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K&L GATES

HOT TOPIC

COMPETITION AND ANTITRUST ISSUES FOR THE GAS & UTILITIES SECTOR



PANEL EXPERTS



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R&C: What do you consider to be the main competition/antitrust developments currently impacting the gas & utilities sector? What key regulatory issues have these companies faced in recent years?

Bruneau: The European Commission (EC) has embarked on a shift toward climate neutrality with the adoption of the 'European Green Deal' in December 2019 in order to become a climate neutral continent by 2050. In this context, gas & utilities companies are dealing with regulatory challenges driven by decarbonisation, which has now taken the form of reaching an ultimate net-zero target. As the EC has adopted several packages of measures and progress reports around energy efficiency goals, emissions reduction through an increasing use of renewable resources and research and innovation in low-carbon technologies, competition law has started to adapt in order to facilitate the implementation of the European Green Deal's climate change and sustainability objectives. Since 2000, gas & utilities companies have been an area of prime focus for the EC's Directorate-General for Competition (DG COMP), with separate sector-specific inquiries covering the gas industry and the capacity mechanisms in electricity markets. Similarly, the DG COMP has significantly intensified its enforcement action to tackle potential anti-competitive behaviour in these markets while considering enabling collaboration between

competitors to achieve sustainability and green goals.

Borsos: Noteworthy antitrust initiatives by regulators include the German competition authority and energy regulator adopting guidelines for the control of abusive practices by electricity generators in 2019. These guidelines establish that prices above marginal costs are legitimate if required by a dominant supplier to cover the costs of its power generation park. This is the first time that a defence against allegations of abusive practices based on cost efficiency has been explicitly accepted by an authority. Outside the European Union (EU), the UK is taking a very proactive competition stance through the Office of Gas and Electricity Markets (OFGEM), the sectoral regulator which also has competition powers. With respect to antitrust enforcement at the EU level, the EC has maintained its efforts to eliminate barriers to the single gas market. A recent example is the commitments accepted by the EC in the Transgaz case, allowing for greater export of gas from Romania to Hungary and Bulgaria. The creation of an energy common market will in fact probably escalate in the near future as the EC irons out national differences created by different take-up levels for different sources of renewables. Going forward, it will be interesting to see how companies and the EC address the satisfaction of the goals of the 'Green Agenda' in a way that does not compromise competition policy, especially as

regards the promotion of hydrogen and 'green gas' alternatives. Similarly, it will be interesting to see how strictly competition rules are enforced in relation to industries which do not fall within the 'renewables' family, given that their economics are compromised but they are still necessary for society to maintain its overall energy 'mix' in order to sustain changes in demand across industries and seasons.

de Ugarte: The current coronavirus (COVID-19) pandemic crisis has affected the financial situation of companies in many industries, no less so in the gas & utilities sector. Indeed, demand for gas and other fossil sources of energy has been under significant pressure. Gas & utilities companies are therefore likely to be looking for ways to expand profitability and reduce costs. In that context, one may expect a wave of consolidation in the industry through M&A activity or joint ventures (JVs). It will thus be interesting to see how this will impact the merger control practice of the EC and other national competition authorities in an industry that is already characterised by a significant degree of concentration in various EU member states. In addition to merger control, we will also see increased foreign direct investment (FDI) control after the introduction by the EC of the 'EU Regulation on a framework for the screening of Foreign Direct Investment in the EU', which entered into force on 11 October 2020. Finally, it will be interesting to see whether companies in

this industry will be able to successfully invoke the so-called 'failing firm defence' in an EU merger control context. So far, this theory has not regularly been invoked successfully by parties to M&A transactions, though the economic fallout resulting from the pandemic may provide fertile ground for such lines of argument. A notable case in this context was Nynas AB's acquisition of Shell's Harburg oil refinery assets, where this theory was applied with a degree of success. We have noticed an increased use by companies of so-called price analytics tools or similar mechanisms. Such tools are set up by companies, or coordinated among companies, with an eye toward price coordination. Competition regulators, such as the EC, have, in the past, expressed concern that such tools and related strategies could lead to increased coordination between companies as well as increased pricing stability. In 2018, the EC fined various companies active in the consumer electronics space for such price monitoring activities.

