussed in chapter 4, this approach lacks economic foundations. Then, it refers to the *Consten and Grundig* reasoning and concludes that ‘practices, [which aim at restricting exports of electricity so as to reserve such electricity for domestic consumption], are generally considered to have as their object the restriction of competition’. Put differently, the Commission seems to apply in the *SvK* case a *per se* rule, according to which congestion shifting by *SvK* is abusive as such and cannot be justified on economic welfare standards.

#### 5.4.4. Neglecting Objective Justification

In this section we discuss whether *SvK*’s congestion shifting could be justified on legitimate grounds, a question which, in our assessment, did not receive sufficient attention by the Commission. The Commission considers *SvK*’s action an impediment to cross-border trade, and this implies that congestion shifting is abusive *per se*. However, we are convinced that a more relaxed procedural framework of Article 9 could have given room for objective justifications (5.4.4.1) such as the ones put forward by *SvK*: that the action was justified based on efficiency improvements (5.4.4.2) and the public interest (5.4.4.3).

##### 5.4.4.1. Objective justification and commitment procedure

The reasoning set out in the preliminary assessment suggests that if the Commission was in fact required by the procedure to find an infringement of Article 102 TFEU (which is not required in a commitment procedure), then it would consider *SvK*’s

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<sup>575</sup> Joined cases 56/64 and 58/64, *Établissements Consten and Grundig v. Commission* [1966] ECR 299, para. 340.

practice as a *per se* abuse. That is, congestion shifting would be presumed unlawful, without allowing evidence to the contrary, by way of justification.

In theory, there are no *per se* abuses under Article 102 TFEU.<sup>576</sup> As is often reiterated by the ECJ, anticompetitive practices of a dominant undertaking are abusive unless they are *objectively justified*.<sup>577</sup> The notion of objective justification developed by the Courts is far from clear, as neither the Commission, nor the ECJ has been consistent in its interpretation.<sup>578</sup> However, the right of a dominant undertaking to defend itself against allegations of abuse on the basis of objective justification is not questioned.<sup>579</sup> Objective justification is thus a defence under competition rules and, as acknowledged by the Courts and the Commission, it captures practices pursuing legitimate public interest objectives as well as those producing efficiency gains.<sup>580</sup>

A standard infringement procedure under Article 7 of Regulation 1/2003 requires the Commission to investigate the case thoroughly and to adopt a *statement of objections*, which triggers clear procedural rights for the undertaking to defend its conduct against the objections raised therein.<sup>581</sup> In other words, once the Commission finds an abuse, the burden of proof shifts to the undertaking, which can try to justify its practices.

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<sup>576</sup> There is, though, a line of case law where the Courts seem to consider certain practices per se abusive (exclusive supply obligations, loyalty rebates and predatory pricing). However, in more recent cases the Courts have become less strict and allow objective justification also with regard to these practices. See Opinion of AG Colomer delivered on 01.04.2008 in joined cases C-468/06 to C-478/06, *Sot. Lélos kai Sia EE and Others v. GlaxoSmithKline AEVE (Syfait II)*, paras. 56-61.

<sup>577</sup> See e.g. case 40-70, *Sirena S.r.l. v. Eda S.r.l. and others* [1971] ECR 69, para. 17. This is the first case in which ECJ refers to objective justification. See also case 311/84, *Centre belge d'études de marché - Télémarketing v. CLT and IPB* [1985] ECR 3261, paras. 26-27.

<sup>578</sup> The concept of ‘objective justification’ lacks a complete theoretical framework causing a lot of confusion as to what could constitute objective justification under Article 102. For the purpose of this case study it is not necessary to enter into this debate. For an extensive discussion see E. ROUSSEVA, ‘The Concept of “Objective Justification” of an Abuse of a Dominant Position: Can it help to Modernise the Analysis under Article 82 EC?’ (2006) 2 *The Competition Law Review* 2, 27-72.

<sup>579</sup> E. ROUSSEVA, *supra* n. 578, p. 27.

<sup>580</sup> See A. JONES and B. SUFRIN, *supra* n. 61, p. 282. R. WHISH (2005), *supra* n. 16, 207.

<sup>581</sup> The Commission adopts statement of objections with a view to adopting a prohibition decision. See Commission notice on best practices, *supra* n. 16, para. 82: ‘The Statement of Objections sets out the preliminary position of the Commission regarding the alleged infringement of Articles 101 and/or 102 TFEU, after its in-depth investigation. Its purpose is to inform the parties concerned of the objections raised against them with a view to enabling them to exercise their rights of defence in writing and orally (at the hearing). It thus constitutes an essential procedural safeguard which ensures that the right to be heard is observed. The parties concerned will be provided with all the information they need to defend themselves effectively and to comment on the allegations made against them.’

However, the *SvK* case was closed by a commitment decision. The Commission does not issue a statement of objections under Article 9, but only formulates its concerns in *a preliminary assessment*. The purpose and content of those documents differ. A preliminary assessment serves an undertaking subject to proceedings as a basis to formulate appropriate commitments, and not to exercise its right of defence. For this purpose, it merely includes the Commission's anticompetitive *concerns*, and not formal *objections*.<sup>582</sup> A statement of objections is a more substantial document, which not only fulfils the requirements of a preliminary assessment, but goes well beyond that.<sup>583</sup>

Comparing the two procedural routes (Article 9 commitment procedure and Article 7 infringement procedure) we believe there is a risk that the objective justification defence is not sufficiently taken into account in the commitment procedure. Formally, the commitment procedure does not give the undertaking any procedural right to rebut the concerns of the Commission, and the dialectic debate is replaced by bargaining over commitments, which might make it more difficult for an undertaking to argue in defence of its actions, and easier for the Commission to disregard them.

This is also apparent from the publicly available case documents, where *SvK* argues in favour of its congestion management methods both in reply to the *DaE*'s complaint, as well as during the negotiations with the Commission.<sup>584</sup> Its argumentation is based on both efficiency considerations and public interest objectives (as discussed in sections 5.4.4.2 and 5.4.4.3 below). The Commission, however, does not take note of this argumentation and only remarks in its decision that *SvK* did not provide sufficient evidence to objectively justify its conduct.<sup>585</sup> Hence, the administrative efficiency feature of the commitment procedure appears to absolve the Commission from taking a closer look at the possible reasons for the allegedly abusive conduct.

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<sup>582</sup> Commission notice on best practices, *supra* n. 16, paras. 121-122.

<sup>583</sup> Commission notice on best practices, *supra* n. 16, paras. 82 and 123. See discussion, *supra* section 1.5.2.2.

<sup>584</sup> Svenska Kraftnät, *The complaint from Dansk Energi*, *supra* n. 466, p. 4 and 9. Svenska Kraftnät, *Background explanations*, *supra* n. 462, p. 11. See also letter of M. Odenberg, *supra* n. 461.

<sup>585</sup> Commission Decision, *supra* n. 439, para. 45.

It is difficult to predict whether the Swedish TSO would have been more successful in justifying its actions under a standard infringement procedure. Objective justification under Article 102 TFEU is rarely accepted in practice, both by the Commission and the Courts.<sup>586</sup> And even though the Regulation 1/2003 and the Commission's notice on best practices<sup>587</sup> are silent as to the possibility of using objective justification in the context of Article 9, this does not mean that an undertaking cannot justify its allegedly anticompetitive conduct on objective grounds to strengthen its bargaining position in the negotiations.<sup>588</sup> Thus, having this indirect role in the negotiations, objective justification can still influence the outcome of the case.<sup>589</sup>

In what follows, we discuss the two arguments used by SvK to defend its congestion management. We believe that the Commission failed to analyse these arguments on their merits. However, we do not want to enquire into whether or not it makes sense for the Commission to assume a more pro-active approach in commitment cases.<sup>590</sup> Rather, we would like to point out that an electricity network is a complex technoeconomic system, where a lot of trade-offs need to be made almost on a continuous basis. A better analysis of this system, and its regulation, could have lead to an enhanced definition of the abuse, and as a result, would have given more guidance for network operators and sector-specific regulators.

#### 5.4.4.2. Objective justification based on efficiencies

SvK maintained that it shifted congestion to the border and preferred not to rely on counter-trading as its cost would be absorbed by the Swedish grid users, and not by

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<sup>586</sup> A. JONES and B. SUFRIN, *supra* n. 61, p. 282. R. WHISH (2005), *supra* n. 16, pp. 207-208. E. ROUSSEVA, *supra* n. 578, p. 35. On the top of that, in order to be justified, the conduct must be proportionate. The application of the proportionality test further limits the scope of this defence.

<sup>587</sup> Commission notice on best practices, *supra* n. 16.

<sup>588</sup> According to some commentators, bilateral negotiations give undertakings an opportunity to explain their conduct to the Commission. See e.g. S. RAB, D. MONNOYEUR and A. SUKHTANKAR, *supra* n. 26, p. 175.

<sup>589</sup> Moreover, the absence of an in-depth analysis of the case might potentially weaken the bargaining position of the Commission, as it cannot provide any strong evidence in support of its anticompetitive allegations.

<sup>590</sup> On the one hand, the Commission enjoys a greater margin of discretion in the commitment negotiations and could theoretically investigate the reasons behind anticompetitive behaviour on its own initiative. On the other hand, a time-consuming investigation might write off the commonly cited benefit of a commitment decision – its administrative efficiency. Nevertheless, the Commission's formalistic approach in the SvK case has been pointed out by commentators. See e.g. A. DE HAUTECLOCQUE and L. HANCHER, *supra* n. 225, pp. 20-22.

those, who benefit from it (i.e. Denmark). SvK argued that it proposed the Danish TSO to share the financial burden of increased counter-trading on several occasions, but its offers were declined.<sup>591</sup>

This argument makes some economic sense. Danish consumption creates a negative externality:<sup>592</sup> it reduces availability of transmission capacity within Sweden. The same applies to the Swedish consumers. If SvK shifts too much of its internal congestion to the border to increase Swedish consumption, it has a negative impact on the Danes, reducing cross-border capacity and thus increasing the cost of energy consumption in Denmark. In chapter 4 we show that SvK can achieve efficient allocation by shifting *some* internal congestion to the border and counter-trading the rest. The optimal amount of congestion shifting depends on the demand levels in Sweden and in Denmark. In social optimum, the electricity day-ahead price in Denmark should be equal to the counter-trading price in South Sweden. Paying this price for their energy consumption, Danish consumers would internalise the cost of congestion they create within Sweden. Still, this does not mean that Denmark should pay a share of the Swedish counter-trading costs, a principle that SvK puts forward. This is because counter-trading costs are not related to the social cost of congestion.<sup>593</sup> As a result of counter-trading, consumers in South Sweden and producers in North Sweden receive implicit subsidies. Consumers in the south pay a lower day-ahead price than when congestion is priced directly in the day-ahead market, as in the case of market splitting. Similarly, producers in the north receive a higher day-ahead price. Those subsidies consist mainly of transfers from the Swedish network operator to the Swedish network users, and are therefore not a measure of the social cost of

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<sup>591</sup> Svenska Kraftnät, *The complaint from Dansk Energi*, supra n. 466, p. 4.

<sup>592</sup> A negative externality is a negative side effect of the consumption of a product on a third party. This concept is common in an environmental context (pollution). When economic agents do not take into account the negative externality of their consumption of a product, the level of consumption of this product will be larger than the social optimum. In order to achieve a socially efficient outcome, those agents need to internalise the externality, so that they take into account the effect of their actions on third parties. This could be done for instance by imposing a tax on the good ('the polluter pays principle') or by the creation of clear property rights.

<sup>593</sup> The social cost of congestion is equal to the forgone benefit of energy trades from North to South Sweden, which could not take place because of exports from Sweden to Denmark. Hence, the social cost of congestion does not show up in the accounts of SvK, as it refers to a hypothetical alternative usage of the transmission line. There is no direct relation between those forgone benefits and the counter-trading costs.

congestion, which the Danes would have to pay in order to internalise their negative externality.

In summary, we show that SvK could have had an efficiency objective in mind, when it shifted some of the internal congestion to the border with Denmark. The Commission's cursory assessment of SvK's behaviour does not consider this possibility. Instead, the Commission compares day-ahead prices in Denmark and Sweden and concludes that SvK's practices are discriminatory and lead to market-partitioning. It has been argued in the previous chapter that the difference in day-ahead prices should not be taken as an indicator for discriminatory behaviour. One would rather need to compare the marginal counter-trading cost in South Sweden with the day-ahead price in Denmark.<sup>594</sup> A more economic approach to the concept of discrimination would not lead to an outright prohibition of congestion shifting in the first place, and would have given SvK the opportunity to justify its actions on efficiency grounds.

#### 5.4.4.3. *Objective justification based on public interest*<sup>595</sup>

SvK argued that maintaining a common electricity market with a common price was advantageous for Sweden. There were genuine concerns, that splitting the market into smaller price zones would have a negative impact on Sweden, by reducing the liquidity in the wholesale market and hindering retail competition.<sup>596</sup>

As a state-run central administrative authority SvK must act in accordance with the Instruction from the Swedish Government.<sup>597</sup> This document, issued on a yearly basis, stipulates SvK's guiding principles and also specifies special tasks. According to the

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<sup>594</sup> For a detailed discussion, see *supra* section 4.5.

<sup>595</sup> Due to conceptual confusion surrounding the notion of objective justification we chose to label the arguments set forth in this section as 'public interest objectives', thereby avoiding concepts such as 'objective necessity' or 'regulatory conduct defence'.

<sup>596</sup> Retailing is the final segment of electricity value chain, that is, the supply of electricity to end-customers. Retail competition exists if end-customers have a possibility to choose their electricity supplier between competing electricity suppliers.

<sup>597</sup> *Supra* n. 500. See also NordREG, *Regulation of the Nordic TSOs – with focus on Market Efficiency and Harmonisation*, Report No. 7/2007, p. 12.

