Kluwer Competition Law Blog

Power Out: Portuguese Energy Giant Fined €40M

José Sá Reis (Universidade do Porto) · Thursday, October 12th, 2023

On September 25th the Lisbon Court of Appeal (TRL) upheld the essence of a 2022 ruling by the Portuguese Competition Court, which in turn had already upheld the 2019 decision of the Portuguese Competition Authority (PCAC) in the EDP case, condemning it to a fine of €40 million – the largest fine ever imposed in Portugal as a consequence of the finding of an abuse of a dominant position.

In recent years the PCA has indeed issued higher individual fines in cartel cases. In the banking cartel decision alone, were each fined 60 and 82 million euros. *Modelo Continente* and *Pingo Doce* (the two largest food distributors in Portuguese territory) have each been sentenced to five fines exceeding €20M (the highest reaching a staggering €75M) in five of the ten hub-and-spoke cartel cases in which both were convicted. These fines, by the way, risk being annulled following a recent clarification of the Portuguese Constitutional Court which, in practice, obliges to disregard all evidence obtained by the seizing of emails between the cartellists, since such seizings were authorized by a public prosecutor instead of the examining magistrate. These two players' fines alone, in this bundle of actions, surpass €468M.

In short, and considering the size of the Portuguese market, the PCA is not exactly gentle when it comes to setting the amount of fines. But if the amounts have been high in cartel cases, they have been much less so regarding individual practices.

During the last few days, however, the TRL has confirmed two fines that are far higher than usual. A few days before the ruling against EDP, the same court confirmed a €24M fine applied by the PCA to Super Bock (the largest Portuguese beer producer and importer) for the practice of resale price maintenance over its "Horeca channel" distributors. Unless they manage to pull a procedural rabbit out of the hat (as the banks are apparently trying to do with the statute of limitations), times are not easy for those who break the rules of competition in Portugal.

Background

EDP was created in 1976 as a state-owned company, resulting from the merger of several public and private capital companies that were nationalized in 1975, following the 1974 coup and the proto-socialist turn that the Portuguese economy and politics experienced for a short period. Together, those companies have dominated the production and distribution of electricity in Portugal for the past decades. This explains that EDP was the monopolist producer and distributor

until 2007, when the sector was, once again, opened up to private initiative and the Iberian wholesale energy market (MIBEL) was put into practice.

Along with this opening up of the market, the privatization transition of EDP began in 1997 and lasted until 2011. This year the last relevant share that the Portuguese state held in the national energy giant (21.35%) was sold to China Three Gorges, a company 100% owned by the Republic of China which became the largest single shareholder from then on.

But there was a problem: about thirty EDP-owned power plants had in place long-term energy purchase agreements (CAE, "*contratos de aquisição de energia*"), which bound the national electric network (REN) to purchase energy from these plants for periods of at least 15 years. The opening up of the Iberian energy market that occurred in June 2007 meant, of course, that such contracts had to be terminated so that all future competitors would have a levelled playing field to operate on.

Nonetheless, given that this move could represent huge losses for the concerned plants, a compensation arrangement termed as "*costs for maintaining contractual balance*" (CMEC: *"custos de manutenção do equilíbrio contratual"*) was set up in 2004. According to this mechanism, each plant would be guaranteed the expected annual turnover until the end of the existing contracts, if the market revenue fell above the contracted figures, and all losses arising from the premature ending of the contracts would be compensated. And by whom, one might ask? By the consumers: these compensations were included in the electricity bill as a specific fee charged directly to consumers. Even if this may look dangerously like a state aid mechanism, the truth is that the EU Commission was consulted in 2004 (and again in 2017) and expressly said it should not be deemed as one. But the story is just beginning.

As in most energy distribution systems, in Portugal, the main wholesale market is complemented by so-called "*system services*". These are reserve electricity distribution markets to which the network administrator (REN) will resort whenever the available energy in the main market is not enough to satisfy the demand at any specific moment. This system services comprehend the primary, secondary and tertiary reserve markets.

The secondary market is also known as the teleregulation service. It comes into operation in a very short time (between 30 seconds and 5 minutes) whenever the primary reserve market cannot cover the needs of the main wholesale market, and operates through daily energy auctions, where the different suppliers bid their offers in terms of both price *and* quantity available. It is important to emphasize that the price effectively paid to the suppliers is not necessarily the one they offered, but instead the so-called *equilibrium price*: the price of the marginal offer that is necessary to cover all the expected demand for a given day.

