

# **Role of Consumers and Anti-Trust in British Energy Markets**

Pros and Cons of Anti Trust in Deregulated Markets

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# Consumers and Energy Markets

1. Sector regulation in UK residential energy markets: voice
2. Switching as a competitive constraint: exit evidence of market power
3. Case Law
  - a) Market definition
  - b) Price discrimination
  - c) Predatory pricing
  - d) Co-ordinated effects
4. Conclusion: exit or voice?

# 1. UK Energy: regulation institutions

- ❖ Separate sector regulator Ofgem (combined)
- ❖ Duties revised 2000: ‘protecting consumers, wherever appropriate by promoting effective competition’; special account of low income, pensionable age, rural, disabled
- ❖ Take account of environmental and social guidance
- ❖ consumer watchdog: information and advocacy
- ❖ Appeal to MMC/CC on price cap determinations; judicial review on procedure

# UK Energy markets

- ❖ Mature markets, 80% connected to gas
- ❖ Different payment methods: direct debit (cheapest), standard credit, prepayment (most expensive)
- ❖ Inherited cross subsidy: prepay less profitable
- ❖ Prepay customers lower average income; not one:one relation with poverty; politically sensitive
- ❖ Markets opened between 1996 and 1999
- ❖ Cost disadvantage for gas incumbent, not electricity

# UK Energy : deregulation

- ❖ National gas, 14 regional electricity markets
  - Confirmed by Ofgem 2004
- ❖ Price cap on individual tariff elements for electricity, average revenue for gas
- ❖ incumbents only, not entrants
- ❖ Main entrants other incumbents
- ❖ Gradual deregulation from 2000 to 2002
- ❖ All caps removed April 2002
- ❖ Companies sensitive to regulator, consumer watchdog, media, public relations
- ❖ Obligated to publish tariffs – listed by watchdog

# Switching as competitive constraint

- ❖ Consumers can exit via switching
- ❖ Limits single, not joint, dominance?
- ❖ No financial switching costs
- ❖ Search, transaction, psychic
- ❖ General single tariff for loyal and new customers (except LE case below)
- ❖ Expect incumbent to match entrant
- ❖ Substantial discounts still for switching, amidst rising prices
- ❖ Evidence of incumbent power for direct debit, standard credit, general uncompetitiveness for prepayment

## % discounts against incumbent

	Direct Dbt	Stand Cred	Prepay
<b>British Gas</b>	15	19	19
<b>Powergen</b>	21	18	22
<b>npower</b>	22	22	24
<b>EDF</b>	18	18	18
<b>S &amp; S</b>	15	15	16
<b>Scottish P</b>	15	15	11

*For medium consumption in each market, November 2004* 7

## Market % by retailer, Dec 03

supplier	Gas national	Electric national	Electric Inc area	Gas and electric
<b>B Gas</b>	61	24		40
<b>Pgen</b>	12	21	58	17
<b>Npower</b>	9	15	56	13
<b>S&amp;Scot</b>	7	14	73	11
<b>EDF</b>	5	14	64	10
<b>Scot P</b>	6	11	61	8
<b>Others</b>	1	1		1

## Electricity bills, Apr 2002, p/year

<b>coefft</b>	<b>Direct Dbt</b>	<b>Stand Cred</b>	<b>Prepay</b>
<b>constant</b>	15839 (454)	16809 (450)	26564 (725)
<b>Distributn</b>	0.97 (.05)	0.97 (.05)	0.33 (.07)
<b>Transmissn</b>	0.81 (.08)	0.83 (.08)	not sig
<b>Distn area</b>	.018 (.004)	.016 (.004)	not sig
<b>Incumbent</b>	2167 (154)	1884 (153)	not sig

*(standard errors in parentheses) for medium consumer*

### 3. Case Law: a) market definition

- ❖ See importance of market definition in defining market shares
- ❖ Ofgem used price parallelism to identify
- ❖ Concluded regional markets as above
- ❖ Implications both for unilateral and coordinated effects
- ❖ ‘ordinary’ sector would be investigated
- ❖ Is sector regulation stronger/weaker than general?

### 3. Case law: b) price discrimination

- ❖ undue discrimination clause inherited from nationalised industries
- ❖ under this provision
  - Regulator found gas incumbent discriminated between payment methods, but not unduly (95, 96, 98)
  - Not discriminatory if all consumers could choose tariff and those who couldn't had capped prices
- ❖ Replaced by undue discrimination where dominant under 1998 CA/article 82
  - LE offered discounts to 'returning' customers
  - No judgement because no material effect on competition

## 3.b) price discrimination: evidence

- ❖ Discounts for direct debit much greater as entrants (reflecting costs?) than as incumbent
- ❖ Incumbent relativities preserved by regulation to 02
- ❖ Since then continued – is there a case now for discrimination where incumbent and dominant given these differences?

# Relative prices as electricity entrants/incumbents October 2004

supplier	incumbent	Entrant av	t stat signif
'average'	0.93	0.91	2.35**
Pgen	0.93	0.93	0.90
Npower	0.89	0.84	3.65***
S&Scot	0.92	0.90	0.64
EDF	0.97	0.95	2.34**
Scot P	0.98	0.91	3.81***

\*\* significant at 5%; \*\*\* significant at 1%

## 3. Case Law: c) predatory pricing

- ❖ Healthy competition vs abuse?
- ❖ Pre CA hinges on intention to exclude and avoidable costs
- ❖ Post CA (Article 82): pre-emptive behaviour
  - ❖ Intentions
  - ❖ Feasibility of recovering losses
  - ❖ Prices relative to costs
- ❖ Pricing below AVC stronger evidence than below avoidable costs

### 3. Case Law: d) coordinated effects

- ❖ Rhetoric in market – “prices on way up”
- ❖ Recall high concentration ratios
  - ❖ HHIs between 4000 and 7000
- ❖ Homogeneity of product & suppliers
- ❖ Repeated interaction in 15 markets
- ❖ Consumer perceive high switching costs
- ❖ Transparency through regulator, now addressing issue

## Conclusion

- ❖ No behavioural (or structural) remedies despite very high concentration and consolidation
- ❖ Considerable (not consistent) price discrimination
- ❖ From (static) competition perspective looks poor, sector regulation seems weak relative to general competition standards
- ❖ Dynamics: half consumers have switched supplier (some returned); reputational concern acts as informal regulation. Is this strong or weak exit?
- ❖ If weak exit, does voice of regulator and consumer body compensate?

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