

COMPETITION ACT 1998 DECISION (CHAPTER II CASE)

12 September 2003

THE GAS AND ELECTRICITY MARKET AUTHORITY'S DECISION UNDER THE COMPETITION ACT 1998 THAT LONDON ELECTRICITY PLC HAS NOT INFRINGED THE PROHIBITION IMPOSED BY SECTION 18 (1) OF THE ACT WITH REGARD TO A 'WIN BACK' OFFER

I. INTRODUCTION

1. Ofgem is the Office of Gas and Electricity Markets, regulating the gas and electricity industries in Great Britain. Ofgem is governed by the Gas and Electricity Markets Authority ("the Authority"). The Competition Act 1998 ("the Act") gives the Authority concurrent powers with the Office of Fair Trading.
2. The Authority will assess complaints under the Act on a case by case basis. The specific circumstances of this case have led the Authority to take the decision that London Electricity plc ("LE") has not infringed the prohibition imposed by section 18(1) of the Act ("the Chapter II prohibition") with regard to an offer made by LE.
3. In accordance with Rule 15 of the Competition Act 1998 (Director's Rules) Order 2000¹ the Authority is issuing a written notice of its decision which states the facts on which the decision is based and the reasons for making it.
4. In line with Part 9 of the Enterprise Act 2002, which repealed section 55 of the Act on 20 June 2003, certain commercially confidential information has been removed from this document.

II. BACKGROUND

The Parties

5. LE is a former Public Electricity Supplier ("PES"), and at the time of the alleged abuse was part of LE Group plc,² based at Templar House, 81-87 High Holborn, London WC1V 6NU. LE Group plc also owns the supply businesses of the former PES South Western Electricity plc.³
6. In this decision the 'London region' means the authorised area of the Public Electricity Supply Licence of London Electricity plc as extant immediately before 1 October 2001; and the 'SWEB region' means the authorised area of the Public Electricity Supply Licence of South Western Electricity plc as extant immediately

¹ Statutory Instrument 2000 No. 293, The Competition Act 1998 (Director's Rules) Order 2000.

² On 30 June 2003 LE Group plc changed its name to EDF Energy plc which is based at 40 Grosvenor Place, Victoria, London, SW1X 7EN.

³ LE Group plc also owns the former PES SEEBOARD plc which it took over on 18 June 2002. This date of acquisition occurred after LE sent the offer to customers. On 30 June 2003 SEEBOARD plc changed its name to EDF Energy (South East) plc with its registered address being 40 Grosvenor Place, Victoria, London, SW1X 7EN.

before 1 October 2001. The SWEB region is situated in the South West of England.⁴

7. Hereafter, the London and SWEB regions are referred to as 'LE's former incumbent regions'.

The Complaint

8. The Authority's investigation was initiated by a complaint made in July 2002 regarding a written offer made by LE. The offer was detailed in a letter that was sent to former LE customers during June 2002.
9. The offer was designed to 'win back' former LE domestic customers who had switched electricity supplier. If they chose to take up the offer, the customer would receive up to £75 over one year in the form of two vouchers redeemable as cheques made payable to the customer in return for switching back to LE.
10. The complainant alleged that LE offered such customers a financial incentive to return to LE that was significantly greater than the savings that most suppliers could offer to new customers. The complainant also noted that in order to obtain the full benefits of the offer, customers were required to stay with LE for a period of time that might be held to constitute a form of 'lock-in'. The complainant also alleged that this conduct was potentially an infringement of the Chapter II prohibition.

CA98 or sectoral legislation

11. The Act amends the Electricity Act 1989 ("EA89") and the Gas Act 1986 ("GA86") to provide that a regulator's duty to take licence enforcement action does not apply where he is satisfied that, in a particular case, it is more appropriate to proceed under the Act.
12. The Authority took the view that the alleged abuse was concerned with price discrimination. There is no route to investigate such conduct under the sectoral legislation as the price discrimination conditions in Supply Licences⁵ do not apply to the sale of electricity to premises; therefore the Authority proceeded under the Act.
13. In order to initiate an investigation under the Act, section 25 requires that the Authority has reasonable grounds for suspicion that there has been an infringement ("the section 25 test"). Preliminary analysis led the Authority to conclude that there were reasonable grounds for suspecting a breach of the Act, and therefore the section 25 test had been met.

⁴ 1 October 2001 is the date on which the transfer and licence schedules under the Utilities Act 2000 took effect.