Instruction, SvK should promote competition in the Swedish wholesale and retail electricity markets.<sup>598</sup> In the light of this objective, keeping a single price might have been in line with the Instruction, as it is claimed to make forward and day-ahead markets more liquid and promote retail competition. Interestingly, Swedish government itself commissioned SvK to investigate the possibility of market splitting in Sweden as early as in 1993. SvK claims that similar studies, also delegated by the Swedish government, have been performed over the years and all of them pointed to the risk of weakening competition and reducing liquidity in the sub-markets.<sup>599</sup> On the top of that, the Swedish stakeholders, headed by the industry association, Swedenergy, were from the outset fairly negative about market splitting. As SvK reports, this scepticism did not end with the implementation of the commitment package and criticism can still be heard.<sup>600</sup>

The question arises as to whether SvK was sufficiently autonomous in setting its congestion management system, for instance, whether it could introduce market splitting independently from the Swedish government.<sup>601</sup> As a public utility, SvK does enjoy decisional autonomy regarding transmission services it provides – it makes decisions and issues regulations.<sup>602</sup> Further, congestion management procedures are not specifically regulated in any legislative act.<sup>603</sup> The Electricity Act sets out criteria on network operation, but these are very general, and include, for instance, the obligation to transmit electricity on reasonable conditions and of good quality.<sup>604</sup> This all demonstrates that SvK has discretion as to whether to keep Sweden as one Elspot

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<sup>598</sup> Article 3 of Government Ordinance, *supra* n. 500. See also Svenska Kraftnät, *Background explanations*, *supra* n. 462, p. 6.

<sup>599</sup> See the letter of M. Odenberg, *supra* n. 461. Finally, in 2008, the Swedish government instructed SvK to start a process of subdividing Sweden into smaller price zones by means of regulation. See Commission Decision, *supra* n. 439, para. 65. See also discussion *infra* section 5.5.

<sup>600</sup> Svenska Kraftnät, *Annual Report 2010*, *supra* n. 493, p. 5. In defiance of these objections, Energy Markets Inspectorate has recently reported that retail competition has not been affected in the first few months after the implementation of market splitting. See Energy Markets Inspectorate (2012), *supra* n. 501.

<sup>601</sup> According to the ruling of the General Court in the *DT* case, the mere existence of regulation which encourages or facilitates abusive conduct does not exempt a dominant firm from the application of competition rules, but in some cases can be considered a mitigating circumstance. See Case T-271/03, *Deutsche Telekom AG v. Commission* [2008] ECR II-477, paras. 85-89 and 311.

<sup>602</sup> NordREG, *supra* n. 597, p. 17.

<sup>603</sup> NordREG, *A Common Definition of the System Operators' Core Activities*, Report 4/2006, p. 35, Appendix 1.

<sup>604</sup> *The Swedish Electricity Act*, *supra* n. 452, chapter 3.

area or to further subdivide it.<sup>605</sup> However, it appears that keeping one price within Sweden has always been a part of a wider socio-geographic policy. Seen from that angle, supply of electricity at a uniform electricity price within Sweden can therefore be considered a ‘service of general economic interest’ in a broader socioeconomic sense.<sup>606</sup> Against this backdrop, SvK’s decisional autonomy to introduce market splitting might have been *de facto* limited by the national policy of maintaining a common price in Sweden, widely supported by the Swedish market.

#### 5.4.5. Proportionality of the final remedy

The introduction of market splitting abolishes the single uniform electricity price which is valid for all the Swedish customers. In other words, it imposes a social policy on Sweden, something which normally remains within the State’s own decision making powers. Given this far-reaching intervention in the Sweden’s social policy domain, we would like to address the question whether the Commission went beyond its discretionary powers, by extracting disproportionate commitments.

First of all, we should note that the Commission enjoys a broad margin of assessment regarding the proportionality of commitments. According to the recent ECJ judgment in the *Alrosa* case, the principle of proportionality, as a general principle of EU law, applies to commitment decisions, but to a limited extent.<sup>607</sup> Had the principle of

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<sup>605</sup> Note that the very fact that SvK offered market splitting as a commitment to the Commission in a bilateral antitrust deal proves this point.

<sup>606</sup> We do not refer to any specific legal definition of services of general economic interest (SGEI) under the Swedish national regulation. The concept of SGEI is not defined by the EU law. In the EU practice, SGEI are economic activities that would not be produced by market forces alone or at least not in the form of an affordable service available indiscriminately to all (see MEMO/11/929 of 20.12.2011). The concept of SGEI depends on Member States, which impose public service obligations on private or public undertakings (service providers) and define the conditions under which these obligations are carried out. Hence, it would be up for the Swedish state to decide that providing electricity at a uniform price within Sweden is considered a service of general economic interest.

<sup>607</sup> The principle of proportionality is a criterion for lawfulness of all measures adopted by the EU institutions and requires that these measures cannot exceed what is appropriate and necessary for attaining the objective pursued, and that where there is a choice between several appropriate measures, recourse must be had to the least onerous and the disadvantages caused must not be disproportionate to the aims pursued. See e.g. case 15/83R, *Denkavit Nederland* [1984] ECR 2171, para. 25, case C-331/88, *Fedesa and others* [1990] ECR I-4023, para. 13, case T-65/98, *Van den Bergh Foods Ltd v. Commission* [2003] ECR II-4653, para. 201, case C-180/00, *Netherlands v. Commission* [2005] ECR I-6603, para. 103.

proportionality fully applied, the Commission would have to (a) test whether the accepted commitments address its concerns formulated in the preliminary assessment, and, (b) consider alternative, less restrictive, measures (if they exist and are known to the Commission) and choose those, provided they also address its concerns.<sup>608</sup> According to the *Alrosa* judgment, in a commitment procedure the second test should be replaced by two weaker requirements. First, (b') the accepted commitments must be the least restrictive (for the undertaking concerned) of all the commitments that were offered by the undertaking and must address the Commission's concerns.<sup>609</sup> Second, (b'') the accepted commitments must not go *manifestly* beyond what is necessary to address its concerns.<sup>610</sup> Consequently, in a case where an undertaking offers only one set of commitments,<sup>611</sup> test (b') is trivially satisfied and the Commission only needs to assess whether (a) it meets its concerns and (b'') is not manifestly disproportionate.<sup>612</sup>

The Commission made SvK's commitments binding in April 2010, that is, while the *Alrosa* case was still pending before the ECJ. This period was marked by uncertainty as to the content of the proportionality test applicable to Article 9 commitments.<sup>613</sup> Given the lack of clear standards, the Commission came up with an almost four-page-

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<sup>608</sup> In 2007, the General Court required such a full proportionality test of commitments in the *Alrosa* case, but its judgment has been subsequently overruled by the ECJ on appeal. See case T-170/06, *Alrosa v. Commission* [2007] ECR II-02601, paras. 112-158.

<sup>609</sup> Case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-05949, paras. 41 and 61.

<sup>610</sup> Case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-05949, para. 42: 'Judicial review for its part relates solely to whether the Commission's assessment is manifestly incorrect.'

<sup>611</sup> Publicly available case documents do not suggest that SvK offered alternative solutions to market splitting (e.g. increased counter-trading) so we assume this was not the case. However, given that negotiations with the Commission are not public, we cannot take it for granted.

<sup>612</sup> In that way the Commission can accept commitments under Article 9 which may go beyond the remedies it can impose in a standard infringement procedure under Article 7, in which case the principle of proportionality is fully applicable. See also Commission notice on best practices, *supra* n. 16, para. 115, which, referring to the *Alrosa* judgment, expressly states that the commitments can go beyond what the Commission could impose in a standard infringement procedure.

<sup>613</sup> The Courts were sending out contradictory signals. On the one hand, the General Court stated in 2007 in the same case that the principle of proportionality applies to commitment procedure just as it applies to the infringement procedure. That is, the Commission is required to test whether the proposed commitments are proportionate to the alleged infringement and necessary to meet the Commission's concerns formulated in the preliminary assessment. See case T-170/06, *Alrosa v. Commission* [2007] ECR II-02601. On the other hand, Advocate General Kokott emphasised the voluntary nature of commitments, and argued for more discretion on the part of the Commission in the assessment of proportionality in commitment cases. Her opinion from September 2009 was a strong signal that the ECJ might overturn the General Court's judgment on appeal and grant the Commission wide latitude in the assessment of commitments. See Opinion of AG Kokott delivered on 17.09.2009 in case C-441/07 P, *Commission v. Alrosa* [2010] ECR I-05949.

long fully-fledged discussion on the proportionality of SvK's commitments, which provides an insight in how the proportionality of the commitments would have been tested, if it were required by law. Regarding the first test (a) the Commission states that SvK will no longer *need* to reduce capacity on the interconnectors, once market splitting is introduced. The Commission argues that this sufficiently addresses concerns formulated in the preliminary assessment. Regarding the second test (b), the Commission finds that there is no other remedy which would be equally effective in meeting its concerns.<sup>614</sup> Resulting price differences do not represent, in view of the Commission, a disproportionate burden for third parties. In this regard, the foreseeable price increase in some areas in Sweden is 'an unavoidable consequence of the commitment which brings the alleged discrimination between Swedish and non-Swedish customers to an end.' Overall, the Commission concludes that the commitments 'are sufficient to address the concerns identified [...] in its preliminary assessment without being disproportionate.'

With regard to the first test, we find that market splitting does not sufficiently address the Commission's concerns. It is true that SvK *does not need* to limit export to solve internal congestion. However, it *can* still do it in order to keep the prices in the new price areas at the same level. Indeed, we show in chapter 4 that despite market splitting, SvK can still shift congestion out of purely strategic reasons (in order to achieve price uniformity). Therefore market splitting alone, without sufficient monitoring, is not sufficient to address the Commission's concerns. This means that, even in the light of the *Alrosa* judgment, the Commission might have breached the principle of proportionality, in the sense that the accepted commitments (market splitting) might not address its concerns set out in the preliminary assessment.<sup>615</sup>

As far as the second test (b) is concerned, the proportionality of market splitting depends on what the Commission wants to achieve in this case, that is, (A) market

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<sup>614</sup> The Commission briefly discusses network investments as an alternative, but concludes that they cannot constitute an equally effective remedy due to long lead times and uncertainty as to their outcome.

<sup>615</sup> Market splitting would also be considered a disproportionate remedy in a standard infringement procedure under Article 7 of Regulation 1/2003 (full proportionality test) since it would still not pass test (a), that is, it could not be considered an effective means to bring the infringement to an end.

integration or (B) economic efficiency. The preliminary assessment suggests that the Commission's objective is (A), as its concerns relate mostly to limiting cross-border capacities impeding market integration and not to inefficient congestion management, which would have been primary concern in variant (B). Had the Commission considered an efficiency standard (B) in its assessment, then market splitting would not have been a proportionate remedy, as a less onerous remedy was at hand. Again we refer here to chapter 4 in saying that efficient allocation can well be obtained by a combination of counter-trading and partial congestion shifting. For SvK, this might be a less onerous remedy with no implementation costs, which is equally effective to meet the Commission's concerns regarding inefficient congestion management. However, it seems that the Commission does not seek an efficient outcome, but simply wants to eliminate congestion shifting and thus increase cross-border flows to enhance market integration (objective (A)). If this is the case, then market splitting is more adequate to address the Commission's concerns regarding cross-border trade than any other method which involves cross-border capacity reductions.

## 5.5. SVK'S COMMITMENTS IN THE LIGHT OF THE NORDIC DEBATE

In this section we discuss the political context of the *SvK* case. The idea of introducing market splitting in Sweden is not new. The Swedish government commissioned SvK to investigate the possibility of subdividing Sweden into smaller price zones as early as 1993. At that time it was suggested to put market splitting on hold, due to the lack of sufficient competition and liquidity in the Swedish electricity market.<sup>616</sup> The movement was rather in the opposite direction, towards integration and the creation of bigger markets. This led to the establishment of Nord Pool in 1996, a joint Scandinavian power exchange, with a day-ahead auction for electricity as the main trading platform (Elspot). At the outset of Nordic integration, cross-border exchanges were limited. As national grids had sufficient transmission capacity to handle domestic flows, congestion within the Nordic countries was not an issue and countries could therefore be defined as single price zones. However, further integration within

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<sup>616</sup> See the letter of M. Odenberg, *supra* n. 461.

the Nordic market and with the European continent increased demand for transmission capacity on cross-border lines. Liquid and transparent market allowed well-informed market players to trade electricity across the borders. International transit flows increased the stress on national grids and congestion within the price zones (individual countries) occurred more frequently.<sup>617</sup> As national congestion was managed by reducing cross-border capacity further Nordic integration was obstructed. As a result, national congestion management systems started to be widely discussed between the Nordic countries. The Swedish market splitting debate naturally moved to the regional level. In 2002, Nordel, a platform for cooperation between the Nordic transmission system operators,<sup>618</sup> suggested further subdivision of the Nordic market into price areas and, among others, splitting Sweden into three zones. At that time, the Swedish power industry voiced its opposition against Nordel's proposal.

The problem of cross-border congestion at the Swedish-Danish border became particularly acute after November 2005 when Danish day-ahead prices often peaked to extremely high levels. The Danish TSO ascribed these price spikes to the SvK's congestion management.<sup>619</sup> In the same year the Swedish Energy Agency reported that SvK and the other Nordic TSOs were extensively limiting cross-border capacities to relieve internal congestion within their control areas.<sup>620</sup> Following this report and the Danish complaints, the Swedish government commissioned the Energy Markets Inspectorate (EMI) to explore alternative congestion management methods, in particular market splitting in Sweden and the effects on competition in the Swedish and the Nordic electricity markets. EMI (2006) suggested splitting the market along cut 2,<sup>621</sup> with a sufficient transitory period for the retail market to adjust, but not along cut 4 since it would substantially weaken competition in the area south of cut 4. EMI proposed an increased use of counter-trading for cut 4 instead, whose cost would be

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<sup>617</sup> Imports come mostly from Norway and Finland. Exports are directed to Eastern and the Western Denmark, Germany, Poland and back to Norway and Finland, but to their Southern parts.

<sup>618</sup> In 2009 Nordel was wound up and its tasks taken over by the European Network of Transmission System Operators for Electricity (ENTSO-E).

<sup>619</sup> Energinet.dk, *Report on price formation in November 2005 in Eastern Denmark*, 14.02.2006, annexed to DaE's complaint.

<sup>620</sup> Swedish Energy Agency, *Hantering av begränsningar i det svenska överföringssystemet för el :ett nordiskt perspektiv*, Report No. ER 2005:11, in Swedish only.