Of course, due to its very nature, demand in this market is almost inelastic, as the purchaser (the network administrator, which is REN) must absolutely meet its needs. Contrary to the primary reserve market (which is compulsory for all main marker players and is not remunerated), participation in the secondary market was voluntary at the time of the infringement and remunerated according to the bids made by the suppliers.

During the infringement period (2009 to 2013), these suppliers included power plants owned by EDP and subject to the CMEC regime, other plants also owned by EDP but operating in an open market regime, and energy supplied by the other market players: Endesa and Iberdrola (both

Spanish) as well as REN-Trading. But according to the PCA decision, which was based on an independent report commissioned by The Brattle Group, during the whole of the infringement period EDP had at least 84% of the telerregulation installed capacity and effectively supplied at least 68% of all of its demand. This circumstance, of course, makes it not only a clear dominant operator but also a price-maker in the secondary (telerregulation) market. In addition, CMEC power plants (especially hydroelectric plants) accounted for a vast majority of the total EDP offer.

The infringement

Investigations started when the Portuguese energy regulator (ERSE) noticed that prices on the secondary market increased by 68% between 2011 and 2012, despite an overall increase of about 56% in the market supply. This finding prompted ERSE to contact the PCA, alerting to what it called *"a practice in use of market power"*. This happened in 2013, and the PCA immediately made two recommendations to the Portuguese government. Firstly, to rethink the rules of the CMEC mechanism. Secondly, to perform an independent audit on the practices of EDP for the past years. This audit was eventually commissioned to The Brattle Group, and performed between 2015 and 2016, resulting in three different and complementary reports jointly known as *"the Brattle Report"*.

Following the conclusions of the Brattle Report, the PCA initiated an official investigation in September 2016, which led, three years later, to the fining of EDP in the amount of €48M. Let's see now what infringements the PCA found.

As we explained earlier, EDP was the price-maker in the secondary reserve market for electricity supply. This meant that it set the prices in the vast majority of the daily auctions since its offer alone was normally enough to satisfy the totality of the demand. According to the PCA, EDP used its dominant position to artificially increase its prices in the secondary market by adopting a practice that managed to harm consumers in two different ways. What EDP did was, in fact, quite simple: it substantially reduced the use of hydric technology by power plants subject to the CMEC mechanism when it operated in the secondary reserve market, replacing it with thermoelectric power plants working on an open market basis, and, therefore, not subject under said mechanism

The first consequence is easy to foresee and derives from the functioning of the CMEC mechanism that was described earlier. Since the output of the power plants benefiting from CMEC was reduced, its turnover diminished. As we saw, the difference between the annual income that each of these plants after their termination had to be compensated through the electricity bill sent to final consumers. So, the lower the production in the CMEC power plants, the higher the compensations each of those plants received – and all this was happening at the expense of the end consumers, domestic and corporate.

But the harm did not stop there. The majority of the most efficient power plants, in terms of costs and output, were hydroelectric plants benefiting from the CMEC mechanism. So, when EDP decided to transfer the majority of its production to open-market plants it did not only increase its CMEC compensations. Actually, increasing the output of several thermoelectric plants, less efficient than the hydric plants, led to the increase of the production cost per Kw/h, which in turn made the price of the bids in the secondary reserve market sky-rocket in one year – so much that it eventually caught the eye of the energy regulator. And let's not forget that EDP was the dominant

player in the secondary market. The fact that it chose to increase its prices led the other price-taker operators to do the same, causing an umbrella effect in which consumers were, of course, the ultimate losers.

The Fine

All things considered, the PCA found that EDP had incurred on the violation of Arts. 102 (2)(b) of the TFEU and the corresponding Art. 11 (2)(b) of the Portuguese Competition Act: as a dominant undertaking, it knowingly limited production, markets or technical development to the prejudice of consumers.

The Competition and Regulation Court (TCRS) upheld the decision of the PCA and most of its reasonings maintaining the €48M fine imposed by the latter. The Lisbon Appeal Court (TRL) reduced the amount of the fine to €40M. The rationale for this decision was quite straightforward. The TCRS decision had concluded that the infringement started not in January 2009, but instead in October of the same year, but maintained the quantum of the fine nevertheless. The TRL took this period shortening into account, together with the lack of a previous offence record and the additional impact of the recent energy crisis, and cut one-sixth off of the initial amount.