R&C: With the coronavirus (COVID-19) pandemic having led to huge spikes in demand and fluctuating costs, what competition/antitrust issues do gas & utilities companies need to consider? To what extent has the crisis been exploited as a 'cover' for non-essential collusion, for example?

Borsos: The economic impact of the COVID-19 crisis on companies active in the gas and utilities sector, in conjunction with the significant fixed costs that characterise the sector, may give rise to consolidation where stronger competitors exploit the opportunity to take over smaller and weaker players. In addition, it is also likely that EU member states will be tempted to develop policies in support of their national incumbents, which may lead to an increase in state subsidies to companies in the sector, especially those considered to be strategic. It is probably too early to detect and to assess the potential exploitation of the crisis as a cover for 'non-essential collusion', however. It is worth noting, though, that this concern has been voiced by various regulators, such as the UK's Competition and Markets Authority (CMA), which has emphasised that it "will not tolerate unscrupulous businesses exploiting the crisis as a 'cover' for non-essential collusion", as well as the EC proclaiming that it will actively monitor markets to detect breaches.

de Ugarte: The EC's position is that an economic crisis will not exempt anti-competitive activities between competitors from antitrust scrutiny. As a general matter, it is still too early to tell whether the COVID-19 pandemic has led to collusion on a wide scale. Soon after the outbreak of the COVID-19

pandemic in Europe, the EC, as well as national competition authorities, were quick to reaffirm

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*Salomé Císnal de Ugarte,
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that the pandemic is not a blanket justification for infringements of EU and national competition law, but that EU and national competition laws should also not stand in the way or unnecessarily hinder a degree of coordination in respect of the distribution and supply of necessary goods and services during the pandemic. Whether the production, supply and distribution of gas and electricity would fall under any lenient consideration by the EC or national competition authorities of coordination among competitors in the context of ensuring the continuous supply of critical goods and services is unclear. In that context, we point to a specific situation in Norway where the local authorities have seemingly indicated that gas transport activities might enjoy a limited exemption from the Norwegian

equivalent of article 101 of the Treaty on the Functioning of the European Union (TFEU). In respect of M&A activity and merger control, at EU level, the EC has on various occasions in 2020 indicated that the pandemic crisis may not form grounds for a relaxed approach to the enforcement of the EU Merger Regulation (EUMR). In April 2020, Margrethe Vestager, the EU commissioner for competition, warned that the crisis “shouldn’t be a shield to allow mergers that would hurt consumers and hold back the recovery”.

Bruneau: The COVID-19 pandemic has created serious disruption for businesses, with industries called to adapt promptly to evolving consumption patterns and demand requirements. Some industries, including companies active in the electricity sector, have experienced a significant impact on their services, with oil and gas prices plummeting amid the COVID-19 crisis, which can create incentives for collusion. In such an uncertain environment, companies need to be mindful of competition and antitrust concerns, especially when considering a potential collaboration with competitors, either in the form of M&A or in the form of joint ventures. Indeed, activities perceived as a ‘cover’ for non-essential collusion are still very much on the EC’s radar, and any form of potential collaboration with competitors needs to be assessed carefully. This includes, among others, exchange of commercially sensitive information, exclusion of competitors within the

same market, and collusion to artificially keep prices high to the detriment of consumers.

R&C: What steps have regulators taken to adapt competition law and enforcement priorities to help suppliers meet recent challenges while protecting consumers from unscrupulous business practices?