<sup>621</sup> Supra n. 520.

shared between the Swedish and the Danish TSOs. The sharing arrangement was motivated by the fact that the Danish customers would profit from increased counter-trading on cut 4, because SvK would not limit cross-border capacity anymore. However, the Danish TSO was reluctant to solve the problem bilaterally. Instead, Dansk Energi, the Danish association of energy companies, reported SvK to the European Commission for shifting congestion to the Danish border. DaE complained that SvK's conduct was harmful to Danish consumers. These allegations were based on an empirical study of Copenhagen Economics, which quantified the economic losses due to SvK's congestion shifting.<sup>622</sup> DaE claimed that SvK's practices were detrimental to competition and trade within the internal market and violated EU competition rules.<sup>623</sup> The Norwegian Electricity Industry Association (EBL) supported the Danish complaint. The threat of a case being taken to the European Commission intensified the market splitting debate in Sweden. In 2007, EMI issued a joint report on market splitting in Sweden, in cooperation with SvK and the Swedish power industry, the so-called POMPE report.<sup>624</sup> The Swedish organisations considered a new price border within the Nordic market between the hydro power region in the North and thermal power in the South. The proposed border would not only split the Swedish market along cut 2, but also subdivide Finland and Norway into new price areas. With respect to Sweden, the POMPE report found that the price border along cut 2 would result in a more efficient utilisation of resources, without harming wholesale competition but with adverse effects on Swedish retail competition on a national basis.

The discussion shifted to the Nordic level again with a series of reports. A report prepared for the Nordic Council of Ministers (NCM's 2007 report) highlighted the

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<sup>622</sup> Copenhagen Economics, *supra* n. 441.

<sup>623</sup> *Supra* n. 442.

<sup>624</sup> The Energy Markets Inspectorate, SvK, Swedenergy and the Confederation of Swedish Enterprise, *Price Areas in the Electricity Market*, EMIR 2007:02, 2007, so-called POMPE Report, available in Swedish at [http://ei.se/Documents/Publikationer/rapporter\\_och\\_pm/Rapporter%202007/Prisområden\\_pa\\_elmarknaden\\_pompe\\_gemensam\\_rapport\\_fran\\_energimarknadsinspektionen\\_svenska\\_kraftnat\\_svensk\\_energi\\_svenskt\\_naringsliv\\_emir\\_2007\\_02.pdf](http://ei.se/Documents/Publikationer/rapporter_och_pm/Rapporter%202007/Prisområden_pa_elmarknaden_pompe_gemensam_rapport_fran_energimarknadsinspektionen_svenska_kraftnat_svensk_energi_svenskt_naringsliv_emir_2007_02.pdf) accessed 20.05.2013.

need for new price areas, independent of the national borders.<sup>625</sup> A second report (NCM's 2008 report) emphasised the inefficiencies of congestion shifting, and showed that increasing the number of prices areas from seven to eleven would improve socioeconomic benefits, and it recommended further market splitting.<sup>626</sup> The Nordic Energy Regulators (NordREG, 2/2007) reported that Congestion shifting constituted a common and frequent congestion management practice among all Nordic TSOs, not only the Swedish one,<sup>627</sup> and saw this as a ground to change the Nordic price areas.<sup>628</sup> The Nordic Competition Authorities (2007) analysed the competitiveness of the Nordic electricity market,<sup>629</sup> but with respect to the Swedish congestion problems, they mainly referred to the results of the POMPE report.<sup>630</sup> Following those reports, the Nordic Council of Ministers asked the national TSOs in 2010 to investigate the introduction of new price areas, and the Swedish government commissioned SvK to start a process to create several price zones in Sweden.<sup>631</sup> This process involved consultations with the Energy Market Inspectorate, the Competition Authority, Nord Pool Spot and dialogues with market participants, including generators, traders, distribution network operators and industrial consumers.<sup>632</sup> This

<sup>625</sup> Ea Energy Analyses and COWI, *Steps for improved congestion management and cost allocation for transit*, Report for the Nordic Council of Ministers, TemaNord 2007:537, April 2007, available at <http://www.norden.org/da/publikationer/publikationer/2007-537> accessed 20.05.2013, p. 17.

<sup>626</sup> Ea Energy Analyses, Hagman Energy and COWI, *Congestion Management in the Nordic Market – evaluation of different market models*. Final Report for the Nordic Council of Ministers (NCM), May 2008. From an economic point of view, nodal pricing, which can be considered an extreme case of market splitting (as opposed to a single price area) is an optimal congestion management method, as it ideally reflects the technical aspects of the transmission network. However, in this report, the consultants analyse further market splitting along all bottlenecks based on a model simplified to 11 price areas due to the availability of data. For details, see Final Report, p. 21.

<sup>627</sup> For instance, during dry years, when electricity flows from the Southern Finland to the North, Fingrid reduces export capacity to Sweden, to relieve internal congestion on cut P1 (part of the congestion is eliminated by counter-trading, if feasible). To the contrary, import from Sweden is limited during wet years, when the surplus of electricity in the North of Finland flows to the South, again creating congestion on cut P1, this time in the opposite direction. Similarly, Statnett reduces export capacities towards Sweden to protect Oslo with its high level of consumption during cold winter days, at the same time reducing Sweden's security of supply (so-called 'Hasle-trappen' or 'Hasle stairway'). See NordREG, *Congestion Management in the Nordic Region* supra n. 438, pp. 15-16 and 25. Organisation of the Nordic TSOs (Nordel), *Nordic Grid Master Plan 2008*, March 2008, p. 28. See also Statnett's website at <http://www.statnett.no/en/The-power-system/The-power-situation/Handling-of-bottlenecks-and-use-of-Elspot-areas/> accessed 20.05.2013. See also The Swedish Energy Agency, *Hantering av begränsningar i det svenska överföringssystemet för el: ett nordiskt perspektiv*, 2005:11, in Swedish only.

<sup>628</sup> NordREG (2007), supra n. 438, p. 13.

<sup>629</sup> Nordic Competition Authorities (2007), supra n. 453.

<sup>630</sup> Nordic Competition Authorities (2007), supra n. 453, pp. 38-39.

<sup>631</sup> Annual Government Regulation Document for Svenska Kraftnät of 2009 (Regleringsbrev för affärsvetket svenska Kraftnät för 2009), in Swedish only.

<sup>632</sup> See Svenska Kraftnät, *Background explanations*, supra n. 462, p. 13.

time, there was no outright opposition from the Swedish industry. However, Svedenergy, the flagship organisation of Swedish power suppliers, suggested waiting with market splitting until the planned investments in the Nordic grid would be finalised.<sup>633</sup> Grid reinforcement would, according to Svedenergy, limit the need to introduce multiple price areas.<sup>634</sup> At the same time, however, this would postpone market splitting until 2013 at the earliest.

It appears that the Nordic debate on market splitting would sooner or later have led to a subdivision of the Swedish market into smaller price areas. However, the antitrust intervention by the European Commission not only intensified the ongoing discussions, but also most probably accelerated the introduction of price zones in Sweden by several years. Evidently, the progress in the market splitting debate was and would have remained slow, partly because other long-term solutions to internal congestion were pursued in parallel to the debate on market splitting (e.g. Nordel's project of grid enforcement), and partly because many stakeholders tried to press their own clashing interests. Clearly, it was easier to introduce market splitting via an antitrust deal. The bilateral character of Article 9 negotiations enabled the Commission to discuss commitments directly with SvK, excluding interest groups' interventions. Of course, any potential opponents to market splitting were given the option to express their concerns about the proposed commitments within a month following their official publication.<sup>635</sup> This phase, called market testing, is an obligatory part of the investigation in which the Commission consults the market regarding the impact of the proposed commitments. Any feedback received from the interested third parties has to be taken into consideration by the Commission before rendering the commitments binding upon the undertaking. If the opposing views expressed by the market participants convince the Commission, it may ask the undertaking in question to modify the commitments accordingly. However, it may also find that the observations received in the market test are not serious enough to

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<sup>633</sup> The so-called ‘Pakken’, a package of five already decided investments in the Nordic grid, included in the Nordel’s 2004 investment plan.

<sup>634</sup> See Svedenergy, *The Electricity Year 2008*, p. 8.

<sup>635</sup> Article 27(4) of Regulation 1/2003, *supra* n. 14.

reconsider the commitments. In such a case, the Commission quotes the opposing views of stakeholders gathered in the consultation, argues why it maintains its position, and accepts the commitments in their initial shape. And this is what happened in the *SvK* case.

Firstly, some stakeholders questioned the adequacy of market splitting as a remedy to tackle internal congestion, arguing for counter-trading and grid investments instead. In response to that, the Commission asserted that market splitting is a sufficient and proportionate remedy to solve the problems identified in the preliminary assessment.<sup>636</sup>

Secondly, the stakeholders feared that market splitting would increase concentration in the Swedish wholesale, retail and balancing markets and, as far as South Sweden is concerned, it would lead to higher prices.<sup>637</sup> In this respect, market participants shared the concerns of the Swedish TSO.<sup>638</sup> However, in view of the Commission, market splitting does not increase concentration, but merely reveals the fact that the market is already concentrated. The Commission quotes the NCM's 2008 report, which recommends splitting the Nordic market into smaller price zones.<sup>639</sup> It also refers to Norway, where retail market remained competitive despite subdivision of the country into Elspot areas. Regarding retail markets, it states that the costs and risks which market splitting poses to retailers (and thus deters entry in retail markets) can be diminished by entering into contracts for differences (CfD)<sup>640</sup> and, in the longer run, by investing in new generation. Regarding wholesale and balancing markets and higher electricity prices in South Sweden, the Commission points out that market splitting will decrease market power and lead to price convergence between South Sweden and North Sweden over time, as it sends correct investments signals to the

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<sup>636</sup> Commission Decision, *supra* n. 439, paras. 51-52.

<sup>637</sup> In the aftermath of market splitting prices in the southern areas of Sweden have indeed increased. As reported in November 2011, particularly affected were electricity consumers in the southern Götaland. See press release 'Elbolag kritiskt till nya elprisområden' available at <http://sverigesradio.se/sida/artikel.aspx?programid=83&artikel=4795027> accessed 20.05.2013, in Swedish only.

<sup>638</sup> Svenska Kraftnät, *The complaint from Dansk Energi*, *supra* n. 466, p. 4.

<sup>639</sup> Nordic Competition Authorities (2007), *supra* n. 453.

<sup>640</sup> CfD is a derivative whose reference price is the difference of the system price and a certain area price. CfD are used for hedging against any price differential between the system price and a specific Elspot area price.

market. In answer to the fears of energy-intensive consumers that higher prices in South Sweden might have a negative impact on their competitiveness, the Commission points out that market splitting creates a level playing field for all industrial consumers in the EU, as price zones reflects the true market conditions. Also, it assures that the Swedish national regulation empowers EMI to monitor electricity prices.<sup>641</sup>

Thirdly, some stakeholders proposed to postpone the implementation of the remedy package until 2013, claiming that an early introduction of price zones puts some of the current financial and long-term supply contracts at risk, as they would change their value. Other stakeholders opted for a longer delay (up to 5 years), until their fixed-price long-term supply contracts with final customers would expire. The Commission rebuts this argumentation, saying that market players in electricity sector are exposed to all kinds of risks and market splitting is just one example of these. It points out that in the light of the market splitting debate stakeholders were aware of an upcoming general change of regulation and the financial risks connected with entering into long-term contracts.<sup>642</sup>

Lastly, some stakeholders were concerned that market splitting might have a negative effect on investments in renewables. Namely, some investment projects in North Sweden, where the largest potential for green energy is located, might appear unprofitable once the energy prices go down in that area. As a result, Sweden would not achieve the 2020 national overall target for the 49% share of green energy in gross final consumption.<sup>643</sup> This set of arguments was also rejected. The Commission noted that new investments in renewable generation in the North cannot contribute to a larger share of renewables in final consumption for 2020, because energy is mostly

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<sup>641</sup> Commission Decision, *supra* n. 439, paras. 53-59.

<sup>642</sup> Commission Decision, *supra* n. 439, paras. 60-69.

<sup>643</sup> Annex 1 of Directive 2009/28/EC of the European Parliament and the Council of 23.04.2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ L 140/16.

consumed in the South and, due to congestion in the grid, more green energy would not be transported there anyway.<sup>644</sup>

Taken together, even though many stakeholders opposed the introduction of the price zones and came up with various arguments against market splitting in response to the Commission's market test, none of them succeeded in stopping or even delaying the implementation of the commitments.<sup>645</sup> It therefore comes as no surprise that the SvK's decision to introduce price zones triggered protests in Sweden and has been challenged under Swedish national law.<sup>646</sup>

## 5.6. EUROPEAN RULES ON CONGESTION MANAGEMENT

This section takes a closer look at the EU sector-specific regulation as a tool to integrate electricity markets, next to competition rules and political pressure. First, we briefly describe the existing EU rules on cross-border congestion management in relation with congestion shifting (5.6.1), and then show that SvK's cross-border capacity reductions do not violate EU law (5.6.2). Large legislative developments in the area of cross-border congestion management are forthcoming, as explained in 5.6.3. Although transparency and allocative efficiency of cross-border capacity will improve as a result, market splitting will not be imposed on Member States. We close this section with a summary of the effects of the EU regulation on congestion shifting (5.6.4).

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<sup>644</sup> Commission Decision, *supra* n. 439, paras. 70-72.

<sup>645</sup> However, on the SvK's request, the Commission agreed for a four-month delay in the implementation of market splitting. See Commission Decision, *supra* n. 439, paras. 60-75.

<sup>646</sup> Appeal by Värnamo Elnät, press release 'Beslut om elprisområdena kan gå till domstol', in Swedish only, available at <http://sverigesradio.se/sida/artikel.aspx?programid=83&artikel=5086389> accessed 20.05.2013.

### 5.6.1. Existing EU Rules on Congestion Shifting

EU laws regarding congestion management on cross-border lines have been under constant development for more than a decade.<sup>647</sup> For the purpose of our case study we focus on the regulatory regime that existed from 2006 until 2009. At that time DaE's complaint was pending before the Commission, and handling it under EU sector-specific regulation might have been under consideration. As the provisions on congestion shifting in EU law have not fundamentally changed by the adoption of the 3<sup>rd</sup> Energy Package in 2009, our analysis also reflects the current situation.

It is important to note from the outset that EU law regulates *cross-border* congestion management only, namely congestion arising on interconnectors between the countries. Relieving congestion on *internal* transmission lines is subject to national rules on congestion management. Notwithstanding their limited scope, the EU rules impose restrictions on congestion shifting<sup>648</sup> since it affects *cross-border* transmission capacities.

