



# **Responses to the energy sector consultation**

**Part of the competition law series**

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# 1 INTRODUCTION

- 1.1 Ofgem would like to thank respondents for their input to the revision of the competition law guideline *Application in the energy sector* (the guideline).
- 1.2 Ofgem received six responses to the consultation. The guideline was revised in light of EC Regulation 1/2003 (the Modernisation Regulation) and to reflect experience in applying the Competition Act 1998. This paper summarises the main issues raised in the responses to the consultation.

## 2 ISSUE: STRUCTURE OF THE GUIDELINE

- 2.1 Some respondents suggested changes to the structure of the guidelines. In particular, one respondent suggested that the first chapter of the guideline could be removed since the issues are discussed in more detail in the other competition law guidelines published by the Office of Fair Trading (OFT). Some respondents also felt that it was not sufficiently clear that the assessment of agreements or conduct is the same under UK competition law as EC competition law and considered there was an unnecessary split in the analysis.

### Response

- 2.2 Ofgem takes the view that the first chapter is necessary to set the context for the guideline. It explains Ofgem's obligations with regards to the application of Articles 81 and 82 when using its sectoral powers. Ofgem notes that the competition law guideline *Modernisation* (OFT442) gives a general overview but not a full explanation of the relationship between EC competition law and Ofgem's sectoral powers. Ofgem concluded that it would retain the general structure of the guideline.
- 2.3 The guidelines have been amended to make it clearer that the economic analysis and procedures are the same for UK competition law as for EC competition law.

### **3 ISSUE: THE APPLICATION OF ARTICLES 81 AND 82**

- 3.1 A number of respondents requested further clarification on the Authority's obligation to apply Articles 81 and 82 when applying national competition law where there is an effect on trade. Some respondents requested a list of the provisions of the Gas and Electricity Act likely to be considered national competition law. In particular, one respondent requested an indication of whether enforcement of the obligation on gas transporters to avoid undue preference or discrimination, set out in section 9(2) of the Gas Act would be considered national competition law. One respondent also wondered whether Ofgem would use its opportunity to enforce stricter competition law at the national level than is required by Article 82. Another respondent found Ofgem's explanation of the relationship between EC competition law and sectoral regulation over-complicated and suggested Ofgem follows the approach in the *Modernisation* competition law guideline.

#### **Response**

- 3.2 It will be Ofgem's practice to consider on a case by case basis whether a particular agreement or conduct under the Gas and Electricity Acts constitutes an application of national competition law. Ofgem will consider the main objective of the particular obligation and assess whether it is consistent with that of Articles 81 and 82. In order to reach a view it may have regard to the legal basis of the provision. As provided for in the Modernisation Regulation the NCAs may apply national competition law more strictly than the Commission applies EC competition law with regards to unilateral conduct. Ofgem may prohibit unilateral conduct under national competition law that the Commission would not necessarily under Article 82 of EC competition law. The guideline has been amended to clarify this approach and to simplify the explanation of the relationship between EC competition law and the Gas and Electricity Acts.

## **4 ISSUE: CLARIFICATION OF THE EFFECT ON TRADE**

- 4.1 Two respondents called for greater guidance on the 'effect on trade'. In particular, one respondent sought clarification in light of the interconnection of electricity networks between the UK, Ireland and North-West Europe.

### **Response**

- 4.2 As explained above it will be Ofgem's practice to consider on a case by case basis whether a particular agreement or conduct may have an effect on trade. As it depends upon the circumstances of a particular case whether there is a potential effect on trade, it is not appropriate to surmise whether there will be an effect on trade as a result of interconnection of national networks. Ofgem will follow the Commission Notice in determining whether there is an effect on trade. It is for this reason that Ofgem has not amended this section of the guideline.

## **5 ISSUE: MARKET DEFINITION**

- 5.1 A number of respondents questioned Ofgem's approach to market definition. Due to limited storage of energy the appropriate definition of the market may be limited to a shorter duration than is the case in other industries. One respondent noted that Ofgem's advice from counsel during the reference to the Competition Commission of the proposed market abuse licence conditions suggested that 'there is no authority to support the proposition that a relevant market can be temporarily transitory.' Another respondent pointed out that although there are high price spikes in individual half hour periods, this does not in itself indicate a breach of competition law as it may be a normal reaction to an imbalance in supply and demand.