The Damages

According to the PCA, the infringement caused damages to end consumers estimated at €139,6M. The Competition Court followed slightly different criteria (adopted in a further technical report) and accepted an estimation between €205,6M and €320,7M, of which €180,4M to €260,7M derived from the imposition of supra-competitive prices, and €21,6M to €60M from the overcompensation received from the CMEC mechanism. Nevertheless, the Court warned that these calculations were made when the timeframe of the infringement included the period from January to October 2009. As we just saw, the fact that it eventually transferred the beginning of the infringement to October would necessarily imply a reduction of these figures.

EDP, as was expected, did not accept these calculations. In fact, one of the points of its appeal to the TRL was precisely the fact that in its opinion the TCRS had failed to prove that effective harm had been imposed on the final consumers. Not only did the TRL disagree with this finding (showing that the TCRS was quite assertive in considering that effective damage had been done, even if its exact quantification was not possible at the time), but also invoked the consistent case law of the ECJ (namely its 2022 ruling in Case C-377/20*, SEN*) to conclude that *"for a practice to be considered an abuse of a dominant position, it is not necessary for it to actually cause harm to consumers that arise as a direct and causal manifestation of the market power held by the company in question"*. In other words, *"it is sufficient for a competition authority to prove that such a practice is likely to undermine the structure of effective competition in the relevant market, unless the dominant undertaking in question demonstrates that the anti-competitive effects that may result from such a practice are offset, or even outweighed, by the positive effects on consumers, notably in terms of price, choice, quality and innovation"*.

Next chapter

The administrative offence procedure ends at the Lisbon Appeal Court since there is no possibility of appeal to the Portuguese Supreme Court regarding such decisions. Even so, it's safe to say that the EDP saga is far from being over. Both the PCA and the TCRS reckoned that the damages inflicted to end consumers amount at least to well above €100M. In fact, an action for damages was already filed in 2021 by *Ius Omnibus,* a consumer protection association. As it is a follow-on action brought in the sequence of the PCA decision, the TCRS (where all damages actions grounded solely on the violation of competition rules must be filed) decided for the lispendence until all possibilities of appeal had been exhausted.

So, the TCRS will now be called to quantify the damages effectively caused by the infringement – what it already did, albeit in a preliminary manner, in its administrative offence decision. From there we will have, for sure, a new appeal to the TRL, and unless all three TRL judges agree with the essence of the TCRS decision, an appeal to the Supreme Court (limited to questions of law).

the Portuguese courts are still struggling to find a balance between the presumptions of damages imposed by Art. 17(2) of Directive 2014/104/EU and the need for legal certainty and accuracy,when it comes to the quantification of damages. In addition, the action that was filed is an *actio popularis*, a mechanism with very little tradition in the Portuguese judicial practice and which is, itself, on the verge of an important reform following the implementation of Directive 2020/1828.

All things considered, this may well be a very important moment in the defence of consumer rights in Portugal, testing both the quantification of damages in such wide-ranging competition law cases and the methods of its distribution among injured parties. Stay tuned!

The author is a partner at Sousa Ferro & Associados, who represents Ius Omnibus in several consumer actions, including the one against EDP. The piece does not necessarily express the opinion of the Law Firm or of its client.

Since the ruling is not yet public available on the TRL website, the link refers to the webpage of its Competition and IP section, where it will be eventually published. The same goes to the ruling on the Super Bock case, mentioned in the 4th paragraph.

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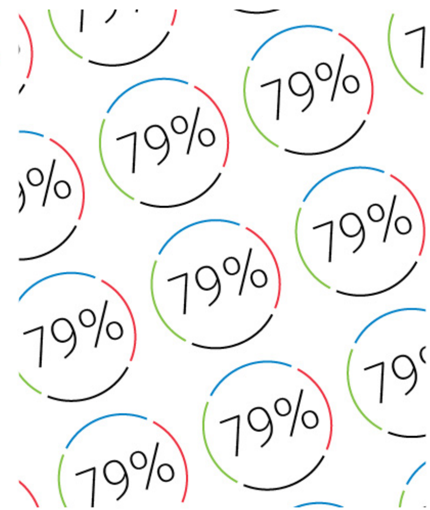

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