In 2006 cross-border congestion management was regulated by provisions of the 2<sup>nd</sup> Energy Package.<sup>649</sup> Directive 2003/54/EC<sup>650</sup> stipulated that TSOs are responsible for ensuring a secure, reliable and efficient electricity system. Further, when managing energy flows in their networks, TSOs should take cross-border trade into account.<sup>651</sup>

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<sup>647</sup> The initiative to create an EU regulatory framework for congestion management on cross border lines started with the 2nd and 3rd meeting of Florence Forum of October 1998 and May 1999. Established in 1998, the Florence Forum is a platform to discuss the creation and development of the internal electricity market and to monitor the market integration process. Participants include governments of the Member States, national regulators, the Commission and, most importantly, market participants: TSOs, traders, consumers, grid users and power exchanges. See Everis and Mercados EMI, *From Regional Markets to a Single European Market*, Study commissioned by the European Commission, Final Report, 2010, p. 16. See also CONSENTEC and Frontier Economics, *supra* n. 516, Executive Summary. Detailed information on the Florence Forum can be found at

[http://ec.europa.eu/energy/gas\\_electricity/electricity/forum\\_electricity\\_florence\\_en.htm](http://ec.europa.eu/energy/gas_electricity/electricity/forum_electricity_florence_en.htm) accessed 20.05.2013.

<sup>648</sup> For instance, already in 2007 the Commission threatened to start infringement procedures against Member States for non-compliance with the provisions of the 2<sup>nd</sup> Energy Package regulating cross-border congestion management, at that time in force See *supra* n. 554 and accompanying text.

<sup>649</sup> A legislative package for an internal gas and electricity market in the EU, replaced in 2009 with the 3<sup>rd</sup> Energy Package.

<sup>650</sup> Directive 2003/54/EC, *supra* n. 73.

<sup>651</sup> Article 9 (c) of Directive 2003/54/EC, *supra* n. 73.

Regulation 1228/2003<sup>652</sup>, which is directly applicable in all Member States, spelled out common rules on *cross-border* congestion management, according to which non-discriminatory market based methods are preferred. They applied to congestion management on interconnectors, however not within the countries. Nevertheless, Regulation 1228/2003 required all TSOs to give maximum interconnector capacity to the market, within the system security limits.<sup>653</sup> The first version of Congestion Management Guidelines (CM Guidelines) annexed to the Regulation, while not imposing any specific (again, cross-border only) congestion management method on the TSOs, gave some indication of favoured mechanisms. Namely, they stated that ‘the possible merits of [...] market splitting [...] for solving “permanent congestion” and counter-trading for solving “temporary congestion” shall be immediately explored as more enduring approach to congestion management.’<sup>654</sup> Thus, both market splitting as well as counter-trading were explicitly mentioned in the CM Guidelines as the methods in preference for dealing with *cross-border* congestion. The CM Guidelines were amended by the end of 2006, which was shortly after DaE submitted its complaint to the Commission.<sup>655</sup> The new version of these Guidelines explicitly stated in paragraph 1.7 that ‘TSOs shall not limit interconnection capacity in order to solve *congestion inside their own control area*’, save for the reasons of (a) operational security, (b) cost-effectiveness, and (c) minimisation of negative impacts on the internal electricity market.<sup>656</sup> If the TSO shifts internal congestion to the borders for any of these reasons, it needs to describe such instances and make it available in a transparent way to all the system users. Finally, according to this new version of the CM Guidelines, these exceptional cross-border capacity reductions were just a stopgap measure, and should not have been considered a permanent solution to congestion problems. They were allowed temporarily, until a long-term remedy was to

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<sup>652</sup> Regulation 1228/2003, *supra* n. 73.

<sup>653</sup> See Article 6 of Regulation 1228/2003, *supra* n. 73.

<sup>654</sup> CM Guidelines, *supra* n. 553, Principles governing methods for congestion management, par. 3.

<sup>655</sup> The Commission was empowered by the 2<sup>nd</sup> Energy Package to amend the CM Guidelines in order to ensure that congestion management methods in use are compatible with internal market objectives. Given the unsatisfactory results of the 2005 energy sector inquiry, the Commission amended the CM Guidelines already in 2006. Commission Decision of 09.11.2006 amending the Annex to Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity, 2006/770/EC [2006] OJ L 312/59, and Article 8(4) of Regulation 1228/2003.

<sup>656</sup> *Ibid.*, para 1.7. Introduction of these exceptional grounds was strongly supported by Germany.

be found. The Guidelines did not impose any deadlines to introduce long-term mechanisms to tackle congestion problems, but they required TSOs to develop plans for achieving such long-term solutions and to present them on a transparent basis to all system users.<sup>657</sup>

The start of formal antitrust proceedings in the *SvK* case coincided with the adoption of the 3<sup>rd</sup> Energy Package in 2009. The old Regulation 1228/2003 is now replaced with Regulation 714/2009<sup>658</sup>, however paragraph 1.7 of CM Guidelines on congestion shifting has been adopted in the 3<sup>rd</sup> Energy Package as it stands and thus still remains applicable.<sup>659</sup>

#### *5.6.2. Existing EU rules on congestion shifting – what do they mean for the TSOs?*

The previous section described the EU law on cross-border congestion management in relation to congestion shifting. In this section we argue that *SvK*'s practice of congestion shifting did not violate EU law. Under the existing EU regulatory regime, the national TSOs have some leeway as to the way they deal with internal congestion. Cross-border capacity reductions are allowed as a method of last resort, provided that network operators are transparent about them and can justify them on one of the three grounds set out in the CM Guidelines, that is, (a) operational security, (b) cost-effectiveness, and (c) minimisation of negative impacts on the internal electricity market. All three criteria are sufficiently broad to explain various instances of congestion shifting.<sup>660</sup>

Operational security (a) is defined by the CM Guidelines as ‘keeping the transmission system within agreed security limits.’<sup>661</sup> The system security reason, in particular, is a plausible justification, if counter-trading is not possible, for instance, due to the lack

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<sup>657</sup> *Ibid.*, para 1.7.

<sup>658</sup> Regulation 714/2009, *supra* n. 91.

<sup>659</sup> CM Guidelines, annexed to Regulation 714/2009, *supra* n. 91, para 1.7.

<sup>660</sup> As we explain further below, we do not consider market splitting an alternative to congestion shifting when analysing the three justification grounds (a-c) in the CM Guidelines.

<sup>661</sup> CM Guidelines, *supra* n. 659, at note 1.

of suitable regulating resources. In order to avoid blackouts, a network operator might prefer to reduce the excessive flows in the grid already in the day-ahead market, by shifting congestion to the borders, instead of running the risk of failing to perform necessary counter-trading in real-time. From the operational security's perspective congestion shifting could be thus considered a safer method than counter-trading.

Justifying congestion shifting on the grounds of cost-effectiveness (b) is also possible. However, the concept of cost-effectiveness is not further explained, which somewhat complicates the assessment. The CM Guidelines are silent as to what cost should be considered in order to justify congestion shifting. Should it be cost for the society as a whole or the cost for the network operator only? In chapter 4 we look at congestion shifting from an economic welfare perspective and we find that a combination of congestion shifting and counter-trading may be socially optimal. In that case, shifting *some* congestion to the border reduces social cost in comparison to the other two methods (counter-trading *alone* or congestion shifting *alone*). Hence we show that a network operator can justify *some* congestion shifting on the grounds of (social) cost-effectiveness. If, on the other hand, we consider cost-effectiveness in a narrow sense, that is, as a cost for the TSO, the assessment is somewhat different. Since counter-trading is costly, the more congestion the network operator shifts to the border, the more cost-effective his congestion management is.<sup>662</sup> Thus, with a narrowly defined concept of cost-effectiveness the network operator can justify *not only some* limited socially optimal amount of congestion shifting, *but all* its congestion shifting. In other words, depending on how the concept of costs is understood under the CM Guidelines, TSOs can justify either *some* or *all* of their congestion shifting on the grounds of cost-effectiveness.

Minimisation of negative impacts on the internal electricity market (c) is the third and last justification ground. Just as in the previous case, the Guidelines do not provide further explanation of this rather broad precondition. This allows for various

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<sup>662</sup> Note, however, that even though counter-trading is costly for TSOs, those costs consist mainly of transfers to generators, and are therefore not true social costs. Counter-trading might give generators wrong long-term investment incentives, but those social costs are very hard to identify.

interpretations, making it a catch-all criterion. Read in conjunction with (a) and (b), it allows for balancing the market integration objective with considerations of efficiency and operational security. Namely, various negative impacts of congestion shifting on internal market in a broad sense (for instance, reducing market liquidity, transparency, and competition in some areas, increasing uncertainty or market power), are weighed against efficiency losses and higher blackout risks connected to the increased reliance on counter-trading. Under such an interpretation of the Guidelines, the TSO could still shift some congestion to the borders and nevertheless comply with the Guidelines, provided it can demonstrate that the amount of congestion shifting is optimal and, at the same time, its negative effects on the neighbouring zones are reduced by the use of counter-trading.

Having said that, we would like to remark that congestion shifting would be more difficult to justify (and this refers to all three justification grounds equally) if market splitting was considered an alternative option for the TSO, next to counter-trading and congestion shifting. For instance, operational security (a) can well be achieved by splitting the market into price zones, as it also eliminates risks connected to counter-trading, just as congestion shifting does. Regarding the second justification ground (b), it would be more difficult to accept cost-saving reasons of congestion shifting if market splitting was an option for the TSO, regardless of what definition of costs we assume, whether that is social costs, or the costs to the TSO. In the previous chapter we show that market splitting is not only socially optimal, but it also brings higher revenues to the TSO than the case of shifting all of its congestion to the borders. Therefore, as long as market splitting is possible, it is as effective as congestion shifting in terms of minimising social cost, and is more effective than congestion shifting in terms of minimising costs to the TSO. Similar considerations regarding advantages of market splitting as a method minimising negative impacts on the internal market (c) apply.

However, in our opinion, market splitting cannot provide a short-run viable alternative to congestion shifting and counter-trading in the light of paragraph 1.7 of the CM

Guidelines. Market splitting constitutes a substantial change in national market design. It requires adaptation of market routines, IT systems and also national regulation, not to mention a certain degree of political endorsement. Implementation of market splitting takes time, therefore this solution cannot be taken into consideration when determining, under this provision, whether separate instances of congestion shifting are justified on the above listed grounds (a, b and c). The imprecise wording of CM Guidelines allows for such an interpretation. It has been mentioned in section 5.6.1 that instances of congestion shifting shall be tolerated only until *a long-term solution* to internal congestion is found. The provision leaves it to the network operators to develop the methodology and projects of a long-term solution, without giving further guidelines in that respect. Market splitting, which took SvK a year and a half to implement, can be considered a long-term (or at least medium-term) solution, which cannot be considered a readily available option for the network operator in case internal congestion occurs. For this reason we do not take market splitting into account, when discussing the three preconditions.<sup>663</sup>

Summarising this section, we conclude the following. First, current EU sector-specific regulation allows national TSOs to shift internal congestion to the borders. Even though the CM Guidelines generally do not permit congestion shifting, they formulate three justifications for doing so, which are broad and vague enough to justify much of current practice by many European network operators. This also the opinion of NordREG who stated in 2007 that congestion shifting is not as such prohibited by the EU law. It suggested that the Nordic TSOs can still ensure compliance with the 2006 CM Guidelines while shifting congestion to the borders, by describing transparently the reasons for cross-border capacity reductions and their effects.<sup>664</sup> Second, the Commission would not have been able to impose market splitting in Sweden based on existing EU rules. Since the CM Guidelines regulate *cross-border* congestion

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<sup>663</sup> Also investments in grid reinforcements, which can take years of planning and building, can reduce the need for congestion management and congestion shifting in the long run. For instance, NordREG's Compliance Report 8/2007 names the Nordel's five prioritised investments in the Nordic grid, *supra* n. 633, as long-term solutions to internal congestion in the meaning of the CM Guidelines. See NordREG, *Congestion Management Guidelines*, Compliance Report 8/2007, p. 10. However, we do not believe that network reinforcements will fully eliminate the need for congestion management.

<sup>664</sup> NordREG's Compliance Report 8/2007, *supra* n. 663, p. 5.

management only, they do not impose any specific method for relieving *internal* congestion on national lines. If the network operator cannot relieve internal congestion without cross-border capacity reductions, the only requirement imposed by the EU law is to develop alternative methods to deal with such congestion in the long run and to present them transparently to the system users. Nevertheless, it is for TSOs to choose a long-term method and its introduction date.

### *5.6.3. The new CACM network code and its impact on congestion shifting*

The EU regulation of cross-border congestion management does not stop with the adoption of the 3<sup>rd</sup> Energy Package. Regulation 713/2009 of the 3<sup>rd</sup> Package creates the Agency for the Cooperation of Energy Regulators (ACER) with focus on cross-border issues and the internal energy market.<sup>665</sup> Regulation 714/2009 of the 3<sup>rd</sup> Package establishes ENTSO-E, the European Network of Transmission System Operators for Electricity, and mandates it to develop a cross-border capacity allocation and congestion management (CACM) network code.<sup>666</sup> The ENTSO-E's final proposal for the CACM network code has been submitted to ACER for evaluation in September 2012,<sup>667</sup> and is expected to enter into force in 2014 following the adoption by the Commission.<sup>668</sup> The CACM network code will take form of a binding EU Regulation, amending the CM Guidelines where necessary. It will be directly applicable in all Member States, without the requirement of transposition into national law. As with all other network codes developed by ENTSO-E, the CACM network code has to be in line with Framework Guidelines adopted by ACER in 2011.<sup>669</sup> <sup>670</sup>

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<sup>665</sup> Regulation 713/2009, *supra* n. 92.

<sup>666</sup> The EU network codes define 'obligations or requirements for entities that operate, plan or use the European electricity transmission system.' See ENTSO-E, *Network Codes Development Process*, 17.02.2012, p. 4.

<sup>667</sup> At the time this chapter was submitted for publication, the CACM network code, in version submitted by ENTSO-E, was evaluated by ACER. In this chapter we refer to the ENTSO-E's final proposal of 27.09.2012, Network Code on Capacity Allocation and Congestion Management, which can be found at <https://www.entsoe.eu/resources/network-codes/capacity-allocation-and-congestion-management/> accessed 20.05.2013.

<sup>668</sup> The EU network codes will be adopted by the Commission in a comitology process, according to the regulatory procedure with scrutiny (RPS). Article 6 (11) read in conjunction with Article 23 (2) of Regulation 713/2009, *supra* n. 92. See ENTSO-E Annual Work Programme 2012-2013 (version of 28.11.2012), downloadable from <https://www.entsoe.eu/publications/key-documents/> accessed 20.05.2013, p. 6.

<sup>669</sup> ACER, *Framework Guidelines*, *supra* n. 517. ACER's *Framework Guidelines* were actually drafted by the European Regulators' Group for Electricity and Gas (ERGEG), a body gathering the heads of all national energy

Those Framework Guidelines are themselves not legally binding, but they specify general requirements that the CACM network code should satisfy. As the CACM network code implements ACER's Framework Guidelines and will become binding law, we focus our discussion on the code and not on the Framework Guidelines.