Bruneau: The exceptional circumstances stemming from the COVID-19 outbreak have led the EC and national competition authorities to reflect on the specific measures to be implemented in response to the crisis. On the one hand, the EC recognised that antitrust law should facilitate the proper implementation of cooperation needed to overcome the crisis. On the other hand, it took the view that antitrust law should still be rigorously enforced to prevent undertakings from using the crisis as a cover for anti-competitive collusion or abuse of their dominant position, including through excessive pricing or by limiting production to the ultimate prejudice of consumers. These considerations led to the adoption of EU guidance with detailed criteria, including an antitrust temporary framework communication on cooperative arrangements for businesses, notably taking the form of comfort letters to ensure the availability of critical supplies during the COVID-19 outbreak. At the same time, while

the EC accommodated its enforcement priorities, it encouraged undertakings and citizens to still report any 'crisis cartels' and other antitrust violations.

de Ugarte: Even during the pandemic crisis, EU and other competition laws remain in place while competition authorities also recognise that competition laws should not stand in the way or unnecessarily hinder urgent efforts to deal with the fallout from the crisis. In this context, we have seen competition authorities around Europe and, where need be, national governments issue guidance on the application of competition laws specifically in the context of the COVID-19 pandemic. For example, the EC issued general guidance early on in the pandemic – in particular the so-called temporary framework communication providing guidance to companies in respect of EU antitrust provisions in response to urgent situations related to the COVID-19 outbreak in respect of “essential products and services”. The EC also issued exceptional derogations from EU competition laws for milk, live plants and flowers. Finally, the EC issued a temporary framework for state aid measures to support the economy in the current COVID-19 outbreak. Various EU jurisdictions issued general or specific guidance, sometimes combined with derogations for some industries of the application of competition laws or industry-specific comfort letters, such as automobile sector restructurings in Germany and increased cooperation in pharmaceutical products in the





Netherlands. Finally, a number of EU jurisdictions also have a dedicated service, mailbox or phone number with the national relevant competition authority to provide informal advice to companies in need of guidance on the application of competition laws during the pandemic.

Borsos: Competition regulators are currently dealing with challenges by being proactive in taking action for the benefit of consumers where high pricing is at issue. By the same token, beyond safeguarding free competition in the interests of consumers, the EC has clarified that collaborative activities may be considered to be compatible with competition rules where such collaborations entail consumer benefits by increasing output or overcoming energy shortfalls, provided that such arrangements are limited in their scope and duration to what is required during the pandemic. In the area of state aid control, it is noteworthy that the EC has prolonged the Guidelines on State Aid for Environmental Protection and Energy 2014-2020 in order to mitigate the impact of the coronavirus outbreak. At the national level, some regulators have also relaxed competition rules. Spain, for example, has declared that it would prioritise its support of business continuity by allowing certain activities that otherwise would be considered to be anti-competitive. Given the strategic nature of the energy sector, we may also need to be prepared for member state intervention that targets acquisitions by non-

EU firms under two separate legal instruments: the recently enacted Regulation (EU) 2019/452 introducing an EU framework for foreign direct investment, as well as the EC's mechanism for the review of foreign subsidies that is due to be enacted over the course of 2021.

R&C: With many governments having temporarily relaxed elements of competition/antitrust law in response to the pandemic, how difficult has it been for companies to adapt accordingly and maintain compliance?

de Ugarte: Particularly across the EU, it cannot be said that authorities and governments have relaxed antitrust rules in an effort to deal with the COVID-19 pandemic. However, certain relaxations have indeed come about, in particular in the state aid space and in respect of the cooperation necessary to ensure a continuous supply of critical goods to deal with the COVID-19 pandemic. The key challenge for companies in this context lies primarily in overcoming the fact that in times where cooperation may be needed, even for non-essential goods and services, the general proposition is that competition laws remain fully in effect. There are difficulties dealing with a degree of disparity and lack of uniformity with regard to the application and enforcement of competition laws by various jurisdictions in the EU. Indeed, some relaxations have

undoubtedly come about in certain jurisdictions but not others. An additional difficulty is in receiving sufficiently clear and timely information from competition authorities in the EU on specific concerns raised by companies during the pandemic. Various competition authorities have either been overwhelmed with questions or proven at times unwilling to give clear guidance.

