

COMPETITION ACT 1998 DECISION (CHAPTER II CASE)

9 June 2004

THE GAS AND ELECTRICITY MARKET AUTHORITY'S DECISION UNDER THE COMPETITION ACT 1998 THAT NPOWER LIMITED HAS NOT INFRINGED THE PROHIBITION IMPOSED BY SECTION 18 (1) OF THE ACT WITH REGARD TO THE SHARING OF TRIAD BENEFITS

INTRODUCTION

1. In October 2002 the Authority received correspondence from a NFFO¹ generator regarding the difficulty it was facing negotiating with npower for a share of the Triad benefits² for the winter of 2002/03. In a letter dated 28 October 2002, the complainant stated that they could not “conceive of a clearer abuse of such power than npower’s current refusal to observe the Code of Practice which Ofgem supports and npower signed”. Following receipt of the complaint, the Authority carried out preliminary informal enquiries with the complainant and also received correspondence from the Non-Fossil Fuel Purchasing Agency (NFPA) regarding their proposal to review the NFFO Replacement Power Purchase Agreements (RPPAs) with regard to the sharing of Triad benefits. On 28 May 2003 the Authority wrote to the complainant to say that it would be appropriate to await the outcome of NFPA’s review of the NFFO 3 and 4 RPPAs before considering the complaint further. The outcome of the review was to include a provision in the NFFO 3 and 4 RPPAs for the sharing of Triad benefits 80/20 in favour of the generator.
2. On 15 July 2003 the Authority received a letter from the complainant stating that, while the situation had been resolved going forward, npower had “abused its market power in its dealings with [the complainant] regarding last winter’s Triad benefits”. The Authority wrote to the complainant on 29 September 2003 to request further information and to clarify that the actual terms of the complaint were that “npower abused its market power when it refused to share the winter 2002/03 Triad avoidance benefits with [the complainant] following the NFFO 3 and 4 auctions in August 2002”. On 10 December 2003 the Authority received further correspondence from the complainant confirming their original allegation and alleging that “npower’s behaviour in the auction process of August 2002 was anti-competitive in that despite effectively being a signatory to the Triad Trading Code of Practice, they did not observe it”. The complainant alleged that “this gave npower an unfair advantage in the bidding process compared to those suppliers who allowed for the cost of Triad sharing”. The complainant’s allegations concerned a 6 month contract period from 1 October 2002 to 31 March 2003.
3. The Authority has taken the decision that, on the evidence before it, there are no reasonable grounds to suspect that the Chapter II prohibition of the Competition Act 1998 (the Act) has been infringed. The Authority investigated the complaint on an informal basis. This document is a summary of the Authority’s conclusions.

¹ The complainant was an operator of a non-fossil fuel generating station under a Non-Fossil Fuel Obligation (NFFO) 3 Order.

² Triad benefits accrue because under National Grid Company’s Statement of the Use of System Charging Methodology suppliers can avoid some Transmission Network Use of System (TNUoS) charges during a particular peak period known as the Triad if the embedded generator they have contracted with, or otherwise sourced from, generates during the Triad.

BACKGROUND

4. npower limited (“npower”) currently holds an electricity supply licence for Great Britain and is the supply brand of its parent company RWE Innogy plc. RWE Innogy plc is the owner of the supply businesses of the former Public Electricity Suppliers³ (“PESs”) in the Midlands, Yorkshire and Northern regions, which were acquired in July 1999, April 2001 and September 2001 respectively⁴. RWE Innogy plc’s registered address is Windmill Hill Business Park, Whitehill Way, Swindon, Wiltshire SN5 6PB. With regard to this particular complaint, the complainant generated electricity within the Midlands region.
5. Under the 1989 Electricity Act, the Secretary of State made five Orders requiring the PESs to contract for certain amounts of electricity generating capacity from renewable sources. These Orders are known as NFFOs. Contracts for the first two Orders, made in 1990 and 1991, have now terminated. Contracts under NFFO 3 will continue until 2013, with the final Order (NFFO 5) not terminating until 2018. The majority of the generators under these arrangements are embedded as they are connected to the Distribution System rather than the National Grid Transmission System.
6. The Utilities Act 2000 placed a supply obligation on all electricity suppliers to source a specific proportion of all their electricity from renewable generation. In turn, an Order made under the Utilities Act 2000 saved and modified the existing NFFO arrangements. The NFFO arrangements were amended to permit any licensed electricity supplier to bid for NFFO generation in an auction administered by the NFPA, which was the nominated person for the purpose of administering the NFFO arrangements⁵.
7. Under the new arrangements, the NFPA purchases the output from individual NFFO generating stations under ‘offtake’ agreements, also referred to as RPPAs, and offers this output to suppliers through an on-line auction process⁶. All licensed suppliers are able to bid for the electricity and successful suppliers are offered short term ‘on-sale’⁷ contracts of 6 months. With regard to the administration of these contracts and the auction process, there are a number of obligations on the NFPA, in particular the NFPA, as the nominated person, must use its reasonable endeavours

