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Excessive Prices in Energy Markets: Some Unorthodox Thoughts

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I. INTRODUCTION

Rising prices are no less a challenge for the regulator than for consumers. In order to respond to high roaming charges, the European Parliament, on 23 May 2007, voted in favour of a Regulation to set roaming prices.[1] I think that the Eurotariff represents one end in the spectrum of solutions available under competition law to deal with the problems posed by high prices. What I find less explored is the other end of the spectrum of solutions to the high prices themselves, i.e., structural remedies. In what follows below, I would like to offer a few thoughts on this issue in the hope of contributing to the discussion on excessive prices in energy markets.

II. THE MANDATE OF *VOLVO/VENG*

Volvo/Veng is rarely cited, if at all, as a case of excessive pricing.[2] Even in the very recent judgment of the Court of First Instance of 24 May 2007 in *Der Grüne Punkt,*[3] which deals with excessive pricing issues, the Court has confined itself to citing the "standard" line of cases on excessive pricing, i.e., *General Motors*, *United Brands* and *British Leyland*.

The omission of *Volvo/Veng* from the progeny of cases on excessive pricing can be explained by the fact that that the case did not provide any concrete indication as to the issues that are more typical of excessive pricing cases, and in particular, how to determine an "excessive" price. Yet I find the lesson of *Volvo/Veng* particularly important, and I believe that its remit is of great significance to our discussion.

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1 See Press Pelease IP/07/696 and text of the Regulation at www.europarl.europa.eu. The Regulation was approved, and it entered into force on 30 June 2007. See Regulation (EC) No 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC.

2 Case 238/87, *AB Volvo v Erik Veng (UK) Ltd.*, [1988] ECR 6211.

3 Case T-151/01, not yet reported, para. 121.

In dealing with the right of a proprietor of a protected design to prevent third parties from manufacturing and selling or importing, without his consent, products incorporating the design, the Court stated that the exercise of that right:

> "may be prohibited by Article 86 if it involves, on the part of an undertaking holding a dominant position, certain abusive conduct such as the arbitrary refusal to supply spare parts to independent repairers, *the fixing of prices for spare parts at an unfair level* or a decision no longer to produce spare parts for a particular model even though many cars of that model are still in circulation…" (emphasis supplied).[4]

The force of the Court's statement should not go unnoticed. In this case, the right in question is, by the admission of the Court, "the very subject-matter of his exclusive right".[5] Yet the Court considered unfair pricing to be a violation of such gravity that is deserved what may be called "capital punishment", i.e., the end of the exclusive right itself.

In my view, the lesson of *Volvo/Veng* is very relevant to our debate because it shows that, first of all, unfair pricing holds such a high rank in the hierarchy of antitrust offences that it should not be so quickly written off in favour of exclusionary abuses.[6] Indeed, the Court in *Volvo/Veng* listed it alongside the classic examples of exclusionary conduct. Second, *Volvo/Veng* also shows that unfair pricing can and should be addressed not so much by bringing the price to what can be considered a just or fair level, but rather by going to the root of the problem. In other words, unfair pricing should be dealt with by attacking the cause of the defendant's market power, of which high prices are a symptom.

Of course, I concur with what has been said before about the care that should be exercised in dealing with issues of high prices. Marc van der Woude has emphasized that no less than five conditions should be satisfied before high prices may be brought as cases of excessive pricing under the competition rules.[7] Similarly, Emil Paulis has highlighted the importance of very high and long lasting barriers to entry and expansion.[8] Once these conditions are present, I argue, the main issue becomes which remedial antitrust action to take. On this point, I must say that ever since *Volvo/Veng*, I rarely find arguments suggesting that one should go to the root of the problem. Like the Commission with its roaming Regulation, I have the impression that often there is a preference for a "quick fix" in the belief that all that can be expected under antitrust law is that the dominant firm will correct its pricing. Amelia Fletcher and Alina Jardine have started to lay the foundation for an alternative approach.[9] They call for "demand side" solutions. I believe that this change of attitude is to be welcomed, but we need bolder solutions for the energy markets. I now turn to this issue.

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4 *Volvo/Veng, supra* note 2, para. 9.

5 *Ibid.,* para. 7.

6 See Bruce Lyons, "The Paradox of the Exclusion of Exploitative Abuse", *Centre for Competition Policy Newsletter,* Spring 2007.

7 See van der Woude, this Volume.

8 See Paulis, this Volume.

9 See Fletcher and Jardine, this Volume.

III. HIGH PRICES AND STRUCTURAL ANTITRUST REMEDIES IN THE ENERGY SECTOR

There is little reason to be apprehensive about structural remedies under antitrust law in the domain of regulated industries. Let us take a look at our colleagues across the Atlantic.

