

The RWE gas foreclosure case: Another energy network divestiture to address foreclosure concerns

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Introduction

On 18 March 2009 the Commission adopted a commitment decision against RWE AG for suspected infringement of EU competition law. The commitments were offered by RWE to address the Commission's concerns about an abuse of RWE's dominant position in the German gas transmission markets. The concerns related to a possible foreclosure of RWE's competitors from access to its gas network and a possible margin squeeze to the detriment of RWE's competitors. In order to resolve the identified concerns, RWE offered to divest its entire German gas transmission network.

The RWE decision was only the second case⁽²⁾ in which a structural divestiture remedy has been offered in an antitrust case under Article 9 of Regulation 1/2003. Once implemented, the divestiture will result in a structural change in the German gas sector, facilitating competition in this sector, not least to the benefit of gas consumers.

The procedure (as in the previous E.ON electricity case), coincided with the discussions on the 3rd Energy Package. The decision, however, exclusively addressed the individual concerns of the competition case and was not related to these discussions.

The abuse under Article 82

The RWE case was based on the results of a surprise inspection at RWE's premises in May 2006⁽³⁾ and on further investigations carried out between 2006 and 2008. In the course of its investigation, the Commission came to the preliminary view that RWE may have abused its dominant position on its gas transmission network — a natural monopoly — by way of a *refusal to supply transportation capacity* and a *margin squeeze*.

⁽¹⁾ The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

⁽²⁾ See also case *E.ON Electricity/Wholesale* (COMP/B-1/39.388 and 39.389, cf. article "The E.ON electricity cases: an antitrust decision with structural remedies", Competition policy newsletter 2009-1, available at http://ec.europa.eu/competition/publications/cpn/2009_1_13.pdf). In the meantime, the Italian company ENI has also offered structural remedies to address competition concerns (see MEMO/10/29)

⁽³⁾ See MEMO/06/205.

Refusal to supply

RWE operates the second largest high-pressure gas transmission network in Germany⁽⁴⁾. The Commission concluded that RWE's gas transmission network can be considered an *essential facility*, since access to it is objectively necessary in order to supply gas to customers within RWE's grid area.

The Commission gathered evidence that RWE may have pursued a strategy of systematically keeping transport capacities — especially on important bottlenecks — for itself. Indeed, RWE has booked almost the entire transport capacity on its own network on a long term basis. This situation contrasts with a steady and significant demand for transmission capacities on RWE's network by third party transport customers who seek to compete with RWE in the downstream gas distribution markets. The Commission's investigation showed that demand by third parties largely exceeded the offered capacities, which led to *numerous rejections* of third parties' transmission requests by RWE.

According to the Commission's Preliminary Assessment, these rejections may have been unjustified. The Commission has gathered evidence that RWE may have understated its technically available capacity and managed the scarce transport capacities on its network in a manner that prevented many competitors from gaining access to it.

As a result, new entrants accounted for only a fraction of the transports on RWE's transmission grid and were unable to compete in an effective manner on the downstream supply market.

Margin squeeze

The Commission also identified concerns as to a possible abuse of a dominant position by way of a margin squeeze. A margin squeeze may occur if a vertically integrated firm which is dominant on an upstream market charges a price for a downstream product or service that prevents even equally efficient competitors from achieving a margin which allows them to compete effectively on the down-

⁽⁴⁾ Gas *transmission networks* are high-pressure network that distribute gas over long-distance pipelines mainly to wholesalers and some large customers. The gas is then transported to other end-customers via short-distance/local *distribution networks*.

stream market⁽⁵⁾. There is evidence that RWE may have intentionally set its transmission tariffs at an artificially high level in order to squeeze its competitors' margin. Such behaviour has the effect of preventing even an equally efficient competitor from competing effectively on the downstream gas supply markets by limiting the ability of competitors or potential entrants to remain in or enter the market, thereby ultimately harming the final consumers.

It appears that, in the period under investigation, RWE had negative profit margins in its downstream gas supply business. RWE's negative results in the downstream gas business contrast with its overall profitable German gas business, including its network business where, according to the available evidence, RWE made considerable annual profits⁽⁶⁾.