³ Public Electricity Supplier (PES) is the former term for the 14 companies in England, Wales and Scotland that from privatisation in 1990 until 1998 had a monopoly in the supply and distribution of electricity in their designated areas. Since 1998, competition has been introduced in supply, therefore these 14 suppliers are now known as ex-PES suppliers.

⁴ National Power plc was the original buyer of the supply business of the former Public Electricity Supplier (“PES”) in the Midlands region. In October 2000 Innogy plc was formally established from the split of National Power plc; with npower as the supply brand name. Innogy plc was the buyer of the supply businesses of the former PESs in the Yorkshire and Northern regions. In March 2002 RWE AG (Germany) announced the agreed takeover of Innogy plc and in October 2003 Innogy plc was renamed RWE Innogy plc.

⁵ The new arrangements came into force on 27 October 2000 (Statutory Instrument 2000 No. 2727, ‘The Electricity from Non-Fossil Fuel Sources Saving Arrangements Order 2000’).

⁶ The ‘offtake’ agreements set terms for, amongst other things, the contracted price the NFFO generator would receive from the NFPA and the contracted capacity the generator would aim to operate to. The ‘offtake’ agreements, or RPPAs, were drafted following consultation with the Confederation of Renewable Energy Associations, Association of Electricity Producers, Department of Trade and Industry and Ofgem.

⁷ The ‘on-sale’ agreement is between the successful supplier and the NFPA. The agreement commits the supplier to, amongst other things, pay for the contracted capacity of the individual generator, if the supplier is successful in the auction, at the successful bid price.

to receive the best price reasonably attainable for the electricity⁸. All electricity suppliers have information available to them in respect of each generator at least 20 days before the start of the main auction. This information includes, amongst other things, the name, address and contract number of each generation plant, the group grid supply point, which identifies the ex-PES region which the generator operates in, the facility description and technology band, and the contracted capacity. The parties to the 'on-sale' contracts are NFPA and the successful supplier, ie the highest bidder. The contracts currently available are NFFO 3, 4 and 5 contracts.

8. Any overall imbalance between the contract price paid to generators by the NFPA and the 'market' price paid by suppliers to the NFPA is made up through the Fossil Fuel Levy (FFL), so long as the RPPAs continue to be qualifying arrangements under the order. If there is an imbalance, after taking account of the NFPA's costs of administering the NFFO arrangements, then the FFL will be paid by suppliers who will pass on this cost to customers. During the period relevant to the complaint, and since that period, the FFL has been zero.
9. In accordance with National Grid Company's Statement of the Use of System Charging Methodology suppliers can avoid some Transmission Network Use of System (TNUoS) charges during three particular peak periods known as the 'Triad' if the embedded generator they have contracted with, or otherwise sourced from, generates during the time of the Triad. These are known as Triad Avoidance Benefits. The Triad comprises the three half hour settlement periods of highest transmission system demand, namely the half hour settlement period of System Peak Demand and the two half hour settlement periods of next highest demand, which are separated from the System Peak Demand and from each other by at least 10 clear days, between November and February inclusive. These benefits accrue to the supplier but through negotiation with the supplier the generator can obtain a share of the Triad benefits. As the majority of NFFO generators are embedded, there is potential for Triad benefits to be available under the NFFO arrangements.
10. Prior to the changes to the NFFO arrangements, referred to in paragraph 6, the complainant had an agreement with Midlands Electricity plc (the PES supplier), which was later honoured by npower when they acquired Midlands Electricity plc in July 1999, to share the Triad benefits 80/20 in favour of the complainant. The Authority has no evidence as to whether this agreement remained in force when the new NFFO arrangements came into effect⁹. However, there was no explicit provision in the NFFO 3 and 4 contracts for the sharing of Triad benefits and there continued to be no explicit provision following the new arrangements. Many suppliers had signed the Transmission Users' Group voluntary Code of Practice on the treatment of Triad benefits, which states that the supplier should share the Triad benefits 80/20 in favour of the generator. It is alleged by the complainant that npower was a signatory to the voluntary Code of Practice. The Authority has no evidence as to whether npower was a signatory to the voluntary Code of Practice. However, it should be noted that the voluntary Code of Practice does not legally oblige the supplier to share the Triad benefits¹⁰.

