Big commitments: Energy firms weigh alternatives for defending antitrust actions

The European Commission is increasingly using commitments – a relatively new tool under EU competition law – to settle antitrust cases against EU energy incumbents such as Distrigas, E.ON, GDF Suez and RWE. The trend raises some interesting questions for energy companies potentially facing legal battles with the EC, Suzanne Rab, competition lawyer with Hogan and Hartson, told **Gala Colover**.

Since May 2004 the EC has had a new way to close antitrust cases without having to reach a formal judgment on whether EU competition law has been broken. Companies can offer commitments – such as terminating a long term contract, modifying supply arrangements, or selling off assets – to resolve the EC's concerns, thus avoiding lengthy legal battles and potential fines of up to 10% of their turnover.

"The new legislative framework introduced a provision that allowed the Commission to bring an end to cases it was pursuing under provisions in EU competition law that deal with anti-competitive agreements and abuse of dominance," said Rab.

The procedure is set out in Article 9 of EU regulation 1/2003 on implementing the competition rules laid down in Article 81 and 82 of the old EC Treaty – now Articles 101 and 102 of the Treaty on the Functioning of the EU, better known as the Lisbon Treaty which entered into force on December 1, 2009.

The Article 9 procedure offers potential efficiencies in investigating and enforcing competition law, said Rab, but uncertainties over the legal limits of the procedure are giving pause for thought. This is partly because closing a case using the commitments procedure does not require the EC to make a decision on whether or not EU law has been broken.

But Rab argues that it is also unclear whether and to what extent the EC needs to satisfy itself that the commitments are proportionate to the offence for which the company is under scrutiny. "This has not yet been conclusively determined," she said.

Also controversial is the relatively limited discussion of alternatives to the structural remedies agreed in a number of cases in the energy sector, she said. For example, in 2008 E.ON committed to sell its German high voltage power grid and RWE committed to sell its German high pressure gas grid, both to settle separate antitrust cases brought by the EC.

The cases followed the EC's energy sector inquiry, launched in June 2005, which found widespread breaches of EU competition law across the EU's 27 national energy markets (*EUE 165/5*). The inquiry concluded that the main failings included too much market concentration in most national markets, customers tied to suppliers through long-term downstream contracts and a lack of transparently available market information.

A vigorous debate followed when the EC proposed in 2007 full ownership unbundling of gas and power grids from parent energy supply companies in its third package of energy market opening laws to address these competition concerns.

But the EC failed to convince France and Germany, and the final version of the third package, adopted last year, allows national governments to offer one or more of three unbundling options – one of which allows parent companies to keep their grids under strict regulatory supervision (*EUE 211/5*).

Nevertheless EC competition officials have been clear that since May 2004 the EC has had the power to impose structural remedies such as forcing parent supply companies to sell grids if doing so would resolve competition concerns. This power is entirely independent of the EU's market opening rules such as in the third package. The difference is that without an EU-wide unbundling requirement the EC has to target and justify each case under competition law – a longer and more labor-intensive approach.

And the E.ON and RWE cases are examples of how the EC has secured full ownership unbundling using the commitments procedure under Article 9. This is significant in terms of the instruments available to promote or safeguard competition, said Rab.

"We've obviously had a heated discussion about the energy package as to whether integrated energy companies need to unbundle. That's been subjected to intense political debate. Yet in at least two of these cases you have competition law concerns about access to networks and as a commitment E.ON and RWE have sold off transmission assets. So that raises a fundamental question as to the appropriate basis and means to secure an outcome which would not necessarily be mandated under the legislation under the third energy package," she said.

"In Article 9 commitments cases, by their very nature, there is no concrete finding of infringement of competition law but there is a decision that the

commitments address the Commission's initial concerns. But the question has been raised: Does the solution need to be proportionate? Could something else have been done to address the concern?"

And while commitments decisions offer companies the advantage of avoiding long, drawn-out infringement proceedings, Rab says those cases resulting in extremely intrusive rulings, like grid sales, suggest that there remains a risk that the procedure can be used to deliver results that extend beyond the EC's competition law enforcement remit.

"These structural remedies have been hotly debated in the context of a legislative process and are now being achieved through a different mechanism, which may address the issue in terms of the competition concerns. The remedies may be sufficient, but are they necessary? That is a different issue," said Rab.

"Where alleged abuses do not consist in denying access but preferential treatment of the company's own operations, less intrusive remedies such as capacity auctions come to mind," she said. "This is not to say that structural remedies can never be appropriate to resolve competition law concerns – for example, where abuses derive from the very structure of the companies concerned (because they have the ability and incentive to favor their own operations); and there is a risk of lasting infringement and no equally effective conduct-based remedy, then a divestment to an independent buyer may be what is needed to ensure a level playing field."

The road to commitment

The EC's antitrust cases against specific energy companies have tended to follow "unannounced inspections" at offices to seize evidence. The EC has followed up by providing the company with a detailed assessment of the suspected breaches, and then discussions start on possible remedies. In seven of the eight cases concluded or nearly concluded by the EC since 2005 the companies involved have offered commitments intended to address the concerns.