Those who may think about *Trinko,* and a sort of reluctance in US antitrust law to tamper with regulated sectors, should be reminded that the most stunning revolution in US telecoms was mandated not by any act of Congress but instead by the *AT&T* consent decree.[10] Thus, at the very origin of the industry, which in the wake of *Trinko* is now enjoying some sort of antitrust immunity, we find a conspicuous structural remedy imposed by a federal judge.

The *AT&T* case should serve to reinvigorate competition authorities and prompt them to think about structural remedies for excessive prices. If all the conditions are indeed met for excessive prices to be considered an abuse, and if therefore (and this requirement should be emphasized) one observes a persistent pattern of very high and long lasting barriers to entry and expansion in which a single firm charges prices that are conspicuously above costs for a long period of time, I would then argue that the firm should not simply be met with merely an order to return to "normal" pricing, with all the difficulties of determining whatever that may be. As has been a long-standing policy in merger cases, the use of structural remedies should be the preferred option for uprooting the problem of excessive pricing under antitrust law.

The choice in favour of structural remedies would also be consistent with the respective roles of sector-specific regulators and competition authorities. One of the reasons for the reluctance to enforce unfair pricing under Article 82 is the fear that the competition authority may become entangled with the day-to-day monitoring of pricing behaviour. That fear is steeped in the conviction that the "right prices" are *the* remedy to excessive pricing offences. If one were to choose the structural remedies option, that fear would clearly be seen as being misguided. The regulator would remain in charge of price setting, while the antitrust authority would be responsible for reforming market structure. In fact, structural remedies may usefully supplement the arsenal of tools given to the regulator. One cannot forget that, while neither the electronic communications nor the energy regulatory framework provides for structural remedies, Article 7 of Regulation 1/2003 does so, and it contains terse language to that effect.[11]

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[10] *MCI Communications Corp v. AT&T*, 708 F.2d 1081 (7th Cir. 1983).

[11] According to Article 7, "[w]here the Commission, acting on a complaint or on its own initiative, finds that there is an infringement of Article 81 or of Article 82 of the Treaty, it may by decision require the undertakings and associations of undertakings concerned to bring such infringement to an end. For this purpose, it may impose on them any behavioural or *structural remedies* which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. *Structural remedies can 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*. If the Commission has a legitimate interest in doing so, it may also find that an infringement has been committed in the past." (emphasis supplied).

Having said that, let me turn to two instances of high prices in the energy sector where structural remedies may be an appropriate antitrust response. At the risk of oversimplification, discussions about high prices in the energy sector normally concern one of the following two matters: (i) prices for access to networks, and/or (ii) prices in the wholesale markets.

1. High prices for access to networks

I do not think that I need to spend too much time dwelling on this issue. The problems of unbundling have been discussed at length by the Commission in connection with the sector inquiry and by stakeholders in its aftermath. I observe that some of the national cases discussed as excessive pricing often concern precisely network pricing (i.e., the price for access to a network component).[12] As we all know, the Council has chosen to defer unbundling in the hope that energy markets will improve. That may also be a sensible solution from an antitrust point of view. As noted, excessive pricing cases should be brought only in the face of the most compelling evidence, including, *inter alia,* proof of systematic pattern of behaviour over time, whereas in certain cases, access to energy networks is a recent development. Here, "the quick fix" may be more appropriate in the short term.

However, it is important to bear mind the confusion that excessive pricing cases – particularly those resulting in orders to apply "the right price" – create as regards the allocation of competences between competition authorities and sector-specific regulators. In the end, it may be even less costly for an undertaking to accept a structural remedy. Here I would recall the British experience of Openreach, which I think is instructive of how a structural solution can be embraced by the undertaking concerned in lieu of a complicated review process based on behavioural commitments. Thus, structural solutions should remain on the agenda for high network prices, even for the sake of protecting the interests of those undertakings which control the networks.

2. High wholesale prices

The second type of high prices are high wholesale prices. Evidence of these types of shortcomings are documented in both the sector inquiry,[13] and in the study published on DG Comp's website on 20 April 2007.[14] High wholesale prices very often translate into high

[12] For instance, the 2003 *Stadwerke Mainz* decision by the FCO and the *Strom II* judgment by Germany's supreme civil court (see Marc van der Woude, "Unfair and Excessive Prices in the Energy Sector", this Volume) concern transmission and distribution charges.

[13] See *supra* note 13.