### **Response**

- 5.2 Ofgem accepts that high price spikes are not necessarily a breach of competition law but may be an indication of normal market forces. However, Ofgem is of the view that limited storability of electricity and (to a lesser extent gas) combined with the half-hourly and daily balancing

arrangements respectively, limit the ability of undertakings to substitute transactions in one time period with another. It is for this reason that the relevant market may be of a shorter duration than in other industries. Although there is currently no authority that a relevant market can be temporarily transitory, temporal markets are a recognised concept. Ofgem has amended this section of the guideline to clarify its approach.

## **6 ISSUE: MARKET DEFINITION CRITERIA WITH ANTI-COMPETITIVE EFFECTS**

- 6.1 Some respondents suggested that Ofgem had strayed into looking at anti-competitive effects of price increases in its analysis of what is the market. In the section about the SSNIP test the guideline discusses the possibility of very high price spikes in the electricity and gas markets many times higher than these benchmark numbers (i.e. the hypothetical 5-10 per cent used in the SSNIP test). The guideline also says that very high wholesale prices even if they only hold for short durations may have significant effect on customers. The respondent argues that this is irrelevant since the benchmark numbers are only for the purpose of applying the SSNIP test to define the relevant market.

### **Response**

- 6.2 It is Ofgem's view that the effects of short-term abuses of dominance can be just as detrimental as the effects of anti-competitive conduct sustained over longer periods, which adds justification to defining relevant markets on a temporal basis. However, to ensure clarity, Ofgem has amended this section of its guideline.

## **7 ISSUE: MARKET POWER AND THE ASSESSMENT OF DOMINANCE**

- 7.1 One respondent questioned Ofgem's consideration of an undertaking's conduct in price setting or its financial performance as a factor in assessing whether an undertaking has market power or is dominant.



## Response

- 7.2 It is Ofgem's view that an undertaking's conduct with regards to pricing or its financial performance may provide evidence of market power or dominance. This view is also expressed in paragraph 6.5 of the *Assessment of market power* competition law guideline (OFT405). Ofgem has concluded that it will not amend this section.

## 8 ISSUE: OFGEM'S APPROACH TO VARIOUS ABUSES OF DOMINANCE

- 8.1 Two respondents requested further guidance on Ofgem's approach to abuses such as price discrimination, on discounts, on refusal to supply (to competitors) and on access in this context to essential facilities. Another respondent questioned Ofgem's approach to predatory pricing, which it suggested deviated from the tests developed in the Courts. This respondent suggested that, since the purpose of the energy guideline is to give general rather than specific information on CA98 enforcement, this section should be deleted.

## Response

- 8.2 In light of the Commission's review of the application of Article 82, Ofgem considers it inappropriate to publish, at this time, detailed guidance on abuses of dominance. Ofgem accepts that its focus on predatory pricing may have been too narrow in focus and has decided to delete this section in view of the Commission review. Ofgem, however, regards it as useful to retain its guidance on the appropriate cost tests when assessing an exclusionary abuse of dominance in the energy sector, since avoidable costs may be more appropriate in the energy sector, which is characterised by high fixed costs.

## 9 ISSUE: CONSISTENCY WITH EC LAW - INTERPRETATION OF SECTION 60

- 9.1 Two respondents were concerned that Ofgem is implying that it has discretion on applying CA98 consistently with EC jurisprudence. One respondent believed that this was suggested by the reference to 'where

appropriate' when explaining that Ofgem will ensure that it applies its powers under the CA98 in a manner that is consistent with relevant EC jurisprudence. The other respondent believed that by outlining the content of the EC Gas and Electricity Directives, Ofgem is indicating that it will consider these when applying CA98.

## **Response**

9.2 Ofgem will apply its powers under CA98 in a manner that is consistent with the relevant EC jurisprudence on a corresponding question, insofar as this is possible, having regard to any relevant differences between the provisions concerned. The guideline has been amended to make this clearer and the sections on the EC Directives have been deleted to avoid confusion.

## **10 ISSUE: SERVICES OF GENERAL ECONOMIC INTEREST**

10.1 One respondent was concerned by the example of Transco as an undertaking which may previously have been considered as being entrusted with the provision of an SGEI in its operation of the gas networks but with the introduction of competition this is now unlikely to be the case. The respondent argued that Transco and each of the IGTs are monopoly network providers in the area they operate and as such should benefit from the exclusion for services of general economic interest.