Regulation 714/2009 provides that the CACM network code regulates *cross-border and market integration* issues, and should not replace national network codes which do not affect cross-border exchange.<sup>671</sup> This wording suggests that the new network code should not interfere with regulation of congestion management at national level. In particular, it should not state whether a country should be split in smaller price zones or use counter-trading. However, any national arrangement which reduces export capacities to relieve internal congestion affects cross-border trade, and as such might be subject to the CACM network code. The CACM network code states that '[t]ransmission system operators will use a common set of remedial actions<sup>[672]</sup> to deal with both internal and cross zonal congestions' and that they 'will coordinate the use of remedial actions in capacity calculation to facilitate more efficient capacity allocation.'<sup>673</sup> The code thus foresees application of similar congestion management methods *both for internal and cross-border lines* at least at a regional level. This can include, for instance, counter-trading actions within zones, across zones or across countries; or internationally coordinated use of circuit breakers and switches to better address transmission constraints; or changes in network topology.<sup>674</sup> Establishing such

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regulatory bodies and advising the Commission on energy market issues (supra n. 519). In 2011 ERGEG was dissolved and its tasks (also development of the Framework Guidelines) were taken over by ACER.

<sup>670</sup> As the third package provides for, the CACM network code has to be in line with the Framework Guidelines. Article 6 (6) of Regulation 714/2009, supra n. 91.

<sup>671</sup> Recital 7 and Article 8 (7) of Regulation 714/2009, supra n. 91.

<sup>672</sup> Remedial actions are defined as measures to relieve physical congestions. Article 2 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, supra n. 667.

<sup>673</sup> Recital 22 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, supra n. 667.

<sup>674</sup> Article 2 (2) of the CACM network code explicitly defines remedial actions which are not fully controlled by the TSO in charge of a control area in which congestion takes place as Cross Control Area Remedial Actions. This implies that remedial actions include actions to relieve internal congestion which are currently performed internally by the relevant TSOs. All TSOs within one Capacity Calculation Region shall coordinate regarding the use of remedial actions for capacity calculation and their real-time application (Recital 22 and Article 30 (6) of the CACM network code, ENTSO-E's final proposal of 27.09.2012, supra n. 667). Further, each Coordinated Capacity Calculator (set at the regional level) shall optimise cross-border capacities using available remedial actions (Article 34 (6) of the CACM network code ENTSO-E's final proposal of 27.09.2012, supra n. 667).

a common set of remedial actions will require harmonisation of national and regional congestion management rules.

Moreover, the CACM network code is going to change how cross-border capacity is determined. Currently, transmission capacity available for trade between two countries is determined *bilaterally* for each interconnector by the neighbouring TSOs. This means that each of the two TSOs sets a forecasted capacity value for that interconnector given operational security constraints of their respective networks. The lower of the two values is then accepted as the transfer capacity available for trade to the market. This capacity is called the Net Transfer Capacity (NTC). The CACM network code foresees that capacity calculations shall be done in a coordinated way at least on a regional level and will be flow-based, although the implementation of those changes might take some years.<sup>675</sup> The advantage of regional flow-based capacity calculation is that it takes the physical characteristics of the network into account and therefore uses transmission capacity more efficiently.<sup>676</sup> It will also prevent discrimination between capacities allocated to different interconnectors.<sup>677</sup>

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<sup>675</sup> See Article 24 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667. Whereas the CACM network code strongly recommends the flow-based (FB) capacity calculation and allocation method, the use of NTC is still permitted, especially for non-meshed networks (e.g. the Nordic market) and in cases where the FB method does not (1) ensure system security, (2) lead to an increase in social welfare (3) provide market participants with sufficient time to adopt their processes. Further, the FB method has not been in operation yet and it requires more experiments with real data before its implemented. See ENTSO-E, *Network code on Capacity Allocation & Congestion Management Supporting Document, A consultation document to support the assessment of the draft network code*, Supporting Document, available at <https://www.entsoe.eu/events/cacm-nc/> accessed 20.05.2013, pp. 19-20.

<sup>676</sup> Electricity flows through the transmission network according to the laws of physics, along the lines of least resistance between its source and destination, just like water flows through a network of canals. By assigning a certain transfer capacity to one interconnector (NTC) in order to enable a cross-border transaction, the network operator ignores the physics, because in reality the contracted electricity flows along many parallel interconnectors to reach the point of destination abroad. These 'unscheduled' flows are taken into account in a flow-based capacity calculation resulting in a more efficient use of interconnectors.

<sup>677</sup> This can be explained easily with an example. Suppose that country A can export to countries B and C. For the reasons of system security total exports (that is the sum of exports to countries B and C) must not exceed a fixed transmission capacity K, which is determined by the physical constraints of the network. In the NTC approach, the network operator in country A would have to divide total export capacity over the cross-border lines in an ad-hoc way, by setting one NTC value for exports from A to B and one from A to C. In the flow-based approach, the network operator does not set a specific capacity value at each border, but gives all the information on the physical constraint to the power exchanges. Those exchanges will then simultaneously operate all regional price zones, ensuring efficient use of the network. Access to the transmission capacity will not be ad-hoc, but based on competitive pressure.

However, the regional flow-based capacity calculation method does not inhibit TSOs from discriminating *between national and cross-border flows*, and congestion shifting can still take place during the calculation of flow-based transmission capacities at the regional level. Regional capacity calculation will be based on data provided by the network operators. For their part, network operators will still need to make assumptions about energy flows that pass over their respective networks *without* international trade<sup>678</sup> and under a number of contingencies,<sup>679</sup> before determining how much transmission capacity is left for international trade. This method implicitly gives *national* flows priority over *cross-border* flows, and assumes that network operators will rely on counter-trading only to a limited extent. If this was the approach assumed in Sweden, it might have led to full congestion shifting in violation of Article 102 TFEU. Hence, depending on the actual implementation of the CACM network code, congestion shifting may still be possible.<sup>680</sup>

Moreover, congestion shifting can take place not only during the calculation of flow-based transmission capacities, but also later, during the so-called validation phase. Namely, once the flow-based capacities are determined in a coordinated way for a region, they still need to be validated for each border by both neighbouring TSOs.

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<sup>678</sup> Note that even if there is no international trade between price zones, flows in one price region might be influenced by loop flows caused by regional imbalances in other price zones. Those loop flows will not create net imports or exports in a price zone, but will affect individual transmission lines.

<sup>679</sup> Contingencies might include a failure of a single or multiple transmission lines, a sudden breakdown of a large power plant, or overloading of a transformator. Network operators often use an N-1 (or N-2) rule, which means that the network needs to remain stable even if one of its N components (or two components) breaks down.

<sup>680</sup> We see two reasons why the network operators could still shift congestion in the new model of regional capacity calculation set up by the upcoming CACM network code. (1) According to Article 30 (4) of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667, in order to determine the available network capacity, network operators should try to maximise the available capacity by foreseeing non-costly remedial actions, (such as changes in network topology), but should not take into account costly remedial actions (such as counter-trading). Hence the capacity that is made available for cross-border capacity is calculated in such a way that there is no need to rely on counter-trading to eliminate congestion. As shown in chapter 4, this is actually identical to the alleged abuse of SvK. (2) In the flow-based regional capacity calculation model electricity system will be represented with one node for each price zone, and the network operator needs to specify the so-called Generation Shift Keys, that is, how much an increase in electricity production in its price zone will affect the flows on each of the lines in the regional model (Article 29 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667). However, in reality, not all generation plants are located in the same location within the price zone, and the impact of a production increase on congestion will depend on the precise location of production. The network operator therefore needs to make assumptions on the typical location of generation within its network. For the Swedish network, SvK is likely to assume that cheap hydro power plants in the North are operating at full capacity, and therefore put a lot of weight on those production levels, leaving less capacity for cross-border trade.

During the validation process, TSOs can correct the capacities for reasons of system security.<sup>681</sup> The CACM network code seems to be stricter than the CM Guidelines as it allows for cross-border capacity reduction *only for reasons of system security*, while the CM Guidelines allow for congestion shifting not only for security reasons, but also for cost-effectiveness and minimising negative impacts on the internal electricity market.<sup>682</sup>

While some provisions of the CACM network code leave scope to TSOs to shift congestion, other provisions impose reporting obligations, which might make congestion shifting more transparent and easier to detect. Firstly, TSOs need to report all reductions of cross-border capacities during the validation process, and to justify those reductions.<sup>683</sup> Secondly, they need to list the location and frequency of congestion in their system, and provide a technical analysis of the existing price zones.<sup>684</sup> In their reports, TSOs may recommend changes in the price zone configuration. On that basis national energy regulators can launch a review of existing price zones, and split, merge, or adjust their borders, taking into consideration internal bottlenecks and loopflows in a meshed network.<sup>685 686</sup> This can lead to more efficient delineation of price zones in the long run.

In summary, the new CACM network code is likely to affect existing methods of relieving internal congestion. In particular, establishing a region-wide set of remedial actions necessitates harmonisation of national arrangements. Despite that, congestion shifting will still be possible during the coordinated capacity calculation process. First, a flow-based capacity calculation method primarily addresses discrimination between different cross-border flows, but still implicitly gives national flows priority over

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<sup>681</sup> Article 31 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667.

<sup>682</sup> Article 31 (3) of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667. The code defines system security as "the ability of the power system to withstand unexpected disturbances or contingencies" (Article 2 (2)), while the CM Guidelines refer to operational security. We assume here that those concepts are identical.

<sup>683</sup> Article 31 (5) of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667.

<sup>684</sup> Article 40 of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667.

<sup>685</sup> With loopflows, zone borders do not necessarily need to be at the congested transmission lines.

<sup>686</sup> A review of price zone configuration can also be launched upon recommendation of ACER. See Article 37 (1) of the CACM network code, ENTSO-E's final proposal of 27.09.2012, *supra* n. 667.

cross-border flows. Second, TSOs can still shift congestion during the capacity validation phase, even though deviating from flow-based capacities is made more difficult (i.e. it can be done for system security reasons only). Nevertheless, additional reporting provisions improve transparency and trigger procedures which might mitigate the problem of congestion shifting in the long run, by introducing changes in network topology.

#### *5.6.4. Limits of the EU regulation*

Under the existing EU regulatory regime SvK would not be required to introduce market splitting in Sweden or to cease congestion shifting and increase counter-trading. The EU law regulates *cross-border* congestion management, whereas TSOs are free to choose their own methods to solve problems with internal congestion. Even though the EU law generally prohibits congestion shifting, because it reduces cross-border transmission capacities in favour of national network users, it leaves a wide scope of exception to this prohibition, allowing TSOs to shift congestion when needed and justify it on grounds of (a) operational security, (b) cost-effectiveness, and (c) minimisation of negative impacts on the internal electricity market. The upcoming CACM network code attempts to harmonise congestion management at regional level, but still leaves scope for congestion shifting, even though deviating from flow-based capacities will be limited to (a) operational security only.

Given our discussion on the EU regulation of congestion management, we conclude that the commitments offered by SvK went beyond what the Commission could achieve on the EU regulatory front. While the EU regulation in force can only promote efficient management of *internal* congestion, without imposing on TSOs any specific congestion management method, the Commission, by means of competition enforcement, actually pushed through market splitting in Sweden. The same could be said with regard to the interim remedy. SvK committed to relieve internal congestion primarily through counter-trading and not to shift congestion to the borders, as long as

it found available regulating resources.<sup>687</sup> A regulatory equivalent of this remedy would amount to an outright ban on congestion shifting, whereas the EU regulation allows for broad exemptions so network operators can continue their current congestion management methods.

The existing EU regulation appears to have reached its limits in terms of controlling congestion shifting. The deficiency of the legal framework derives to some extent from the Union's limited competence to regulate energy markets. The current CM Guidelines regulate *cross-border* congestion management only, whereas congestion management on national electricity lines does not underlie the provisions of the EU Regulations, but remains in the Member State's sphere of competence and is regulated in national network codes. As a result, transmission networks are governed by an unwieldy dual legal regime.

We believe that further regulation based on this artificial separation of the transmission network into cross-border and national lines will prove to be a futile exercise, given the physical complexity of transmission systems. In a meshed network, any national transaction will also affect electricity flows over cross-border transmission lines, and by the same token, any international transaction will affect electricity flows over national transmission lines. Technically, it is thus impossible to separate national lines from interconnectors. Treating them as legally independent problems only frustrates progress in congestion management.<sup>688</sup>

In our opinion, it would not make sense for the Commission to outright prohibit or limit congestion shifting under the EU regulation. Instead, we would suggest that the Commission, through or in cooperation with ACER, national energy regulators and

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<sup>687</sup> In fact, SvK argued in the case that it would not be possible to completely eliminate congestion shifting and rely on counter-trading, due to lack of sufficient regulating resources. See Commission Decision, *supra* n. 439, para. 49. In practice, SvK did shift congestion to the borders in the interim phase, whereas counter-trading could not be carried out, most often due to unavailability of suitable regulating resources in a given area. See Svenska Kraftnät, *Monitoring Reports*, *supra* n. 476. This does not change the fact, however, that the interim procedure, giving priority to counter-trading, was aiming at complete elimination of congestion shifting.

<sup>688</sup> Fortunately, this problem is well-understood by the stakeholders and some aspects are voluntarily harmonised at the regional level. For instance, even though EU law regulates the use of cross-border congestion rents, Nord Pool applies this provision also to congestion rents collected from internal bottlenecks.

TSOs, tackles market design head-on, using a more economics-based approach. International transmission capacity should be determined by balancing the costs of counter-trading against the benefits of cross-border trade. A large number of price zones should be introduced in order to limit the cost of counter-trading and ensure correct locational price signals.<sup>689</sup> Once an efficient market design is in place, the legal discussion of congestion shifting will fade away. The upcoming CACM network code, taking a more comprehensive approach to congestion management, is somewhat promising in that respect. We hope that the new provisions will not ignore the organisation of internal congestion management schemes, consider the possibility of more price zones, allow for cross-border counter-trading, and integrate internal and cross-border congestion management.

## 5.7. CONCLUSIONS

This chapter illustrates how the Commission uses competition rules in the *SvK* case to foster electricity market integration in the Nordic countries. We analyse this case against the backdrop of political debate on market splitting that was ongoing in the Nordic countries, particularly in Sweden, and the existing EU regulation on cross-border congestion management.

