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Competition in EU Electricity Markets
The Role of Antitrust Policy

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(*) The views expressed are those of the author and not necessarily reflect those of the European Commission

Overview

- What are the main obstacles to competition and market integration?
- Can competition policy at EU level help reduce such obstacles?

Impediments to competition: A bird's eye view

- Insufficient or ineffective unbundling between transmission and generation
- Imports have not been a viable source of competition because of interconnection constraints
- Incumbents dominate the generation of electricity in national markets

Insufficient unbundling
Network operators help affiliates

- Vertical integration creates incentives for cross-subsidisation between network activities and unregulated activities
- Low margins in generation and retail discourage entry
- Discriminatory use of the network and access to information

Solutions – mostly regulatory

- Fully independent TSOs (1st best: ownership unbundling)
- Access based on published regulated prices which are reflective of the costs of the network business
- Likewise DSOs need to be adequately separated from supply companies to ensure cost reflective tariffs and the removal of any cross subsidies.

The independence of regulators is crucial to ensure fair network access in terms of tariff levels and structure.

Insufficient flows between Member States

- Low inter-connection capacity relative to domestic capacity
- Insufficient information about really available capacity in inter-connectors
- Long-term reservations of certain IC
- Lack of intra-day balancing across borders

Solutions – mostly regulatory

- Increased interconnection may dramatically improve market structure, particularly in smaller Member States

- But investments in physical capacity of inter-connectors may not be necessary with clear and consistent rules concerning:
  - the allocation of capacity and
  - the interaction of congestion management with the electricity wholesale market.

Concentration in Generation

- Barriers to entry in generation:
  - (scarcity of locations, long amortisation periods and construction times, little scope to invest in base load – hydro, nuclear -, no access to gas at competitive prices, environmental regulations)
- Electricity is susceptible to the exercise of market power
  - Supply=Demand at each instant in time and location in network
  - Very inelastic demand
  - Supply gets inelastic at high demand levels as capacity constraints are approached (spot electricity prices are volatile)
  - Network congestion combined with non-storability limit the geographic extent of the market constraining the ability of remote suppliers to compete

Solutions – a mixed bag

- Governments (or regulators) can exercise influence:
  - Conditions relating to the location or technology of new plant can be imposed through the authorisation process
  - Offer incentives to accelerate investment
  - Mandatory divestment and virtual power plants

    (caution is required not to undermine the market process and thereby discourage spontaneous investment).
- Regulators must:
  - Ensure generators give transparent information regarding availability of capacity
  - Monitor unilateral market conduct. Here clear guidelines on bidding behaviour of dominant generators are needed (no ad-hoc interventions)

Competition policy can mitigate the impact of high concentration …up to a point

- Ex post control of abusive conduct with antitrust tools is likely to be ineffective.
- But a strong Merger control policy is necessary to limit further horizontal and vertical integration.

Article 82
Abuse of dominance cases

- Investigations into capacity reservation can lead to improved access to inter-connectors.

- But difficult to identify behavioural abusive practices (as opposed to contractual practices)

- Generation companies easily invoke:
  - technical constraints (congestion, maintenance, …)
  - economical factors (worldwide commodity prices, financing necessities, …)

- …all of which are difficult to investigate.

Excessive Pricing" abuses are even more difficult to challenge:

- On the electricity wholesale market, the competition conditions depend on time. Should the relevant market be defined on a limited period (peak hours only)?

- In electricity markets a company can have a decisive impact on prices largely below the dominance level in the meaning of article 82

- And what is the competitive price? What is a "reasonable" margin?
  - past prices are not constant – not a good benchmark

Merger control plays a key role

- Prevent the increase of horizontal or vertical market power
- In some cases carefully constructed remedies can promote liberalization
  - e.g.. EdF/EnBW. EDF agreed to make available to competitors 6,000 MW located in France
  - But behavioural remedies are insufficiently credible and difficult to enforce (e.g. EdF/Hidrocantabrico)
- It appears that most competition is to be coming from electricity incumbents entering the gas market and vice versa. Thus a strict policy on mergers involving gas and electricity companies is also crucial.
  - (e.g. EDP/ENI/GDP merger)