## **Response**

10.2 It remains Ofgem's view that the exclusion from the application of competition law is narrow. An undertaking must prove that all the requirements have been met: it has been entrusted with a service of general economic interest and that the application of competition law would obstruct the performance, in law or in fact, of the particular task entrusted to it. Where an undertaking satisfies these requirements, the exclusion will only apply to the particular task, not to the undertaking itself or all its activities. Following the introduction of competition it is unlikely that the gas network companies will be considered to have been entrusted with a general service of general economic interest for the

general operation of the gas networks. However, Ofgem will assess on a case by case basis whether the exclusion applies. The section has been amended to make this clearer.

## **11 ISSUE: CHARACTERISTICS OF THE ENERGY MARKETS – END CUSTOMERS REQUIRE HIGH LEVELS OF INFORMATION**

- 11.1 One respondent suggested that competition in the retail market was fully effective and that the statement that 'relatively high levels of information are required to compare competing offers' should be removed from the list of specific characteristics of the energy sector.

### **Response**

- 11.2 It remains Ofgem's view that customers require relatively high levels of information to compare competing offers when switching supplier. However, Ofgem agrees that this is not a characteristic unique to the energy sector or rarely found in other markets since customers in many markets require considerable information to compare offers. It is for this reason that Ofgem has removed the reference.

## **12 ISSUE: MARKET SHARES**

- 12.1 One respondent was concerned that Ofgem misquoted the competition law guideline *Assessment of market power* in saying that market share is an important factor but it does not alone determine whether an undertaking is dominant. The *Assessment of market power* guideline states that there are other factors such as: competitors' positions and ease of entry into the market to consider when establishing dominance. Ofgem believes that a low market share may be compatible with dominance in the energy sector.

### **Response**

- 12.2 It remains Ofgem's view that there are no market share thresholds for defining dominance. Ofgem accepts that the European Courts and the OFT have stated that undertakings are unlikely to be dominant below certain thresholds. However, due to the ability of undertakings to affect

prices over short periods, Ofgem may consider undertakings with market shares below these thresholds dominant. The section has been amended to ensure that quotations are compatible with the competition law guidelines.

### **13 ISSUE: BLOCK EXEMPTIONS**

- 13.1 One respondent requested more information on what is meant by the term 'Block Exemption', how Block Exemptions differ from individual exemptions and indicate if any of the Commission's Block Exemptions are relevant to the energy sector.

#### **Response**

- 13.2 This section of the guideline has been amended to give more information on these points.

### **14 ISSUE: COMMITMENTS**

- 14.1 One respondent requested information on what constitutes 'a serious abuse of a dominant position' in the context of Ofgem not accepting commitments.

- 14.2 The Office of Fair Trading (not the Regulators) has a statutory duty under section 31(D) of the Competition Act to provide guidance on commitments. Therefore, this section of the guideline replicates the approach in the *Enforcement* competition law guideline. Ofgem has concluded that it is not appropriate to amend this section.

### **15 ISSUE: PENALTIES**

- 15.1 One respondent considers that in considering the level of penalties imposed under the CA98, Ofgem should take account of whether undertakings are able to finance their activities as required if Ofgem were setting a penalty under the Gas or Electricity Acts.

## Response

- 15.2 The OFT (not the Regulators) has a statutory duty under section 38(4) of the Competition Act to issue guidance on penalties which is approved by the Secretary of State. Ofgem must have regard to this guidance when setting penalties. It would, therefore, be incorrect for Ofgem to take into account factors other than those in the OFT guidance when setting penalties. Ofgem has concluded that it will not amend this section.

## 16 ISSUE: COMPLIANCE PROGRAMMES

- 16.1 One respondent considers that the energy guideline should not refer to the materials published by the OFT concerning the content of compliance programmes.

## Response

- 16.2 It remains Ofgem's view that this information is useful. Ofgem has concluded that it will not amend this section.

## 17 ISSUE: TRANSITIONAL ARRANGEMENTS

- 17.1 One respondent was concerned about Ofgem taking a view on whether RTPA would have applied to a particular agreement. It argued that Ofgem should only take a view on the putative applicability of the RTPA to a particular agreement after consultation with the OFT (which was expert in such analysis).

## Response

- 17.2 This section has been amended to make it clearer that Ofgem will not be taking such a view.