We find that the Commission employed Article 102 TFEU in a rather contrived manner by considering national congestion management an EU internal market problem and therefore also a competition law problem. Namely, it argued that *SvK* hampered cross-border trade and discriminated on the basis of nationality, thus violating competition rules. Whereas the Commission's anticompetitive analysis focused on internal market issues, important aspects of *SvK*'s alleged abuse could have been objectively justified. For example, there could have been possible efficiency benefits of shifting congestion and maintaining a single electricity price in

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<sup>689</sup> In order for network users to receive the right signals for their consumption, production and investments decisions, prices should reflect the cost of electricity and therefore be differentiated according to location. Prices should be lower in Nord Sweden where cheap hydro production is available and higher in Stockholm, because both setting up generation plants in South Sweden as well as building transmission lines to transport cheap hydro power from Nord Sweden is costly.

public interest. But these possible objective justifications were left off the table by the Commission.

Dealing with the SvK case under commitment procedure made it easier for the Commission to put market integration arguments under the umbrella of Article 102 TFEU and to use competition policy to reach its objective of an integrated electricity market. The standard of proof is much lower in the commitment procedure. The Commission is not required to find an abuse, but merely to formulate its anticompetitive concerns. And there exist no formal procedures which would take objective justification into consideration. Even though market participants have an opportunity to share their views on commitments in the market test, this phase is quick and their concerns can be too easily dismissed by the Commission.

The Commission's focus on fostering market integration through competition policy might backfire, as its assessment lacks solid economic underpinnings, and does not provide correct insights as to how congestion problems should be solved. Furthermore, it does not contribute to the development of a sound EU regulatory framework for congestion management. Had the Commission instead used an efficiency standard in its anticompetitive analysis, it would have resulted in a more nuanced assessment as to whether SvK abused its dominant position by shifting congestion. A thorough economic analysis of the case would have provided more lessons for congestion management in other regions in Europe and contributed to the development of the EU network codes.<sup>690</sup>

As a result of this case, SvK changed its congestion management by introducing market splitting in Sweden. Market splitting is a transparent and efficient way to deal with congestion, which, unlike counter-trading, gives optimal, long-term investment incentives to generators and brings the network operator additional revenue to finance future grid investments. Therefore, we believe that market splitting provides an economically sound solution to Swedish congestion in the long run. However, market

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<sup>690</sup> Supra n. 676.

splitting alone does not prevent future potential abuses, as SvK could still manipulate capacity declarations in order to relieve internal congestion. In any case, market splitting brings more transparency to the market, and thus simplifies detection of congestion shifting.

Judging from the SvK case, competition enforcement appears to be a convenient energy policy tool for the Commission in situations where there is no significant progress on the EU regulatory front and where national interests and industry groups successfully defend existing market arrangements. The Commission's antitrust action against SvK changed the Swedish congestion management system in a surprisingly fast and unproblematic manner. Neither Swedish policy makers, nor the existing EU regulation could have achieved the same result as quickly and effectively. However, we do not believe that the Commission is likely to use similar antitrust actions against other network operators, and will, for the time being, allow ACER, national energy regulators and ENTSO-E to harmonise congestion management regimes at the EU level by issuing further regulatory measures based on the 3<sup>rd</sup> Energy Package in the form of guidelines and the EU network codes.

It was relatively easy to introduce market splitting in Sweden, as local political support for market splitting was growing, preparatory steps of splitting the Swedish market were ongoing, and the market players had a decade-long experience with market splitting in Elspot, the Nordic day-ahead electricity market. This might be hard to repeat elsewhere, given that governments are generally hostile towards market splitting, and market participants are inexperienced with respect to new methods of congestion management. An efficient solution to a complex techno-economic problem such as congestion management is certainly not going to come from competition policy alone, but also through changes on the regulatory front. Efficient EU network codes need to be put in place and enforced, and capacity declarations need to be monitored by the national energy regulators. The problem of congestion shifting is probably only going to be solved once cross-border and internal congestion are treated identically, and sufficiently small price zones are introduced. This will require close

coordination between power exchanges and network operators, and clear guidance from sector-specific regulation, both at the EU and national levels.



## 6. CONCLUSIONS

This thesis is a collection of essays on the instrumental use of commitment decisions for the completion of the internal electricity market. Each core chapter can be viewed in isolation and closes with a concluding section on the specific issues raised therein. Instead, to sum up the thesis as a whole, this last chapter attempts to address the question that has been posed in the introduction, namely:

Has Article 9 contributed to creating the EU internal market for electricity, and if so, at what cost?

As suggested at the outset,<sup>691</sup> this question has two dimensions, which is reflected by the following sections.

### 6.1. ENERGY POLICY DIMENSION

Chapter 1 explains that the completion of the EU internal market for electricity hinges upon two intertwined processes, i.e. opening markets to competition (market liberalisation)<sup>692</sup> and facilitating cross-border trade which takes competition to a supranational level (market integration).<sup>693</sup> These two processes can be considered goals *per se* and, as argued throughout this thesis, the Commission pursues them in the *E.ON* and the *SvK* cases.<sup>694</sup>

#### 6.1.1. *Regulatory objectives pursued by the Commission*

Chapter 3 attempts to show that the Commission's objective in the *E.ON* case is market liberalisation, i.e. opening the German electricity wholesale market to more competition. There is no reference to market liberalisation in the text of the Commission's decision. Instead, the Commission came up with a rather far-fetched

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<sup>691</sup> Supra, section 1.6.

<sup>692</sup> Market liberalisation in the broad sense. Supra n. 65.

<sup>693</sup> Supra, section 1.2.3

<sup>694</sup> Further referred to as the 'selected cases' or the 'analysed cases'.

theory of harm based on capacity withholding. However, as explained in chapter 3, divestitures offered by E.ON had as their aim making the structure of the wholesale market more competitive rather than addressing the Commission's specific anticompetitive concerns.

Chapter 5 argues instead that the *SvK* case had a clear market integration dimension which is already reflected in the wording of the commitment decision. In that sense this decision differs from the one adopted in the *E.ON* case, where the Commission does not explicitly refers to any potential regulatory objective which could drive its action. The reason for this difference is simple. Both market liberalisation and market integration are energy policy objectives, but only market integration is also considered a competition policy objective. It is thus safe for the Commission to invoke it under competition rules, whereas referring to market liberalisation would be a signal of instrumentalisation. Also, the two decisions were adopted in different periods of time. The *E.ON* decision was one of the first Article 9 decisions following the General Court's ruling in *Alrosa*, and the Commission might have been concerned to provide a legally 'clean' theory of anticompetitive harm, free of arguments imported from its other policies. This might have been less important for the Commission in the *SvK* case, as the opinion of Advocate-General Kokott proposing to set aside the General Court's ruling might have suggested that restrictions imposed on the Commission when accepting commitments would soon be relaxed. Apart from this clear reference to market integration in the Commission's *SvK* decision, this objective was mirrored by the commitment package. In particular, the *SvK*'s interim commitment to cease congestion shifting and increase counter-trading would maximise cross-border trade at the expense of efficiency.

Summarising, both cases are examples of an instrumental use of commitment decisions to foster primarily regulatory objectives, liberalisation and integration of electricity markets. However, whereas instrumentalisation in the *SvK* is apparent, because the decision is mostly based on the market integration *rationale (explicit instrumentalisation)*, the *E.ON* case illustrates *de facto* instrumentalisation, where

the Commission's action under competition rules has a primarily regulatory purpose, but is hidden behind purely competition-based reasoning (**implicit instrumentalisation**). As a result, the Commission's preliminary assessment is on its face conform with competition framework in *both* cases, because the Commission either does not suggest it uses competition rules for regulatory objectives, or, if it suggests, a regulatory objective is also considered a competition objective.

#### *6.1.2. Overcoming the limits of sector-specific regulation*

The selected cases show that the Commission might want to use competition rules for regulatory purposes whenever achieving the desired result through sector-specific regulation is not possible, or when it considers that competition enforcement would bring this result quicker.

The relationship between the Commission's antitrust intervention and the EU regulation is to some extent similar in the analysed cases, allowing for the following observations. (1) First, the anticompetitive concerns raised by the Commission in these cases were either not addressed by the existing sector-specific regulation, or the provisions were ineffective. (2) Second, the accepted commitments went beyond what the Commission could achieve by regulatory measures. (3) Third, the Commission's intervention in these cases to some extent activated regulation in those areas, i.e. contributed to the adoption of new provisions or development of the existing ones.

German electricity wholesale market was deregulated already in 1998 as a result of the 1<sup>st</sup> Energy Package<sup>695</sup> but markets remained highly concentrated, with the four major generators (so-called 'big Four') controlling most of the capacity.<sup>696</sup> Whereas the energy reforms abolished regional monopolies and created minimum conditions

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<sup>695</sup> For transposition of the 1<sup>st</sup> Energy Package into German legislation, see Bundesgesetzblatt (German Federal Law Gazette), BGBl. 1998 I, p. 730.

<sup>696</sup> In 2008 E.ON and RWE owned about 60% of domestic generation capacity, whereas E.ON, RWE, Vattenfall and EnBW controlled about 80%.

for entry in generation segment,<sup>697</sup> little could be done about the oligopolistic market structure. Consequently, new entry did not happen. In that respect, the Commission's antitrust intervention was an attempt to 'correct' the structure of the German market. Forcing E.ON to divest 20% of its generation capacity was something which could not have been legitimately achieved by adopting sector-specific regulation. Also, risks of potential manipulation in the electricity wholesale trading were still not addressed by the EU law at that time, because the European power exchanges were considered not liquid enough to have a true cross-border dimension, and thus were of little EU interest.<sup>698</sup> The Commission argued in the *E.ON* decision that market manipulation on the German power exchange would have affected also interconnected markets, which signalled that regulating this area is in the EU interest.<sup>699</sup> Soon after, the Commission came up with the REMIT proposal, regulating trade in energy markets and preventing insider trading and market manipulation.<sup>700</sup>

By the same token, SvK's commitment to split the Swedish market into price zones went beyond what the Commission could achieve by enforcing sector-specific regulation. Even though the EU law regulates cross-border congestion management it does not impose any specific congestion management method to deal with internal congestion. Congestion shifting is generally not allowed, but in reality cannot be complied with. The scope of exemption which reflects this reality makes the provision superfluous. As suggested in chapter 5, the upcoming CACM network code takes a different regulatory approach in that respect. Namely, it might reduce the *need* for congestion shifting in the future, insofar as it leads to more efficient congestion management and cross-border capacity allocation. The Danish complaint signaled that national congestion management has a clear cross-border impact and needs attention at the EU level. Thus, the *SvK* case might have been a trigger for further regulation.

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<sup>697</sup> For instance, by requiring Member States to set up licensing and tendering procedures for new generation.

<sup>698</sup> See U. SCHOLZ and S. PURPS, *supra* n. 225, p. 78.

<sup>699</sup> European Commission, *Impact Assessment – Accompanying document to the Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency*, Commission Staff Working Document SEC(2010) 1510 final, Brussels 08.12.2010, pp. 9-10.

<sup>700</sup> Regulation 1227/2011 (REMIT), *supra* n. 102.

### *6.1.3. Overcoming political opposition*

The selected cases show that the Commission might also want to resort to competition rules to overcome political opposition of Member States or interests of industry stakeholders.

The E.ON case received a lot of media attention in Germany, not so much because of extensive capacity divestitures, but because E.ON also committed to sell off its electricity transmission network.<sup>701</sup> The network divestiture came as a surprise to the German government which was in fierce opposition to the Commission's legislative proposal of ownership unbundling included in the 3<sup>rd</sup> Energy Package. While the Commission's initial proposal has been diluted in the final text adopted by the Council,<sup>702</sup> the E.ON's commitments have been hailed as the Commission's political victory over the German government.<sup>703</sup> Two other energy giants, Vattenfall and RWE, followed suit and also divested their networks, maybe in expectation that, sooner or later, ownership unbundling becomes a regulatory standard.<sup>704</sup> The *E.ON* case demonstrates how the Commission has managed to short-circuit political opposition to ownership unbundling by bilateral negotiations with E.ON to the same effect.

In the Swedish case, the Commission's deal with SvK to introduce market splitting has to be viewed in the context of a long and difficult political discussion on whether Sweden should remain one-price zone or not. As we argue in chapter 5, the SvK case played a crucial role in this debate and accelerated the introduction of price zones in Sweden. The Commission's antitrust intervention brought quicker results, mostly because Swedish industry stakeholders opposed to market splitting, successfully

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<sup>701</sup> The network divestiture commitment has been offered by E.ON to close another antitrust investigation, running in parallel to the investigation analysed in this thesis, the *German Electricity Balancing Market* case (Case COMP/39.389). Both cases have been closed with the same commitment decision.

<sup>702</sup> Supra, section 1.2.3.3.

<sup>703</sup> Supra nn. 305-306.

<sup>704</sup> For Vattenfall's divestiture, see press release 'Swedish energy firm Vattenfall sells German power grid' available at <http://www.dw.de/swedish-energy-firm-vattenfall-sells-german-power-grid/a-5348498> accessed 20.05.2013. RWE divested its gas transmission network in a commitment case (COMP/39.402 – *RWE gas foreclosure*).

blocking regulatory initiatives at the national and Nordic levels, were ignored in Article 9 negotiations.

#### *6.1.4. The Commission's bigger toolbox for regulatory purposes*

Article 9 commitment decisions in the electricity sector can be viewed as one of the Commission's energy policy tools, next to adopting sector-specific regulation and exercising political pressure against governments and energy industry stakeholders. The Commission resorts to competition rules when the two other instruments do not deliver desired results. However, the Commission's antitrust actions should not be considered an alternative but rather a complementary (or supportive) tool in implementing its energy policy, very closely interlinked with the two other instruments. To the extent Article 9 accelerates sector-specific regulation and overcomes political deadlocks, it contributes to the Commission's plans to complete the EU internal market for electricity.

However, the instrumental use of Article 9 raises some serious concerns at the case level, which can be viewed as a *cost* of instrumentalisation. From the energy policy perspective, a commitment decision boils down to an intervention in the electricity market, which can have 1) policy consequences, 2) market consequences.

(1) From the policy' point of view, the Commission's antitrust intervention is a problem-solving exercise, regardless of whether the problem is of competition or regulatory nature. In complex electricity markets, and assuming that the Commission does not fully investigate the case but instead pursues regulatory objectives, there is a high risk that it either gets the problem wrong, the solution, or both. Since the Commission's reasoning is set forth in a binding decision, there is a risk that the Commission's methodology in assessing the problem and the proposed solution in form of commitments provides incorrect insights for energy policy or sets regulatory standards in that specific area.