⁵ Electricity Supply Licence: Standard Conditions, Utilities Act 2000, Determination of Standard Licence Conditions for Electricity Supply Licences, Standard Licence Condition 12A.

III. LEGAL AND ECONOMIC ASSESSMENT

Chapter II Prohibition

14. In order for there to be an infringement of section 18 of the Act, 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 an effect on trade within the UK.
15. The Authority is satisfied that for the purpose of the Act LE is an undertaking.

Assessment of dominance

16. The Authority concluded that LE's conduct to date does not infringe the Chapter II prohibition (conclusions in this regard are detailed below) and therefore has not established any final determination of the market(s) in this case or whether LE is dominant in those market(s). However, the Authority has indicated below which markets are potentially relevant for the purposes of conducting a preliminary investigation. The preliminary assessment of dominance which follows also assists in the understanding of the context of the investigation.
17. In *Freeserve v Director General of Telecommunications*⁶, the Competition Appeal Tribunal ("CAT") stated that:

"How far, in any given case, the Director sets out the assumptions he has made on relevant market and dominance, will be largely a matter for him, subject of course to the need for the Director to give adequate reasons for his decision".⁷

The Relevant Market

18. The relevant market normally comprises a relevant product market and a relevant geographic market. Market definition focuses on the degree to which there are supply or demand side substitutes for the product and the degree to which new entry is possible. Market definition analysis may also include the consideration of the specific conduct in question and the effect of that conduct. The following sets out the Authority's preliminary assessment of the relevant market.
19. The Authority considered whether market conditions had materially altered since its December 2002 publication on electricity supply competition.⁸ The December 2002 paper analysed prices in order to assess the extent to which competitive conditions were uniform between domestic electricity and gas supply, and across different geographic areas. This has implications for the definition of the relevant product and geographic market(s) respectively.

⁶ Case No 1007/2/3/02 *Freeserve.com plc v Director General of Telecommunications* [2003] CAT 5.

⁷ *Ibid.*, paragraph 131.

⁸ "Electricity supply competition: an Ofgem Occasional Paper", Ofgem, December 2002. This document is available on the Ofgem website at www.ofgem.gov.uk.

20. Given the price parallelism analysis set out in the December 2002 paper⁹ and similar price parallelism analysis conducted in relation to LE's former incumbent regions, the geographic market has been assumed to be regional rather than national. Consequently, the relevant geographic market was considered to be each of LE's former incumbent regions as defined in paragraphs 6 and 7 above.
21. With regard to the product market the pricing analysis in the December 2002 paper has also indicated that gas and electricity are unlikely to be substitutes in the short term.
22. Therefore, the Authority took the preliminary view that the relevant markets were the two geographic regions for the supply of electricity in each of LE's former incumbent regions (SWEB and London regions).
23. As stated above the Authority will consider each complaint on a case by case basis and therefore does not rule out a different market definition in future cases. A different market definition may result from, amongst other things, the Great Britain domestic electricity supply market becoming more mature.¹⁰

Dominance

24. Dominance has been defined by the European Court as:

'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers'.¹¹

25. An undertaking is unlikely to be dominant if it does not have substantial market power. Market power is not, however, an absolute term but a matter of degree; the degree of market power will depend on the circumstances of each case.
26. As stated above, because the Authority has decided that LE's conduct has not infringed the Chapter II prohibition it has not been necessary to reach a final conclusion on dominance. However, for the purpose of the section 25 test the Authority considered three measures of market power:
 - (i) absolute market share,
 - (ii) relative market share, and
 - (iii) the ability to act independently of competitors and customers.
27. LE's absolute share of domestic electricity customers at the time of the alleged abuse (June 2002) was 69% in the London region and 71% in the SWEB region. These market shares had been gradually eroding over the preceding years.¹²
28. Relative market shares may indicate the extent to which other market players act as a competitive constraint on the market leader. In each of the relevant markets

⁹ Ibid., page 17.

¹⁰ See Ofgem, Domestic gas and electricity supply competition: Recent developments, June 2003. This document is available on the Ofgem website at www.ofgem.gov.uk.

¹¹ Case 27/76 United Brands v Commission [1978] ECR207, [1978]1 CMLR429;

¹² Market shares are set out on page 45, Ofgem, Domestic gas and electricity supply competition: Recent developments, June 2003. This document is available on the Ofgem website at www.ofgem.gov.uk.

LE had the highest share of domestic electricity customers in June 2002. The electricity supplier with the next largest share of domestic electricity customers had [...] in the London region and [...] in the SWEB region. All other market players had market shares of less than [...] in the London region and less than [...] in the SWEB region.