The EC publishes the commitments in the EU's Official Journal and invites third parties to comment. "That's a market test," said Rab. "Following that there is a review by the advisory committee and ultimately there may be an Article 9 decision. But the EC is not bound to accept the commitments offered and may switch to an Article 7 procedure." Article 7 allows the EC to impose behavioral or structural remedies "which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end," if it finds that EU competition law has been broken.

But when a case is resolved by Article 9 commitments, the EC does not say that there has been an infringement, said Rab. "All it is saying is that 'we had competition concerns. These commitments that have been offered resolve our concerns.' That's very different from a decision which says 'x' energy company has infringed Article 101 or 102 of the [Lisbon] Treaty and we will therefore issue a fine."

This is a crucial point in terms of the precedent value of the case, because despite involving quite intrusive commitments by the parties "all [the EC] has said is that the case is resolved though commitments. It does not say that these companies have violated the law. And that is the interesting issue for the value of future cases," said Rab.

"The remedies may be sufficient, but are they necessary?" – Rab

A full investigation in all cases would destroy the value of the Article 9 procedure in speeding up case closure, cutting costs "and just allowing everybody to move on," said Rab. "But in terms of the way the law develops there is surely a need for there to be a sufficient number of formal findings just to achieve some clarity. That is not to say that all cases must be resolved under Article 7, but that where a sufficient number go down alternative routes this can leave many open questions as to the limits of the law."

These issues are relevant for other cases brought by the EC where commitments have been offered, but not yet accepted.

France's EDF and Belgium's Electrabel both face cases involving long term contracts in the power markets, and commitments offered by Swedish transmission system operator Svenske Kraftnat to stop limiting export capacity as a way to manage internal congestion are currently under consultation (*EUE 217/1*).

The EC is also market testing proposals by E.ON to commit to "significant, structural reduction of its long-term gas capacity reservations which prevent access of competitors to infrastructure needed to supply gas to customers within E.ON's network," (*EUE 224/5*).

Most recently, the EC this month welcomed structural remedies offered by Italy's Eni in response to concerns that the company may have restricted competition in the Italian gas market (*EUE 226/1*).

Rab splits these cases broadly into customer foreclosure issues, such as tying up customers in long term contracts – as in cases involving Distrigas and EDF (*EUE 164/5*) and issues involving access to the network, such as alleged capacity hoarding, and strategic underinvestment, which constitute the majority of cases being settled using the commitments procedure.

Theory of harm

Here hangs another question mark. "In order to establish that there is a competition problem, there needs to be evidence as to why this is a problem against a coherent legal and economic framework," said Rab. This is known as a theory of harm.

"The Commission has raised some quite interesting theories of harm about capacity hoarding and strategic under-investment," she said. "Could 'strategic under-investment' be a problem? Could there be an obligation under competition law to invest in capacity enhancements to infrastructure to allow other market participants to enter? That's quite a bold theory."

This is not addressed in the EC's guidance on abuse of dominance, she said. "In fact, it may be debated whether competition law enforcement is the best tool to raise levels of investment. The use of regulatory incentives might provide a more targeted and predictable approach than the use of enforcement under Article 102."

Diamond case may offer clarity

The energy industry would do well to follow developments in similar competition cases in other sectors which are currently testing the strength of commitments secured under Article 9, said Rab.

"To date, there have not been challenges of commitments to the European Courts by parties who offered those commitments," said Rab. But third parties have challenged the EC's decisions. The first of these to be reviewed by the General Court (previously known as the Court of the First Instance) has now reached the Court of Justice. It concerns the well-known global diamond company De Beers and a smaller Russian diamond company called Alrosa.

Although this case is in a different sector, Rab said it will be instructive for the prospect of companies' and third parties' rights of defense, and it should clarify issues around whether commitments need to be proportionate.

The EC's case against Alrosa and De Beers was centered on an agreement that Alrosa would sell most of its export output to De Beers, which the EC said raised concerns about infringements of EU rules on abuse of dominance (Article 102) and of provisions on anti-competitive agreements (Article 101).

The EC rejected two draft commitments proposals from De Beers and Alrosa, but finally accepted draft commitments offered to the EC by De Beers on its own that basically prevented the supply arrangement between Alrosa and De Beers, Rab said, explaining how the case developed. Alrosa then challenged that decision to the General Court, which compared the Article 9 [commitments] procedure to the Article 7 [infringements] procedure.

"The General Court concluded that the Commission should have looked at the proportionality of the commitments and Alrosa had a right to be heard as a third party," said Rab. "Obviously Alrosa occupied a unique position on this because Alrosa wasn't some unrelated third party. Alrosa was a counter party to the commitments and to the supply arrangements."

The EC launched a counter-challenge, and has now taken the case to the Court of Justice of the EU (formerly the ECJ). The decision is pending.