This risk is well-illustrated by the *SvK* case, where the market integration objective affects the Commission's assessment of congestion shifting to such an extent that it is considered *per se* abusive. The Commission's analysis not only does not contribute in any way to the development of an economically sound regulatory approach to congestion management, but also, what is worse, it provides faulty intuition which might be then adapted by sector-specific regulation.<sup>705</sup> The assessment of capacity withholding in the *E.ON* case also demonstrates shortcomings, because, as argued in chapter 3, the Commission tried to proliferate its anticompetitive concerns to increase its bargaining power and extract far-reaching commitments, rather than to come up with a robust theory of harm with sound economic underpinnings.

(2) At the market level, the consequence of the Commission's action is a specific commitment package which is supposed to address the market problem (assuming there is one) or achieve other related regulatory objectives. Commitments can have a substantial impact on the market, altering the behaviour of market players or bringing substantial changes to the market structure. As explained in chapter 1, there is a risk that commitment packages might not always address the problem identified by the Commission and, what is worse, might even have a negative impact on the functioning of the market.<sup>706</sup>

The selected cases are illustrative in that respect too. The across-the-board divestiture offered by E.ON was not best tailored to remove concerns about the alleged capacity withholding, but was supposed to 'correct' the less competitive market structure. By the same token, market splitting does not solve congestion shifting without sufficient monitoring of *SvK*'s behaviour, however it has a positive impact on the market because it improves the Swedish congestion management. This is not the case of the *SvK*'s interim commitments to cease congestion shifting and rely solely on counter-trading, as it is not an optimal way of solving internal congestion.

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<sup>705</sup> In both analysed cases the Commission's antitrust action triggered to some extent the subsequent legislative proposals, so they might well build on the Commission's methodology developed in these cases. See e.g. European Commission, *Impact Assessment*, supra n. 699, pp. 9-10, referring to the Commission's decision in the *E.ON* case.

<sup>706</sup> Infra, section 1.5.2.1.

## 6.2. COMPETITION POLICY DIMENSION

The concerns about the instrumental use of commitment decisions have been structured in Chapter 1 around three potential suboptimal outcomes, two of which are deviations from the optimal standard of intervention (scenarios **(1a)**: suboptimal case selection and prioritisation, and **(1b)**: suboptimal antitrust response) and one relates to the pro-Article 9 bias in the Commission's antitrust enforcement toolbox **(2)**.

### 6.2.1. *Suboptimal case selection and prioritisation (1a)*

It has been argued in the commitment debate that the option to close cases under Article 9 lowers the Commission's enforcement costs which might impact its case selection and prioritisation. Namely, the Commission might want to intervene in cases where an infringement of competition rules is minor or difficult to prove. It is also argued that instrumentalisation might further distort the Commission's enforcement priorities, because, once regulatory objectives come into picture, the Commission might put a greater weight on the potential gains from intervention.

Chapter 3 argues that it would be very difficult to prove an abuse of capacity withholding. Even if E.ON indeed engaged in this type of price manipulation, either on its own or in collusion with other market players, there is a high chance that the Commission would not find any evidence.<sup>707</sup> The same holds for congestion shifting, classified as abusive in the *SvK* case. Whereas instances of limiting cross-border capacity are observable, the reasons behind them are known only to the network operators (or more specifically, to the engineers in the control room) making congestion shifting impossible to detect. The *SvK* case is specific in that respect because the Swedish network operator was very open about its congestion management, so it would not be challenge for the Commission to 'prove' an abuse. What is more disturbing in the *SvK* case is a finding that congestion shifting is abusive

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<sup>707</sup> In this respect see the results of the investigation into German electricity wholesale market subsequently carried out by the Bundeskartellamt, *supra* nn. 327 and 336.

in the first place. In that respect, concerns that the Commission might intervene in cases where an infringement is minor boils down here to an extreme case where there is no infringement at all.

The cases studied in this thesis are in fact dubious from the competition law point of view (the *SvK* case) and the Commission's concerns relate to infringements which are very difficult to prove (the *E.ON* case, the *SvK* case). This might seem to support the view that Article 9 might encourage the Commission to intervene in weak cases. However, it does not mean that the Commission would not have intervened in these cases, but for Article 9. At least, it is not clear whether the option to close cases under Article 9 has an impact (if any) on the Commission's increased intervention in the energy sector. For instance, the *E.ON* case was a consequence of the energy sector inquiry and should not be viewed in isolation. Follow-up investigations against energy incumbents have built on the energy sector inquiry and were supposed to create a general impression that the Commission does not 'waste words' in its Final Report<sup>708</sup> and is determined to solve issues raised therein.<sup>709</sup> The threat of high fines under infringement proceedings together with the prospect that structural changes will be imposed by the EU regulation sooner or later (e.g. in case of ownership unbundling) apparently created sufficient pressure on E.ON to offer commitments.<sup>710</sup> It seems likely that the *E.ON* case would have been settled informally, had there been no commitment procedure to opt for. The *SvK* case is different insofar as it was triggered by a complaint, and it took the Commission quite some time to decide whether to deal with it under competition rules or not. In that respect the possibility of quickly reaching an agreement with *SvK* under Article 9 might have made the competition law route more attractive in comparison to other possible solutions. Still, there are no reasons why the Commission could not have reached an informal settlement with *SvK* to the same effect.

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<sup>708</sup> Final Report, *supra* n. 78.

<sup>709</sup> See e.g. N. KROES, *supra* n. 60.

<sup>710</sup> In particular, Commissioner Kroes' statements made at that time about high fines and far-reaching structural remedies imposed under Article 7 were supposed to increase pressure on the companies. See N. KROES, *supra* n. 85, p. 4.

In result, it is not clear whether the existence of an Article 9 option played any role in the Commission's decision to intervene under competition rules. Most of the recent energy-related commitment cases were a natural consequence of the energy sector inquiry and the Commission would have opened them anyway and tried to extract commitments informally. The reason why the Commission prefers to close a case under Article 9 is the fact that it can impose fines for non-compliance, and, more importantly,<sup>711</sup> it can set some sort of precedence for the competition and business community, something which can only be achieved by a binding decision. The precedence-setting value of commitment cases, so frequently emphasised by the Commission, seems to be an important element of instrumentalisation, because it allows the Commission to achieve the desired regulatory objectives going beyond the individual investigation and draws competition enforcement somewhat closer to regulation. In fact, precedence setting played an important role in both analysed cases.<sup>712</sup> This is actually a matter of concern, and can thus be viewed as a cost to instrumentalisation from the competition policy perspective. Given that Article 9 cases are weak it would be undesirable if they served to clarify competition policy or contributed to the development of new legal principles or rules. Nevertheless, given the sector-specific context of these cases, there is little risk that the Commission's methodology to assess competition problems identified therein (capacity withholding or congestion shifting) goes beyond competition enforcement in the electricity markets.<sup>713</sup>

To sum it up, the two analysed cases are weak but it does not imply that the option to dispose of cases under Article 9 might impact the Commission's case selection and prioritisation. To the contrary, the example of the Commission's intervention in the

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<sup>711</sup> Undertakings usually comply with informal commitments as well, just because (instead of a fine for non-compliance) they risk that the Commission re-opens its investigation. They also might want to keep a 'clean' record with the Commission. Thus, in that respect, I do not see much difference between a commitment procedure and a settlement.

<sup>712</sup> The *E.ON* case was supposed to set a standard for network divestiture remedies, whereas the *SvK* case was a clear message for other TSOs to respect internal market rules. Supra n. 547 and accompanying text.

<sup>713</sup> However, it might have some standard-setting effects in related industries. For instance, the Commission's test for assessing the compatibility of long-term gas contracts with competition developed in the *Distrigaz* case (COMP/37.966 - *Distrigaz*) was then re-used in the case of long-term electricity contracts of EDF (COMP/39.386 – *Long-term electricity contracts*). See IP/10/290 of 17.03.2010.

energy markets show that the very presence of regulatory objectives leads to instrumentalisation of competition rules in general, and weak cases would have been targeted no matter whether Article 9 route was feasible or not. Lastly and most importantly, it's not really the number of weak cases under Article 9 which should give raise to concerns, but the fact that because of Article 9 weak cases can become law.

#### *6.2.2. Suboptimal antitrust response (1b)*

Another point raised in the commitment debate related to the Commission's antitrust response which might be disproportional to the infringement identified in the preliminary assessment. This problem occurs in both analysed cases and might have negative implications for the energy sector both at the policy level and at the market level, as discussed in section 6.1.4 above.

The same risks can be identified, but this time from the competition policy' perspective. At the competition policy level, precedence-setting effects of Article 9 decisions can provide incorrect insights for future competition enforcement, insofar as '[o]ther market participants can learn from the decision and the commitments what was considered by the Commission sufficient to remove the competition concerns'.<sup>714</sup>

Given that concerns are far-fetched and commitments often do not even remove them, no lessons should be learnt from these cases. Again, given the sector-specific context of the cases, there is little risk that commitments offered in electricity cases can inspire the Commission or national competition agencies when enforcing competition law in other industries, so the risk of ill-developed standards relate to the electricity sector only.<sup>715</sup> At the market level, specific commitment package might be ineffective or might even have a negative impact on competition.

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<sup>714</sup> European Commission, *Antitrust Manual of Procedures*, supra n. 43, chapter 16 on commitment decisions, para. 2.6.

<sup>715</sup> But see supra n. 713.

### *6.2.3. Pro-Article 9 bias (2)*

Lastly, some concerns were expressed that Article 9 can become a surrogate for Article 7, and because of that, all the benefits linked to an infringement decision (i.e. clarification of law, bringing an infringement to an end, public censure, deterrence, disgorgement of illicit gains, punishment and facilitation of damages actions) are lost.

It appears that once Article 9 is instrumentalised, these concerns are not valid anymore. Both selected cases are not suitable for an Article 7 decision. As argued in chapter 3, E.ON's alleged capacity withholding abuse would be extremely difficult to prove and the Commission would probably reach a settlement informally, otherwise would have to close its investigation without finding any infringement of competition rules.<sup>716</sup> To the contrary, SvK was plain-spoken about congestion shifting, so it was less problematic for the Commission to collect necessary evidence and Article 7 decision was theoretically possible. However, the benefits of finding an infringement of competition rules in cases where the Commission pursues regulatory goals are highly undesirable, both in terms of precedence-setting and punishment effects. As explained above, some risks in terms of precedence setting are already present in Article 9 cases, and they are definitely higher in Article 7 decisions. Further, it would seem rather inappropriate to punish SvK for resorting to a method of congestion management practiced by all transmission system operators.

Concluding, it seems that in cases where regulatory goals come into picture and skew both the Commission's anticompetitive assessment and the antitrust response, Article 7 route is not appropriate, especially because of its clear precedence-setting effects.

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<sup>716</sup> The Commission has launched parallel investigations against E.ON, RWE and Vattenfall accusing them of abusive capacity withholding. Only E.ON offered commitments, whereas the two other investigations were closed without any commitments being made. Subsequently, the Bundeskartellamt has carried out extensive investigations into possible capacity withholding in the German market between 2007 and 2008, but concluded that, in view of uncertainties, 'the non-operation of profitable power plants identified in the [...] inquiry [was] too limited to initiate specific abuse proceedings with respect to the period examined.' See Bundeskartellamt, *supra* n. 327, Summary, p. 13.

#### *6.2.4. The Commission's smaller toolbox for regulatory purposes*

As argued in chapter 2, Regulation 1/2003<sup>717</sup> introduced major changes to the Commission's competition enforcement which all together make it an attractive set of rules for achieving regulatory objectives. To illustrate this, the E.ON case has been triggered by the sector inquiry pursuant to Article 17 and the Commission could extract far-reaching commitments pursuant to Article 9 because E.ON felt threatened by infringement proceedings and the imposition of structural remedies pursuant to Article 7 and high antitrust fines pursuant to Article 23 and periodic penalty payments pursuant to Article 24. When applied in the electricity sector Article 9 should not be viewed in isolation, but as a part of the competition enforcement toolbox harnessed by the Commission to help it create the EU internal market for electricity.

The two analysed cases show that some concerns expressed in the commitment debate remain valid, once confronted with the Commission's commitments-based practice in the electricity sector, and some are overblown. First of all, Article 9 should be viewed as one element of the competition policy toolbox and as such does not seem to have a big impact on the Commission's case selection and priority-setting. Intervention is determined by the goals which the Commission strives to achieve with respect to electricity markets and antitrust intervention would take place anyway. Informal settlements would be then the preferred way of closing weak cases. Secondly, weak cases and disproportionate commitments pose a risk to competition policy insofar as they can establish incorrect legal rules and principles. However, precedence-setting effects of these cases are limited to electricity markets, so only a narrow sphere of competition policy would be negatively affected. Thirdly, at the market level, inadequate commitments can be ineffective or can result in harm to competition. Lastly, pro-Article 9 bias occurs but is rather required, given that cases driven by regulatory objectives are not really competition cases and as such should never set standards in competition enforcement. In that respect, if instrumentalisation of

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<sup>717</sup> Supra n. 14.

antitrust enforcement occurs, it would be more desirable from the competition policy' perspective if cases were settled informally.

### 6.3. ADDRESSING THE RESEARCH QUESTION

The first leg of the research question can be answered in the affirmative. The Commission is very pragmatic in using all the instruments it has at hand to push forward its project of creating an internal market for electricity. This includes regulation, competition enforcement and all sorts of political pressure. To the extent that commitment decisions accelerate sector-specific regulation and overcome political deadlocks, they contribute to the Commission's energy policy goals.

This contribution involves some cost, to energy policy, competition policy, and most importantly, to electricity markets. Two major risks can be identified.

First of all, Article 9 cases, skewed by regulatory objectives, might provide incorrect insights as to the market problem at issue which might then be adapted by the complementing sector-specific regulation and, due to precedence-setting effects, competition policy applied to similar electricity cases in the future. Second of all, commitment packages are bargains between the Commission, pursuing regulatory objectives, and the companies, protecting their own interests. Consequently, such packages might not always address the competition and/or regulatory problems at issue, focusing instead on energy policy objectives. In the worst case scenario, this may result in less efficient markets.

Thus, electricity markets might be negatively affected either **indirectly**, by application of sector-specific regulation or competition policy building on previous commitment decisions, or **directly**, through the implementation of inadequate commitments in individual cases.

Concluding, Article 9 generally contributed to achieving the policy objectives of the internal electricity market, but its use for that purpose does not come without cost. Given that this cost is ultimately borne by the internal electricity market, the Commission should take a more balanced approach to the instrumental use of Article 9 so that it does not do more harm than good.