Borsos: A rapidly changing regulatory environment certainly represents some unique compliance challenges. This is particularly true when organisations are focused on adapting to a crisis and navigating their businesses in an uncertain economic environment. That said, during the COVID-19 crisis, the overall level of risk related to competition law compliance has not increased significantly. Monitoring and adjusting to an ever-changing sequence of regulatory developments across the globe is of course challenging. An increased level of diligence with updated and effective internal compliance programmes continues to be key. The greater difficulty will be for those parties that have adapted to the 'new normal' to reorientate their behaviour when antitrust enforcement arguably ramps up after the pandemic has come to an end.

Bruneau: COVID-19 has created unprecedented issues for businesses, as many companies have struggled to adjust swiftly to the needs of the rapidly evolving markets. Many companies, incentivised

by the necessity to be able to respond to short-term fluctuating demands, while contemplating the most efficient ways to secure the long-term survival of their industries, found themselves in a position to consider horizontal cooperation initiatives. In response to such needs, governments introduced new rules or temporarily relaxed elements of their existing competition and antitrust framework. This has also been reflected at EU level. However, despite the more flexible approach to competition and antitrust enforcement, it quickly became clear that companies still need to comply at all times with competition law. These considerations, in addition to the challenges posed by the 'new' reality of the remote working environment, have undoubtedly created additional difficulties for companies attempting to adapt and maintain compliance. Still, most legal departments have continued to maintain their standard compliance training, although they have done so remotely.

R&C: How would you describe recent enforcement efforts to curb anti-competitive business practices in the gas & utilities sector? On what areas are regulators focused?

Borsos: During the last few years, the EU has been focusing its enforcement efforts in support of the European single energy market, by initiating various investigations into the energy sector, and in particular into the export restrictions applied by

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some of the region's dominant energy suppliers. In 2018, the EC imposed a fine of €77m on a subsidiary of the largest Bulgarian natural gas distribution company, Bulgargaz. It also imposed binding obligations on Gazprom to enable free flow of gas at competitive prices in Central and Eastern European gas markets. Both of these interventions were significant. As a result of the COVID-19 crisis, and with the further consolidation of the industry, regulators will likely be compelled to turn their focus once more to ensuring that consolidation does not harm competition. A new area of focus may well be on designs by foreign companies to acquire local

energy firms. State aid control will also continue to play an important role in the EC's enforcement activities in this industry and it can be expected that the EC will continue to strictly scrutinise support measures implemented by national governments, as showcased by the in-depth investigation initiated by the EC just before the COVID-19 crisis in February 2020, in relation to the compensation mechanism that France implemented regarding the storage of natural gas.

Bruneau: We have witnessed a noticeable increase in EU competition enforcement activity in the gas & utilities sector, which complements policy initiatives in line with the European Green Deal's objectives. Antitrust efforts at EU level concentrate on eliminating barriers to a single energy market and on ensuring lower prices, higher investment and improved productivity. In the utilities sector, the EC updated the rules on state aid in September 2020 to help energy-intensive industries deal with higher electricity prices from the EU's emissions trading system, although electricity companies had to deal with overcapacity and negative electricity prices during the COVID-19 crisis. Meanwhile, the EC's horizontal guidelines on collaboration between competitors, as well as the Vertical Block Exemption Regulation (VBER), are under review, which is an even more topical subject

amid the COVID-19 pandemic. In a broader context, the EC has also published a call for contributions to

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*Mélanie Bruneau,
K&L Gates LLP*

determine how EU antitrust, state aid and merger control can better support the implementation of sustainability policies. That would be an interesting topic for companies in the gas & utilities sector to follow.

de Ugarte: Gas & utilities companies are often very large companies regularly operating in national markets facing an economic crisis common to all industry sectors – where the energy sector has been hit hard economically and there has been an important shift away from fossil sources of energy generation into cleaner and greener sources of energy generation. In this context, from a competition law perspective, gas & utilities

companies may face scrutiny under laws prohibiting abuses of a dominant position, laws prohibiting anti-competitive collusion and merger control laws. At EC level, the focus in this industry has mostly been on unilateral conduct, merger control and state aid. Beyond the EU level, national competition authorities of EU member states have also investigated cases in the gas & utilities space.