The Commission has gathered evidence that the margin squeeze may have been reinforced by RWE deliberately creating an asymmetry in the cost structure between RWE and its competitors. Indeed, important parts of RWE's network tariffs applied only to third party users. RWE's *rebate policy*, for instance, granted significant rebates for transmission contracts with a long duration. Although, in theory, these high rebates were also available to competitors, in practice RWE benefited from its rebate scheme almost exclusively, not least because it was almost impossible for new competitors to obtain the necessary long-term capacities. Also, RWE's policy with regard to its fees for *balancing services*⁽⁷⁾ had an asymmetrical effect. While RWE was itself exempted from paying balancing costs, other transport customers faced the risk of high penalty fees within RWE's transmission network. There is evidence that these balancing fees had a highly deterrent effect on downstream competitors.

The remedy: Proportionality of network divestiture; energy policy through the back door?

To address the Commission's competition concerns, RWE offered a *structural remedy*, namely to sell its existing German high-pressure gas transmission

network with a total length of approx. 4 000 km, including the necessary personnel and ancillary assets and services necessary for a viable gas transport business, to a purchaser who is *independent* of RWE and who does not give rise to *prima facie* competition concerns. The market test of the commitments confirmed that they were necessary and proportionate to remedy the abovementioned competition concerns. Accordingly, the Commission was able to make the commitments binding by its decision of 18 March 2009⁽⁸⁾. The sale of RWE's network will take place under the supervision of a trustee, and the buyer is subject to the Commission's approval⁽⁹⁾.

Proportionality of the network divestiture

As regards the *proportionality of the remedies*⁽¹⁰⁾, the RWE case provides a particularly comprehensive illustration of the necessity of the structural remedy that was eventually accepted: All the concerns in the Commission's investigation were related to practices by which RWE potentially abused its network dominance to fend off competition in the downstream supply market (where RWE ultimately succeeded in safeguarding its traditional dominant position). Concrete evidence substantiated the Commission's concern that the incentives of RWE as a vertically integrated company had actually led RWE to favour its own supply business to the detriment of downstream competition and, ultimately, consumers.

In such a scenario, it appears difficult to argue that the Commission should not be entitled to accept remedies which were voluntarily offered by RWE and which are

- an *appropriate* means to remove the competition concerns, as the divestiture makes it virtually impossible for RWE to abuse its network;⁽¹¹⁾
- the *least burdensome* means to remove the concerns, since it is clear that other, behavioural solutions (such as a promise not to engage in such practices any longer) would not be as effective

⁽⁵⁾ See e.g. Commission Decision of 4 July 2007 relating to proceedings under Article 82 of the EC Treaty (Case COMP/38.784 – *Wanadoo España vs. Telefónica*, paragraph 282).

⁽⁶⁾ Despite the potentially inflated prices paid by RWE TSO to another RWE subsidiary (RWE Energy) for internal services.

⁽⁷⁾ Balancing services are intended to bridge the differences between forecasted and actual transport volumes, i.e. the balancing service provider buys gas from shippers if these have unexpected excess capacities and sells gas to shippers if they need more gas than expected. In order to avoid that transport customers abuse the balancing services of network operators, network operators usually charge a certain "penalty" to their transport customers in imbalance.

⁽⁸⁾ If commitments given in the context of the Article 9 Regulation 1/2003 decision are not complied with within a given timeframe, the Commission may impose on the committing party (here: RWE) a fine of up to 10% of total worldwide turnover without having to reach a final decision as to whether the antitrust rules have been infringed.

⁽⁹⁾ In order not to negatively affect the commercial interest of RWE the date by which the divestiture has to be concluded cannot be disclosed.

⁽¹⁰⁾ See in this respect notably recital 12 of Regulation 1/2003; see also the findings of the CFI in its "Alrosa" judgement of 22 July 2007 (Case T-170/06, ECR II- II-2601). The judgment is, however, being challenged by the Commission before the ECJ, see case C-441/07 P.