⁸ For further details of the duties of the NFPA, see Statutory Instrument 2000 No. 2727, referred to above.

⁹ If the agreement did remain in force following the changes to the NFFO arrangements then, as it was a contractual arrangement between the two parties, it would have been a matter for the counterparties as regards enforcement of that agreement.

¹⁰ At the time of the alleged abuse, the NFPA stated in their 'points to note' on their website, www.nfpa.co.uk, that the "NFPA does not claim that the NFFO 3 and NFFO 4 'on-sale' contracts entitle the successful bidder to any Triad benefits (or like benefits) which may arise by virtue of the generation to which the contract refers. It is our

11. The complainant had a NFFO 3 power 'offtake' contract with the NFPA. npower, as the successful bidder for the complainant's generation in the August 2002 auction, entered into a 6 month 'on-sale' contract with the NFPA for the complainant's generation. The 'on-sale' contract period was for 1 October 2002 to 31 March 2003. Following the auction, it is alleged by the complainant that they were unable to negotiate a share of the Triad benefits from npower.
12. On 17 June 2003 the Authority received from the NFPA a letter and copies of proposed agreements which amended the NFFO 3 and 4 RPPAs to expressly provide for the sharing of Triad benefits. The Authority wrote to the NFPA on 9 July 2003 to confirm that it was initially prepared to consider the NFFO 3 and 4 RPPAs, as amended, as continuing to be qualifying arrangements for the purposes of the FFL¹¹. It has since been confirmed by the NFPA that amendments to the NFFO 3 and 4 RPPAs to allow for the sharing of Triad benefits 80/20 in favour of the generator took effect on 1 October 2003. This amendment ensures that, going forward, there should be no recurrence of the situation the complainant found themselves in.

THE AUTHORITY'S INVESTIGATION

13. Following the amendments to the RPPAs to expressly provide for the sharing of Triad benefits, the complainant wrote to the Authority in July 2003 saying that while the situation had been resolved going forward through the amendments, it had not addressed the allegation that npower had abused its market power during the winter of 2002/03. Following this letter, the Authority reviewed the allegations and conducted informal enquiries with regard to the NFFO arrangements and the complaint itself. These enquiries took the form of information requests to the complainant and the NFPA on an informal basis, and subsequent analysis of the information received.
14. In order for there to be an infringement of section 18 (Chapter II prohibition) of the Competition Act 1998, it must be established that: the undertaking concerned has a dominant position in the relevant market in the UK; the undertaking has abused this dominant position; and this abuse has or could have an effect on trade within the UK.
15. Turning to the first allegation, that npower abused its market power in refusing to share the winter 2002/03 Triad benefits. The auction is open to all licensed electricity suppliers and, given NFPA's obligation to use its reasonable endeavours to receive the best price reasonably attainable for the electricity, the contract is awarded to the highest bidder; no other factors are relevant to the award of the contract. The Authority has no reason to doubt that the auction is won on a transparent and fair basis. The duration and terms of the 'on-sale' contract are set by the NFPA and therefore the supplier, irrespective of whether it holds market power,

understanding that, subject to the detailed procedures adopted from time to time for trading of Triad benefits, such benefits should be subject to separate bilateral agreement between the generator and a supplier". It should be noted that this statement by the NFPA does not legally oblige the supplier to share the Triad benefits with the generator.