R&C: Have any recent, high-profile competition/antitrust cases in the gas & utilities sector caught your eye? What do they tell us about current regulatory attitudes and priorities?

Bruneau: The gas & utilities sector has received intense EU and national competition scrutiny with one of the goals to open up the market to new entrants facing anti-competitive practices from incumbent operators and to create a single market within the EU. Recent EC antitrust enforcement action seems to tackle a wide range of issues, from collusive behaviour to exclusionary conduct and exploitative abuses by dominant incumbents, primarily on the basis of article 102 of the TFEU. One of the high-profile cases in this regard is the €77m fine imposed in relation to an abuse of dominant position on the Bulgarian wholesale electricity market. The EC has further stressed that its antitrust enforcement's main objective is to ensure that energy can flow freely by addressing

territorial restrictions in supply contracts, as well as upstream and downstream and network foreclosure issues. That rationale was prominent in the EC's investigations in liquified natural gas (LNG) cases, which illustrated the EC's intention to remove restrictions on the free flow of natural gas in Europe.

Borsos: An interesting case that has been in the spotlight concerns the legal challenge initiated by German municipal suppliers against the EC's decision in the REW/E.ON asset swap. This merger led to RWE taking over the operations of the renewable energy subsidiary Innogy, as well as those of Austrian utility Kelag, thus making it Europe's third-largest renewable energy company. This case demonstrates the EC's willingness to support operators in energy markets where the deal is designed to facilitate greater efficiencies in the sector. However, it is just as important to note that following the respective EU court rulings in the UK state aid capacity market case and the OPAL pipeline case, yet another reversal in the EU courts might weaken the EC's credibility in energy sector competition enforcement, which might open the door to further challenges of its decisions in the future.

R&C: As the fallout from the global pandemic continues, what competition/antitrust issues are set to challenge the gas & utilities sector over the coming

months? What steps do they need to take to ensure they remain compliant and avoid regulatory enforcement action?

Borsos: At the EU level, state aid cases in the electricity sector are likely to arise. In order for EU member states to ensure the security of supply and satisfaction of environmental objectives, they will probably proceed to the review of their capacity payments and RES support schemes with a view to attracting more investment in the sector. In addition, companies active in the utilities sector will likely look into the most cost-effective ways to generate efficiencies. Acquisitions to consolidate infrastructure sharing and the creation of joint ventures, and cooperation agreements will often be closely associated with these types of initiatives, potentially raising various horizontal competition issues, both under merger control rules and under article 101 of the TFEU. In order to avoid facing regulatory obstacles in their endeavours, European energy companies should intensify their antitrust compliance efforts when entering into joint ventures and cooperation agreements. Ensuring compliance with EU state aid rules will also remain an important strategic consideration in their market behaviour.

Bruneau: As gas & utilities companies evolve and adapt their strategies toward decarbonisation, new competition challenges are expected to arise. COVID-19 has revamped the debate on whether antitrust rules are fit for purpose, whereas collaboration between competitors and further monitoring of potential anti-competitive practices is expected to be a prevailing issue. Another topic to watch is the interplay between the EU's industrial policy and state aid rules. Several of the EC's landmark rulings on member states' capacity mechanism procedures have signalled that the application of national industrial policy measures, including monetary support for gas & utilities companies, could be challenged under state aid rules. In this context, effective compliance management and governance remains critical. Companies' proactive approach, paired with regular communication and continuous compliance training, are essential factors for early detection of antitrust violations. However, there is no one-size-fits-all approach – a tailor-made risk assessment is a crucial component of compliance. **RC**