⁽¹¹⁾ The Commission also ensured that the purchaser of the network will have no incentives to negatively or positively discriminate against any of its customers.

and might be difficult (or even impossible) to monitor in practice; and

- *proportionate* to the identified competition concerns, not least with an eye to the large number of customers who are accessible only through RWE's gas transmission network, and the substantial potential harm for these customers⁽¹²⁾.

Independence from the political negotiations on the 3rd Energy Package

The offer of remedies during the negotiations on the 3rd Internal Energy Market Legislative Package⁽¹³⁾ ("3rd Energy Package") and the adoption of the decision a few weeks before the completion of the negotiations on the new regulatory framework have been widely commented on. Some authors have cast doubts on whether the Commission's decision to accept *structural remedies* was proportionate⁽¹⁴⁾ in view of the Community legislator's decision to accept alternative models for energy companies, such as ownership unbundling⁽¹⁵⁾.

It is contended that the negotiations on the 3rd Energy Package and their outcome were not directly relevant in terms of the remedies that the Commission can accept or impose in an individual competition case. The Commission's obligation to act against infringements of competition law does not stem from changing secondary legislation, but *follows directly from the EC Treaty*.

The fact that the 3rd Energy Package has ultimately not imposed ownership unbundling on the main European energy companies does not mean that ownership unbundling cannot be the necessary remedy in individual antitrust cases. Indeed, the solutions for individual cases of suspected or proven antitrust infringements may well differ from general regulatory solutions for a sector.

The commitment decision in the RWE case exclusively addressed the individual concerns of the competition case at issue.

Link to Sector Inquiry

While the RWE case was conducted independently of the parallel discussions on the 3rd Energy Package, it is true that the case provides a particularly good *illustration of competition* problems that can arise in the case of vertical integration between network operators and dominant supply companies, as identified in the Commission's Energy Sector Inquiry. The Sector Inquiry⁽¹⁶⁾ highlighted a number of structural problems in the energy markets, inherited from the pre-liberalisation period, and characterised national energy monopolists. In particular the vertical integration of production, transmission and distribution activities was found to preserve an incentive for the owners of the transport networks to favour their own supply business and to keep entry barriers for newcomers high⁽¹⁷⁾. The RWE case is, in this respect, a valuable case-study⁽¹⁸⁾ on the practical difficulties for energy companies to reconcile the diverging obligations to offer non-discriminatory access to competitors and to comply with unbundling rules on the one hand, and to maximise profits for the vertically integrated company on the other hand.

Conclusion

The Commission's competition law enforcement activities in the energy sector show that European energy markets are still lagging behind in terms of achieving a "level playing field".⁽¹⁹⁾ In that respect, the RWE case, concluded with a network divestment remedy, is a significant step forward for competition in that sector, both in its own right and because of its value as a precedent.

⁽¹²⁾ See on the proportionality analysis also *von Rosenberg*, ECLR 2009, 237 et seq.

⁽¹³⁾ On the final shape of the 3rd Energy Package see e.g. http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/misc/108740.pdf

⁽¹⁴⁾ See e.g. *Klees*, WuW 2009, 374 ("Sündenfall [fall of man] for competition policy") et seq.; *Ebricke*, WuW 2008, 411 ("Energy policy with competition instruments"); *Hauschild*, Handelsblatt of 2.3.2009 ("Unbundle Neelie Kroes!", <http://www.handelsblatt.com/politik/handelsblatt-kommentar/entflechtet-kroes;1398305>).

⁽¹⁵⁾ See *Ebricke*, WuW 2008, 411.

⁽¹⁶⁾ See *Final Report on the Sector Inquiry*, Communication from the Commission (COM(2006) 851 final), available at: http://ec.europa.eu/competition/sectors/energy/inquiry/full_report_part1.pdf

⁽¹⁷⁾ *Final Report on the Sector Inquiry*, page 47 et seq.

⁽¹⁸⁾ See also *Manoussakis*, World Competition 2009, 227.

⁽¹⁹⁾ See *inter alia* the ongoing investigations against EdF (see MEMO/08/809), Suez (see MEMO/08/809), GdF (MEMO/08/328), ENI (MEMO/09/120), E.ON/GdF (MEMO/08/394) and Svenska Kraftnät (MEMO/09/191).