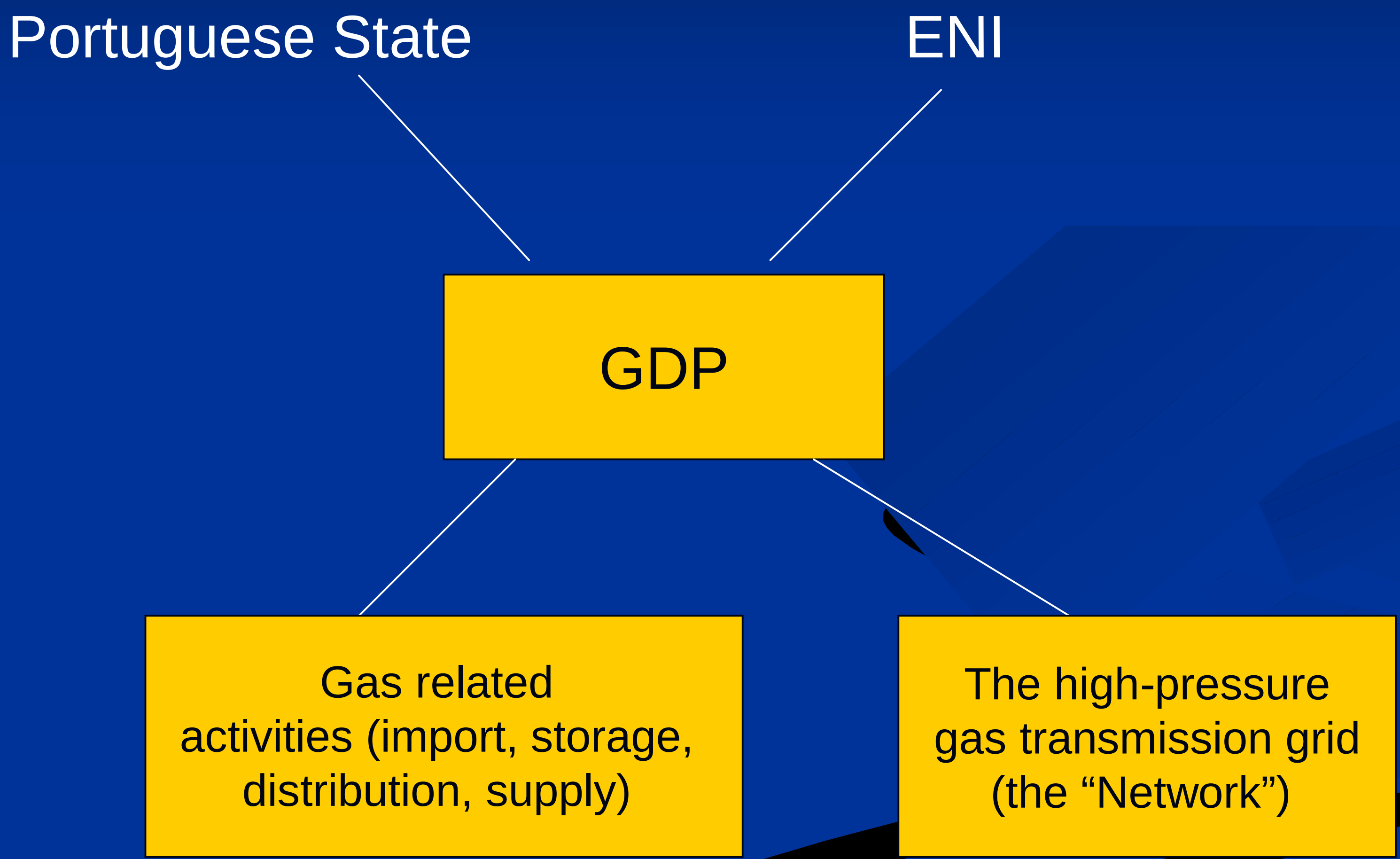
The operation

- Acquisition of joint control

  by ENI and EDP (electricity incumbent)

  over GDP (gas incumbent)

The pre-merger situation



The post merger situation

ENI

EDP

(30 % participation)

REN
(electricity grid operator)

GDP

Gas related activities (import, storage, distribution, supply)

Network <u>except:</u>
entry points (LNG terminal, international pipeline) and storage

Product markets

- Electricity:
  - Wholesale supply
  - Ancillary services / balancing power
  - Retail supply to large industrial customers
  - Retail supply to small customers
- Gas:
  - Supply to Power Producers (CCGTs)
  - Supply to LDCs (Local distribution companies)
  - Supply to Large Industrial Customers
  - Supply to small customers

Geographic markets

- All markets are national in scope at most
- The parties contended that wholesale supply will soon be Iberian in scope owing to the launch of the MIBEL
- Contention dismissed by investigation
  - many controversial aspects on market functioning to be agreed before MIBEL starts
  - Launching of MIBEL postponed several times: latest summit, new official „start" in July 2005
  - interconnection capacity will remain insufficient
  - competitive conditions in SP and PT likely to remain significantly different even after MIBEL starts

Virtually no competition in either gas or electricity

- EDP dominant in all electricity markets. E.g. wholesale electricity:
  - 70% generation capacity:
    - generation mix
    - new gas-fired power plant
  - State aid / Stranded costs
  - Minority shareholdings in other plants
  - New power plants uncertain
  - Insufficient level of interconnections
- GDP is a quasi-monopoly on all the gas markets

Electricity wholesale: Strengthening of dominance

- Horizontal effects: elimination of GDP as best-placed potential competitor
- Vertical effects (input foreclosure):
  - Privileged access to gas resources in PT from GDP
  - Access to information on competitors' gas consumption (marginal costs & daily nominations)
  - Raising rivals' costs (of new entrants and one existing gas-fired competitor)

Gas supply to (a) CCGTs (b) LDCs Strengthening of dominance

- Customer foreclosure
  - of all existing demand not reserved by GDP
    - (a) short term requirements of CCGTs
    - (b) supply of Portgás (only distribution company in PT not controlled by GDP)
  - not likely compensated by new “independent” demand

Gas supply to (c) large industrials and (d) small customers Strengthening of dominance

- Horizontal effects: Removal of EDP as best-placed potential competitor with strong incentives to enter:
  - access to gas (through CCGT),
  - customer base, strong energy brand in PT, dual-fuel offer
  - already present in gas retail (Portgás)
  - EDP second gas player in Spain.

Can competition policy play a broader role?

- Energy consumers complain that:
  - prices are increasing
  - less generators reply to tenders
  - the price spread between the remaining suppliers competing for the same contract has decreased substantially
  - generators are failing to offer an adequate range of contract structures, especially longer term arrangements.

Response: Energy Sector Enquiry

- DG COMP has announced the intention to undertake a more systematic market investigation.
- Such sector enquiry should lead to:
  - concrete competition advocacy initiatives, e.g.:
    - should there be an obligation of ownership unbundling to network operators?
    - should the powers of the energy regulators be increased?
  - specific enforcement actions in leading cases (which if appropriate, may also serve as a precedent)

Thanks for your attention