29. In order to investigate whether LE was able to act independently of its competitors and customers the Authority also conducted analysis of relative prices in LE's former incumbent regions. This analysis indicated that LE was able to maintain published prices (not inclusive of the winback offer) above the level of its competitors without demonstrable differences in non-price factors.
30. Given the Authority's findings on the allegedly abusive behaviour, it is not necessary to reach a final conclusion on whether LE holds a dominant position on a relevant market.

Assessment of alleged abuse

Does the offer constitute a 'lock-in'?

31. Under the offer, four months after switching back to LE the customer was entitled to a voucher worth £25; nine months after switching back the customer was entitled to a second voucher worth £50. The vouchers were redeemable as cheques and the customers could spend the money as they wished. In order to benefit from the full £75 the customer was required to stay with LE for a period of thirteen months. However, the customer was free to switch at any time during this period and could switch after thirteen months having realised the full benefit of the offer.
32. Because of the specific terms of the offer it did not raise significant concerns with regard to locking a customer into a contract.¹³

Price discrimination

33. An undertaking can be said to be discriminating when it applies dissimilar terms and conditions to equivalent transactions with other trading parties. Discrimination may occur if prices do not reflect any relevant differences in cost, quantity, quality or any other characteristics of the product supplied.
34. Price discrimination is only an abuse under the Act if it has an anti-competitive effect. This may be the case, for example, if the price is predatory or if discrimination has the effect of raising barriers to entry and/or barriers to expansion.¹⁴
35. Conversely, in some cases, price discrimination may have a welfare enhancing effect, for example if output is increased as a result of discrimination.

¹³ 'Lock-ins' were discussed in more detail the December 2002 publication. "Electricity supply competition: an Ofgem Occasional Paper", Ofgem, December 2002. This document is available on the Ofgem website at www.ofgem.gov.uk. Page 32.

¹⁴ OFT 414, The Competition Act 1998, Assessment of individual agreements and conduct, OFT September 1999, para. 3.11 – 3.12.

36. LE's win-back offer appeared to discriminate in terms of offering different prices to different customer groups: former LE customers who have switched away and LE customers who have not switched. The offer targeted LE's competitors' customers and so may have had an anti-competitive effect on LE's competitors.
37. The Authority used cost data already available to it in order to determine whether the offer price (calculated as an annual Standard Domestic bill minus the value of the vouchers) was below cost. This analysis indicated that the offer did not appear to be cost reflective and therefore may have had the effect of restricting competition on the relevant markets.
38. The Authority decided that it had reasonable grounds to suspect a breach of the Act under section 25. It was therefore decided to use powers bestowed under section 26 to initiate an investigation to assess the effect of the offer on competition by determining: how many customers had been contacted with the aim of making the offer; how many had taken up the offer; and the duration of the offer.
39. As a result of an information request to LE under section 26 of the Act LE provided the Authority with detailed information regarding the offer. This included information concerning the number of customers to whom the offer was made, the number of customers who had taken up the offer, the geographical distribution of these customers, the business plan associated with the offer, and copies of letters, vouchers and the terms and conditions of the offer. LE also provided information concerning the cost of the offer.

Table 1: Results of section 26 notice

	Start date	End date	Number of electricity customers contacted	Number of electricity customers who took up the offer
London region	[...]	[...]	[...]	[...]
SWEB region	[...]	[...]	[...]	[...]
Other regions	[...]	[...]	[...]	[...]
Total	N/A	N/A	[...]	[...]

40. Table 1 summarises the key information regarding the scope of the offer submitted by LE. The table indicates that the offer was limited in terms of the number of customers contacted by LE, the number of customers taking up the offer and the length of time for which the offer was made to customers.
41. The fact that there was a severely limited take up of the offer meant that the price discrimination between former LE customers who had switched and LE customers who had not switched did not have an anti-competitive effect. Because there was no anti-competitive effect it followed that there was no evidence of abuse and therefore the Authority concluded that there was no material effect on competition.

IV. EFFECT ON TRADE IN THE UK

42. Given there was no evidence of abuse it was not necessary to establish whether LE's conduct may affect trade within the UK.

V. CONCLUSION

43. Due to the severely limited take up of the win-back offer there was no anti-competitive effect as a result of price discrimination. The Authority therefore concluded that there was no abuse. On this basis the Authority has reached the decision that LE has not infringed the Chapter II prohibition of the Act in respect of this offer.