The Changing Dynamics Of Europe's Liberalising Energy Markets: What Taking The EC Treaty Seriously Means For The Future

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Liberalisation and regulation

- Classic utility regulation: addressed monopoly and public service issues
- Liberalisation: contraction and redefinition of monopoly franchises.
- Primary unbundling: production, transmission/ distribution, and supply.
- Secondary unbundling: transport and system operations
- Reformed regulation: regulation <u>for</u> competition (e.g. network/market governance), as well as <u>of</u> monopoly.

Regulation for competition

- Competition policy ‘plus’ appropriate for transition from monopoly. Compared with traditional antitrust:
  - More pro-active: search for methods of promoting competition
  - More *ex ante*
  - More prescriptive
  - Particular emphases on discrimination and multi-market effects
- What about longer term?
  - Substitutable for, or complementary with, markets/competition?
- The key battle is for control of sectoral policy. Will this be captured by special interests (the traditional outcome), or will it become a complement to competition policy?

Three scenarios

- Sector specific regulation withers as competition develops, and is replaced by competition law. Unrealistic:
  - Energy regulation is not just about monopoly issues.
  - Monopoly emerged in part to deal with balancing issues.
  - Balancing issues remain, even after liberalisation.
- Sector specific regulation remains, but is governed by the principles of competition policy.
  - First part likely whatever, second part is desirable for good policy
- Sector specific regulation remains, but is driven by a mish-mash of policy objectives.
  - Inevitably more political, and likely to create market distortions.

Competition policy and antitrust

- Antitrust deals with agreements (e.g. cartels), dominance/monopoly, and mergers.
- European policy always more ‘programmatic’ than US, since it was conceived for different purposes: eliminating barriers that hindered the common/single market.
- In consequence, the European formulation is more easily co-ordinated with sectoral policies for competition.
- Articles 81 and 82 establish principles that, applied to the regulatory supervision of energy markets, are both sound and radical in their longer-term implications.

Article 81

1. Prohibits as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention , restriction or distortion of competition within the common market ….
2. Any prohibited agreements or decisions shall be automatically void.
3. The provision of paragraph 1 may be declared inapplicable in the case of agreements, decisions or concerted practices that contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which do not: (a) impose restrictions which are not indispensable to the attainment of these objectives; (b) afford undertakings the possibility of eliminating competition.

Art 81: main points

- Wide ranging in principle, though limited in application by trade effects (but not when applied in national legislation).
- Primacy of competition. Possible exemptions but:
  - Need to demonstrate them, and consumers must benefit.
  - Indispensability test.
  - Competition must not be eliminated.
- This is <u>not</u> cost benefit analysis (compare with Regulatory Impact Assessments).
- Taken seriously, the 'indispensability' test is a radical and powerful force for more effective policy making, as well as for market harmonisation.

Article 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

(a) imposing unfair purchase prices, selling prices or trading conditions

(b) limiting production, markets, or technical development to the prejudice of consumers

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage

(d) imposing supplementary obligations in contracts which, by their nature and normal commercial practice, have no connection with the subject of the contracts

Article 82: main points

- Based upon the notion of *standards of conduct*.
- Often put in terms of ‘special responsibilities’.
- Standards are linked to the possession of economic power
- Roughly: special responsibilities are automatically attached to positions of power.
- Thus, those with power to cause substantial harm have special responsibilities not to cause such harm.
- The prohibition of 'abuse' is central to effective market supervision, although it will need to apply more widely than is currently contemplated by competition case law.

Article 86(2): Services of general economic interest

- *"Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."*

Article 86(2): significance and interpretation

- Open to interpretation, as indicated in the Green Paper (May 2003). But:

  1. Need to specify requirements precisely.

  2. Service provider must be able to meet demand.

  3. Crucially, there must be no alternative way of fulfilling the requirements that has a less detrimental effect on competition (indispensability again).

- Competition concerns therefore remain paramount, to a degree determined by the narrowness of the interpretation of 86(2).

A European regulatory policy strategy?

- Apply Treaty principles more generally, including to regulatory decisions.
- Art 81: Is there a restriction of competition? Are there benefits from the restriction? Is the restriction indispensable? Is competition eliminated?
- Art 82: Is there a potential for conduct that could cause significant harm (market power)? What special responsibilities should apply in the relevant circumstances? Have those responsibilities been discharged?
- Narrow interpretation of Art 86(2), taking indispensability seriously.

First attempts: recent UK examples

- Art 81. The Electricity Pool vs NETA. Compare: standard market design approach (planned markets); RIA approach (cost benefit: which is better?); the Treaty approach (balancing implies special requirements, but what is the least restrictive, feasible means of satisfying the requirements?). See Ofgem NETA consultation document, July 1999, which takes the third of these approaches.
- Art 82. The Market Abuse Licence Condition (1999/2000) sought to apply Treaty principles more generally, given that, in tight system conditions, many participants have the power to cause harm. Aim: specification of standards of conduct conducive to liquidity, security of supply, etc. Opposition (much from the US) by advocates of the Californian approach and of planned market design. Initiative failed.

Cross-check with Art. 86(2)

- Pool:
  - Was there a clear requirement? Yes: balancing.
  - Could demand be satisfied. Yes.
  - Was there an alternative way of meeting requirements with less detrimental effects on competition? Yes: NETA.
  - Hence, from third answer, no exclusion by virtue of 86(2).
- Capacity enhancement measures (security of supply?):
  - Is there a clear requirement? Not demonstrated.
  - Can demand be satisfied? Not demonstrated: crowding out.
  - Is there a more competitive alternative? Yes: Article 82 ‘plus’.
  - Conclusion?: Directive not fully aligned with Treaty and case law?