¹¹ If a generator seeks a NFFO contract amendment and the NFPA agree to the proposed change, NFPA contacts the Authority to establish whether such a contract amendment would cause that revised arrangement to cease to be a qualifying arrangement under the order. The concept of a qualifying arrangement is relevant to the payment of FFL support to the NFPA, as the Authority can only make payments to the NFPA in respect of qualifying arrangements.

is not in a position to dictate or impose any terms or conditions¹². At the time of the alleged abuse, the Triad Avoidance Benefit accrued to the supplier and there was no legal obligation to share this benefit with the generator. There was at the relevant time, a voluntary Code of Practice whereby suppliers were encouraged to share the benefits but there was no obligation to follow it. It was therefore a unilateral decision on the part of the supplier whether to share the benefit which is not necessarily abusive in terms of the Chapter II prohibition.

16. Turning to the second allegation, that npower used its alleged position of dominance to gain an unfair advantage in the auction process. Whilst it could be argued that npower, as an ex-PES supplier, is a dominant supplier of electricity in the Midlands, Yorkshire or Northern regions and therefore a dominant purchaser of electricity, there is little evidence to suggest how that alleged market power could be leveraged or used in the purchase of NFFO generation or, to the extent that any special responsibility arises, that there is any abuse, or behaviour that would otherwise constitute an abuse. As explained above, NFFO generation is won through an auction process. The Authority has no reason to doubt that the auction is won on a transparent and fair basis. Bidding for NFFO generation is open to any supplier and the resulting contract is awarded to the supplier who makes the highest bid at the relevant time; it does not therefore depend on any alleged dominant position. Moreover, as an open competitive auction process, potential bidders are free to structure their bid as they see fit on a unilateral basis. It is for the supplier making the bid to decide its bid price irrespective of the voluntary Code of Practice. Annex A explains the data, which was received from the NFPA, and some of the results obtained to consider whether, despite the auction process, npower was likely to have any advantage over other suppliers during the auction process. From this data, the Authority considers that there is no evidence to suggest that npower enjoyed any particular advantage over other suppliers. As a result, taking the information supplied by the complainant and our own findings, there are no reasonable grounds for suspecting that npower could have used its alleged position of dominance in the supply of electricity in one of its ex-PES regions to gain any unfair advantage over its competitors in order to win the auction process.

THE AUTHORITY'S DECISION

17. After careful consideration of the facts the Authority takes the view that there are no reasonable grounds for suspecting that the Chapter II prohibition has been infringed. In particular, the Authority does not have any reasonable grounds for suspecting that npower is able to use its alleged market power in relation to the purchase of renewable electricity under NFFO arrangements given the NFFO bidding system. Even if npower were deemed to hold a dominant position in the supply of electricity on a regional basis or nationally its decision to retain the Triad benefit, to which it is lawfully entitled, is not considered to be an abuse. Furthermore, the Authority does not have any evidence that there has been an anti-competitive effect.
18. In considering whether npower was dominant on the relevant market, it has not been necessary to make a final determination on the relevant market.

¹² Annex A explains the data collected for the purposes of considering whether, despite the auction process, npower was likely to hold any advantage over other suppliers during the auction process.

ANNEX A

19. In order to gain an understanding of whether npower was likely to hold market power, and whether this was to the detriment of smaller suppliers, in the auction process of August 2002, the Authority informally requested that NFFPA provide it with details of npower's bids during the auction of August 2002 and details of the bids won by all suppliers during the auction process of August 2002¹³. The following information was obtained from this data:

- during the August 2002 auction process 11 licensed electricity suppliers won bids for 159 NFFO 3 and 4 generation contracts
- of the 159 NFFO 3 and 4 contracts successfully awarded, at least 20 of these went to suppliers that together supplied less than 10% of all electricity to domestic and industrial and commercial customers
- of the 159 NFFO 3 and 4 contracts successfully awarded, npower won less than 5% of them
- of the NFFO 3 and 4 contracts available in npower's ex-PES regions, npower won less than 20% of them.

¹³ The raw data relating to which suppliers won NFFO contracts during the auction process of August 2002 is available through the ROCs register.