#### 6.4. SCOPE FOR FURTHER RESEARCH

One possible extension of this research is to explore how workable and effective the offered commitments are in practice. This question is beyond the scope of this thesis and could be addressed by more empirical studies. The selected case studies illustrate that commitments packages can go well beyond what is necessary to solve the competition problems, or might not even address them properly. Do they then achieve the ‘hidden’ regulatory objective? For instance, it would be very interesting to see whether E.ON’s divestments of generation capacity indeed rendered the German market more competitive. Things can often go wrong with divestitures, due to information asymmetries coupled with the undertaking’s interest to protect the *status quo*. For instance, E.ON’s commitments might have resulted in asset swaps between the ‘big Four’, which would not have substantially affected the market structure for the better,<sup>718</sup> and in the worst case scenario would have facilitated collusion.<sup>719</sup> The SvK’s interim commitments to increase counter-trade and cease congestion shifting (apart from being inefficient) turned out to be completely ineffective.<sup>720</sup> The introduction of market splitting in Sweden triggered follow-on actions challenging the

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<sup>718</sup> This point has been raised by third parties in the market test of E.ON’s commitments. Some respondents argued that swaps ‘should not be allowed as the number of buyers is thereby limited to those undertakings who own generation assets.’ In addition, they saw risk that swaps would result in an oligopolistic structure at the EU level. The Commission emphasised that the buyer is going to be chosen by E.ON ‘as long as he [...] does not create *prima facie* competition concerns.’ The Commission did not see the risk of cross-border swaps, maintaining that the electricity wholesale market is national in scope. See Commission Decision, *supra* n. 320, para. 62.

<sup>719</sup> The risk of collusion increases with a more symmetric distribution of capacities, because ‘symmetric companies’ can more easily sustain a tacit agreement through retaliation. For relevant literature about how symmetry helps collusion, see e.g. O. COMpte, F. JENNY and P. REY, ‘Capacity Constraints, Mergers and Collusion’ (2002) 46 *European Economic Review*, 1-31, K.-U. KUHN and M. MOTTA, ‘The Economics of Joint Dominance’ (1999), mimeo, University of Michigan, or P. BARLA, ‘Firm Size Inequality and Market Power’ (2000) 18 *International Journal of Industrial Organization* 5, 693-722.

<sup>720</sup> *Supra* nn. 513-514.

scope of the Commission's commitment decision.<sup>721</sup> More research focused on the actual impact of commitments on electricity markets would tell us more about the costs of Article 9 instrumentalisation and might thus be worth taking up.

Further research might also take a closer look at the implementation of commitments, and in cases of behavioural remedies, firms' adherence to commitments. The question about the effectiveness of commitments is closely related to designating an appropriate mechanism for their surveillance in the longer run. It would be interesting to see whether the Commission's supervision in that respect is sufficient or whether it should be strengthened, for instance, by empowering NRAs/NCAs to carry out monitoring over the implementation and maintenance of commitments, and to report on their effects on competition in the electricity sector.

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<sup>721</sup> Supra n. 646.

## 7. SUMMARY OF THE THESIS

This thesis is a collection of essays about the instrumental use of commitment decisions to facilitate the completion of the European internal electricity market.

European policy can shape markets in many ways, two most evident being EU regulation and competition enforcement. The interplay between these two instruments has been extensively discussed in the context of different sectors, and still attracts a lot of scholarly attention, both from academics and practitioners. One of the major concerns in this debate is the instrumental use of competition rules. It has been observed that competition enforcement in Europe is triggered not only as a response to an anticompetitive harm occurring in the market, but that it sometimes becomes a powerful tool in the European Commission's hands to pursue regulatory rather than purely competition goals. This is particularly true in case of formerly state-owned monopolies. Since their liberalisation, these industries have become an interface between the new sector-specific regulation and newly applied competition rules. As a result, the two regimes converged to some degree. On the one hand, sector-specific regulation aims now to facilitate competition in the newly created markets and often protects them from monopolistic practices. On the other hand, competition law in these sectors is sometimes applied beyond its proper limits in order to meet the objectives of sector-specific regulation. The latter phenomenon, i.e. instrumentalised competition enforcement, might have a substantial impact both on competition policy and regulation, and ultimately on markets to which they apply, and is thus worth considering closely.

Commitment decisions are a relatively new and increasingly common way of closing antitrust investigations into market practices *prima facie* suspected of having anti-competitive effects, whereby an investigated undertaking offers certain commitments to the Commission. If the Commission considers them sufficient to remedy its anticompetitive concerns, it makes them binding in the form of a commitment decision. At the same time, the central question as to whether the undertaking has

violated competition law or not, is left open. Instead of fully investigating the case in order to establish a breach of competition rules, the Commission only summarises its preliminary concerns regarding *allegedly* anticompetitive behaviour and specifies commitments agreed with the undertaking as a remedy to these concerns.

It is a common view that the existing legal framework and practice surrounding commitment decisions might encourage and facilitate instrumentalisation. Namely, the Commission avails of the opportunity to use commitment decisions as a ‘quick fix’ for regulatory purposes, because of the relatively undemanding procedural requirements for their adoption, coupled with the broad discretion available to the Commission in accepting various forms of commitments, the lack of sufficient judicial control and the undertakings’ interest in avoiding fines for a violation of law. Further, it is argued that instrumentalisation of competition rules is more likely to occur in markets that are already subject to an intense regulatory intervention.

This thesis focuses on competition enforcement in the electricity sector, where the regulatory objective of completing the EU internal market is clearly defined and the Commission’s incentive to use competition rules to promote this objective might be particularly strong.

Over the last decade the Commission has been openly speaking about harnessing competition rules to foster the liberalisation and integration of electricity and gas markets, and thus push forward its energy policy agenda. In pursuit of this aim, it launched a sector-wide competition inquiry into European energy markets in 2005 and then followed up with a wave of commitment decisions in individual antitrust proceedings against electricity and gas incumbents. This intensified antitrust intervention provided for a substantial body of competition cases driven by energy policy objectives, i.e. liberalisation and integration of energy markets, rather than concerns about any alleged anti-competitive conduct.

This thesis attempts to determine whether the Commission uses commitment decisions in the electricity sector in a regulatory fashion to promote primarily energy (rather than competition) policy objectives and, if this is the case, the thesis discusses the cost of such instrumentalisation. The core of this research consists of four articles. The first article discusses the new (post-2004) EU antitrust enforcement regime. In particular, it argues that sector inquiries, commitment decisions and structural remedies might facilitate instrumentalisation of competition rules, which is illustrated here by a relatively unproblematic use of excessive pricing provisions. In principle, overpricing by a dominant firm results in direct exploitation of customers, and should theoretically trigger an intervention on the part of the Commission under Article 102 TFEU. In practice, excessive pricing actions have always been considered controversial and not without practical problems, and are thus launched by the Commission only in rare cases. However, since the adoption of Regulation 1/2003 and the increased empowerment of the Commission, several antitrust investigations have been initiated into price manipulation by energy incumbents. This thesis finds that sector inquiries, commitment decisions and structural remedies might encourage the Commission to take a more pro-active approach to overpricing, and to instrumentalisation of competition rules in general. This theoretical discussion of the first article is followed by two in-depth case studies concerning antitrust investigations in the electricity markets.

The first case study focuses on the Commission's investigation into alleged price manipulation in the German electricity wholesale market. The Commission accused E.ON of abusing its dominant position by withholding generation capacity in order to raise electricity wholesale prices. In spite of no convincing evidence, as well as flaws in its assessment, the Commission extracted from E.ON substantial capacity divestments. The conclusions of this case study indicate that instrumentalisation might have adverse impacts on competition policy. First, it leads to a number of 'weak' cases, based on far-fetched arguments. Second, it results in commitments which are not tailored to the abuse at issue but are in line with the Commission's energy policy

objectives and, being an outcome of negotiations, are further swayed by the firm's own strategic interests.

The second case study concerns the Commission's intervention in the congestion management methods of the Swedish network operator, Svenska Kraftnät (SvK). According to the Commission, SvK might have abused its dominant position by limiting cross-border transmission capacity in order to relieve congestion within Sweden. In response to the investigation, SvK committed to temporarily reduce transmission flow of electricity on internal network bottlenecks primarily by introducing national measures and by not reducing interconnection capacity. In the long-term, it agreed to split the Swedish market into multiple price zones.

This case study consists of separate economic and legal analyses of the case. The economic analysis concerns SvK's alleged abuse and the commitment package, and concludes with three observations. Firstly, it might be socially optimal to reduce cross-border capacity in response to internal congestion. Given that the Commission negotiated commitments from SvK without an in-depth economic assessment of the case, it risked preventing efficient behaviour. Secondly, handling internal congestion primarily by national measures is not socially optimal, and it cannot be ruled out that it reduces overall welfare. Thirdly, even though splitting the market into price zones may improve allocative efficiency within Sweden, it does not prevent SvK from potential manipulation of cross-border transmission capacity.

The legal analysis attempts to show the Commission uses competition law enforcement to foster market integration in the electricity sector. Even though the Commission's action under competition rules was contrived and lacked economic depth, the commitment package provided an economically sound, long-term solution to network access and congestion management in Sweden. Such a quick and far-reaching change of Swedish congestion management could not have been achieved by Swedish policymakers or enforcement of the EU sector-specific regulation.

The thesis finds that the Commission is very pragmatic in using all the instruments it has at hand to push forward its project of creating an internal market for electricity. This includes regulation, competition enforcement and all sorts of political pressure. To the extent that commitment decisions accelerate sector-specific regulation and overcome political deadlocks, they contribute to the Commission's energy policy goals.

However, instrumentalisation of competition rules comes at a certain cost to competition policy, energy policy and, most importantly, to electricity markets themselves. Two major risks can be identified.

- (1) First, the Commission's anticompetitive assessment of the case, often cursory and skewed by regulatory objectives, might provide incorrect insights. These insights might then negatively influence both electricity-specific regulation as well as electricity-specific competition enforcement. On the one hand, future regulation of electricity markets can build on these incorrect insights. On the other hand, these insights can be adapted by competition rules applied in the future to similar cases.
- (2) Second, commitment packages are bargains between the Commission, pursuing regulatory objectives, and the companies, protecting their own interests. Consequently, such packages might not always address the competition and/or regulatory problems at issue, focusing instead on energy policy objectives. In the worst case scenario, this may result in less efficient markets.

Thus, electricity markets might be negatively affected either indirectly, by application of sector-specific regulation or competition policy building on previous commitment decisions, or directly, through the implementation of inadequate commitments in individual cases.

Concluding, commitment decisions generally contributed to achieving the policy objectives of the internal electricity market, but their use for that purpose does not

come without cost. Given that this cost is ultimately borne by the internal electricity market, the Commission should take a more balanced approach to the instrumental use of commitment decisions so that it does not do more harm than good.

## 8. SAMENVATTING

Dit proefschrift bestaat uit een collectie essays over een instrumenteel gebruik van toezeggingen voor de voltooiing van de interne elektriciteitsmarkt.

Het Europese beleid kan markten op vele manieren vorm geven, twee van de meest evidente manieren zijn regulering en handhaving van mededingingsrecht. Het samenspel tussen deze twee instrumenten trekt veel wetenschappelijke aandacht. Een van de belangrijkste zorgen in het mededinging vs. regulering debat is het instrumentele gebruik van mededingingsregels. Er is gebleken dat handhaving van mededingingsrecht niet alleen plaatsvindt als een reactie op schade als gevolg van concurrentiebeperkingen die voorkomt op de markt, maar dat het soms een krachtig instrument wordt in de handen van de Europese Commissie om reguleringsdoeleinden na te streven.

Meer recent zijn zorgen geuit over de instrumentalisering van mededingingsregels in de context van de toezeggingen van de Commissie. In het bijzonder wordt betoogd dat het bestaande juridische raamwerk van toezeggingen hun gebruik voor reguleringsdoeleinden kan aanmoedigen en faciliteren. In dit proefschrift wordt gezocht naar voorbeelden van een dergelijke instrumentalisering in de elektriciteitsmarkt. De Commissie heeft gedurende het laatste decennium sterk ingegrepen in deze sector middels mededingingsregels en heeft een aantal toezeggingen gedaan, ingegeven door de doelstellingen van het energiebeleid, zoals liberalisering en integratie van elektriciteitsmarkten, en niet zozeer door zorgen over concurrentiebeperkend gedrag in het verleden.

Dit proefschrift concludeert dat de Commissie erg pragmatisch is in het gebruik van alle mogelijke instrumenten die ter beschikking staan om het creëren van een interne elektriciteitsmarkt te stimuleren. Hierbij zijn inbegrepen regulering, handhaving van mededingingsrecht en allerlei vormen van politieke druk. Voor zover toezeggingen

sector-specifieke regulering versnellen en politieke impasses voorkomen, dragen zij bij aan de energiebeleidsdoelstellingen van de Commissie.

Echter, instrumentalisering van mededingingsregels gaat ten koste van mededingingsbeleid, energiebeleid en allereerst ten laste van de elektriciteitsmarkten zelf. Twee grote risico's kunnen worden geïdentificeerd. Allereerst zou de concurrentiebeperkende beoordeling van de zaak door de Commissie, vaak summier en beïnvloed door reguleringsdoeleinden, een verkeerd beeld kunnen geven. Deze zouden op hun beurt in gelijke zaken door sector-specifieke regulering en handhaving van mededingingsrecht kunnen worden aangepast. Ten tweede zijn toezeggingen het resultaat van onderhandelingen tussen de Commissie, die reguleringsdoelstellingen nastreeft, en de bedrijven die hun eigen belangen beschermen, zodat ze niet altijd de betreffende mededingings- en/of reguleringsproblemen aanpakken, wat in het slechtste geval in minder efficiënte markten kan resulteren. Kortom, elektriciteitsmarkten zouden negatief beïnvloed kunnen worden, hetzij direct, door de implementatie van inadequate toezeggingen in individuele gevallen, hetzij indirect, door toepassing van sector-specifieke regulering of mededingingsbeleid dat gebaseerd is op eerdere toezeggingen.

Concluderend: toezeggingen hebben over het algemeen bijgedragen aan het creëren van de interne elektriciteitsmarkt, maar hun gebruik voor dit doel komt niet zonder kosten. Gegeven dat deze kosten uiteindelijk door de interne elektriciteitsmarkt worden gedragen, zou de Commissie toezeggingen uiterst voorzichtig moeten gebruiken om te voorkomen dat ze meer kwaad dan goed doen.

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