[14] See Press Release IP/07/522: "The European Commission has published a detailed study carried out by an external consultant which finds that fuel costs have contributed to the increase of EU electricity prices since 2003, but that wholesale electricity prices are significantly higher than would be expected on perfectly competitive markets. The differences are highest when only a few generators with available capacity are needed to meet demand, especially at peak time. The results of the study broadly support the conclusions of the Commission's Final Report of the Energy Sector Competition Inquiry

prices for final customers. As such, they are a very visible item on the agenda of national governments. It is difficult for competition authorities to resist the temptation of going for the "quick fix" in excessive pricing cases and ordering companies to behave in a particular way. Indeed, who would trust the "invisible hand" with structural measures which may or may not work, which may take time to deliver, and which moreover may earn you a powerful enemy, i.e., the incumbent energy company?

In spite of these concerns, however, I think that structural measures deserve credit as a remedy to high wholesale prices. First of all, the "quick fix" may work in the short term to appease customers, but there is no guarantee as to its effectiveness in the medium to long term. Second, "quick fix" measures may be quickly ordered, but they certainly take time to carry out. That is to say that antitrust action takes place after the damage to the market has already been done. This is compounded by the fact that, given the difficulty of proving an excessive pricing case, decisions may come only after a significant lag following the alleged offence.[15] Third, I agree with Marc van der Woude and François Lévèque that it would be ironic if energy liberalization were to end in regulated prices. It is well known that the Commission has criticized Member States for using tariffs to protect energy intensive customers from high prices. It would seem odd if antitrust action resulted in much the same type of measure.

By contrast, I think that structural remedies have advantages as a solution to excessive pricing. First of all, they can more happily co-exist with regulation. Structural remedies are one-off measures that leave the regulators' remit intact. In fact, such remedies do not replace regulatory intervention but accompany it, and they can add to what a regulator can do.[16] Second, structural remedies in the energy sector do not necessarily result in an irreversible situation. Through Virtual Power Plant (VPP) or gas release programmes, the incumbent's market power can be temporarily reduced. The incumbent retains ownership of the assets concerned, and these assets can then be returned to him once competition has taken off. Third, structural remedies are more in tune with the liberalization effort, as they are based on the same market logic that is the premise on which liberalization legislation is built.

(see IP/07/26 and MEMO/07/15), namely that competition in EU wholesale electricity markets is not yet functioning properly."

15 In Italy, the *Enel* case on wholesale prices in the pool was initiated in April 2005 and was closed in December 2006 when the company offered commitments. A "typical" case could last longer since, in this case, the Italian Antitrust Authority did not have to prove an infringement. See Case A366 - *COMPORTAMENTI RESTRITTIVI SULLA BORSA ELETTRICA*, decision of 20 December 2006 (Boll. 49/2006).

16 See *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973). Although it did not entail a structural remedy, *Otter Tail* is a good example of an antitrust remedy in the energy sector which in fact enlarged the remit of the regulator. In that case, the US Supreme Court held that it was illegal monopolization under Section 2 of the Sherman Act for a large electricity utility to refuse to transmit power as part of an attempt by the utility to stop other providers from competing with it in the sale of electricity to final customers. The Court imposed an obligation to transmit such electricity, and it empowered the regulator to oversee compliance.

IV. CONCLUSION

In my intervention, I have mentioned the Eurotariff several times with a hint of criticism. Let me be more clear about it. The Eurotariff may be odd in a liberalized market. But it certainly deserves praise. It takes no small dose of courage to tackle telecoms companies in such a head-on way. Thus, the Eurotariff shows that the Commission can muster the courage that it takes to pass bold measures in the face of strong opposition.

What deserves less praise is inertia. We have seen too much of that in the energy sector.[17] There are hints that change may be imminent. However, for over a decade, the Commission has maintained conspicuous silence with respect to this sector, relying on informal action. That has left a significant enforcement gap. It would be a pity if, after all this time, all we could get was an energy version of the Eurotariff.

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[17] See, e.g., C. Cultrera, "Les décisions GDF – La Commission est formelle : les clauses de restriction territoriale dans les contrats de gaz violent l'article 81", *Competition Policy Newsletter,* Number 1, Spring 2005. As noted by Cultrera, the Commission's decisions addressed to GDF and ENI "*sont très intéressantes à maints égards: elles sont les premières décisions formelles adoptées par la Commission depuis une décennie dans le secteur de l'énergie et viennent confirmer, après un certain nombre d'affaires concernant les clauses de restriction territoriale clôturées par règlement amiable, que ces clauses violent l'article 81 du traité.*" (emphasis supplied).