"So we await the Court's ruling on the extent to which the Commission needs to look at proportionality," said Rab. "What we do know is that Article 9 and Article 7 are different procedures, but the extent to which [the EC] needs to undertake a full analysis of the facts and the proportionality of the commitments remains to be decided."

The ruling could have a big impact. "If [the Court of Justice rules that] the Commission needs to go through the full analysis – as it would do with the Article 7 cases – it would appear to deprive Article 9 of its utility as an alternative means of bringing these [competition] cases to an end," said Rab. "But at the same time Article 9 is not a free-for-all for the Commission to accept any commitments that are offered."

The case offers hope that there will be more clarity. But even if the EC resolves a case under Article 9, competition authorities or third parties could still bring the same case to court at national level. And while EU countries cannot take action that runs counter to the EC's decisions, this means that companies 'settling' cases with the EC using the commitments procedure may still find themselves having to fend off potential investigations, fines and damages actions at national level.

Weighing up the options

So, with all these issues to take into account – not only for the parties involved, but for the EC and third parties as well – what are the benefits of using the commitments procedure to close cases?

"If you're looking at it from the Commission's perspective, they have the potential to achieve a very specific modification in the market and they do not have to go through the full [infringements] process. The prospect of an appeal may be reduced, although not eliminated," said Rab.

"If you look at it from the perspective of the parties involved, they avoid a fine, which may be a considerable win for them, [and] they have not had to go through a full investigation procedure that could well last a number of years." A drawn-out legal battle leads to uncertainty as to where the business stands and causes costly disruption of management time while they fight an investigation. "But at the same time the business agrees to what can be quite intrusive modifications to their commercial practices." Whether this is worth

Pros and cons of agreeing commitments vs fighting EC antitrust cases

No offer of commitments

Pros

- A strong case could result in no infringement decision and a clean bill of health. But this requires confidence in the legal case and evidence for the defense

Cons

- Potential fines/ Infringement decisions/damage to corporate health

Explore commitments

Pros

- Offers insight into the EC's concerns
- Shows a willingness to cooperate and goodwill

Cons

- This may signal some lack of confidence in cases where a dialogue on potentially offering up some concessions has already begun.
- Once a party is engaged in commitments talks market testing could be perceived by third parties as a sign of weakness, giving them confidence to pursue cases against the party in different procedures at national level.

Offer soft commitments

Pros

- Shows willingness to cooperate and goodwill without immediately offering major concessions, which could be made later if the EC deems the first offer unsatisfactory.

Cons

- Similar to exploring commitments, but "too soft" commitments may also further antagonize third parties.

Agree hard commitments

Pros

- Case closure, saves costs of fighting long infringement proceedings, no fine, less disruption of management time, enables more consensual outcome than an infringement decision.

Cons

- Risk of offering too much, setting a 'precedent' for the future
- Third parties may still appeal (eg Alrosa)

An Article 9 decision does not preclude private action in member states in front of the courts, or stop a national authority making a decision provided it does not run counter to the commitments decision.

speedier case closure will very much depend on the strength of the evidence and legal arguments and the EC's appetite to pursue the case, said Rab.

"From the perspective of third parties, looking at where the law stands, they have an outcome and there is case closure, but in terms of assessing what is needed in the future [for example] in terms of long term supply contracts, [or] when a network needs to be open…at the end of the day, these are not formal findings of infringement. A commitments decision is less useful when bringing private actions before the courts as it cannot be relied on as proof of infringement, although it may be treated as evidence and the third party may cite the Commission-raised concerns."

Companies considering whether to close cases by offering commitments using the Article 9 procedure therefore need to carefully weigh their options: offer commitments or instead object to the EC's decision, wait for the investigation to play out – and fight any fine or infringement decision all the way through the European Courts, said Rab. Clearly the choices offer pros and cons (*see left*).

The Article 9 procedure offers some real advantages for bringing competition cases to an end quickly, said Rab. "It means we don't have to wait around for what can be many years for a case to be resolved. But this does afford significant discretion to the Commission as to how it resolves the cases and going forwards because, although these cases are very useful, their precedent value is more limited."

In January this year, the EC issued a consultation on its best practices, which includes a commentary about Article 9. The results are due back in the first week of March. And the very fact that so many of the cases being pursued after the energy sector competition inquiry are being dealt with using the Article 9 procedure makes the EC consultation highly topical, said Rab.

"When looking at the substantive issues in the energy sector guidance would be welcome on where all these cases take us, because there is probably a limit to the cases the Commission can pursue from the sector inquiry. We're now 2 years down the line from that. There are suggestions that these cases are drawing to an end. But at the same time these cases are significant. The principles articulated in the recent cases dealing with such issues as long-term contracts, capacity hoarding, strategic under-investment and margin squeeze will remain relevant as Europe's energy companies assess their commercial practices for compatibility with competition law on an ongoing basis," she said.

** Suzanne Rab is Counsel of competition law at Hogan and Hartson. Hogan and Hartson works with a number of major European energy companies, but has not represented any in negotiating commitments under Article 9 of the EU Regulation 1/2003.*