

Consultation of parties with a direct concern regarding the proposed new domestic gas metering contracts for National Grid meters

Consultation

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Overview:

Following a finding by Ofgem of a breach of the competition rules by National Grid in respect of its "Legacy MSA" contracts in 2008 those contracts have required revisiting, as by operation of law those contracts are void *ab initio*. Ofgem's finding was subsequently upheld in substance by both the Competition Appeal Tribunal in April 2009 and the Court of Appeal in February 2010 (with the prospect of further litigation only ending once the Supreme Court had refused permission several months later).

The contracts are in the course of renegotiation between National Grid and several counterparties. While there is no obligation on any party to sign up to those contracts, bearing in mind, in particular, the exhortation of the Competition Appeal Tribunal that the Authority be engaged with the process of changing these contracts to bring them into line with the competition rules, the Authority, having considered the current draft contracts, seeks by this limited consultation to elicit the views of those directly affected by the new proposed contract. In doing so, Ofgem has regard to its public law duties to enable directly affected parties to raise any concerns they may have as to compliance with competition rules in order that these may be properly considered.

Third parties who have not been provided with the draft proposals, may request sight of the documentation in writing, stating the nature of their position as an interested party.

Context

In February 2008 the Authority made a Decision that National Grid had breached the Chapter II prohibition of the Competition Act 1998 (the Act) and Article 82 of the EC Treaty¹.

Chapter II of the Act prohibits the abuse of a dominant position in a market by one or more undertakings which may affect trade within the UK. Article 82 of the EC Treaty prohibits the abuse of a dominant position in a market by one or more undertakings which may affect trade between Member States.

The decision was challenged by National Grid, but in respect of the Legacy MSAs substantially upheld by both the Competition Appeal Tribunal (case [2009] CAT 14 of 29 April 2009) and the Court of Appeal ([2010] EWCA Civ 114 judgment of 23 February 2010).²

National Grid (and certain potential counterparties) have kept Ofgem informed of developments as regards a potential replacement contract. It is not Ofgem's role to intervene in commercial negotiations, but only to ensure (i) that the contracts are not problematic under the competition rules and (ii) that all affected parties are heard as to the former issue.³

This consultation document therefore relates purely to a question of legal analysis of a marginally redacted version of a contract which contains elements which may be commercially confidential, and is directed solely at parties with a direct concern, such as parties already competing with National Grid in the relevant market, parties likely to enter the market, and potential counterparties to the contract.

In terms of Ofgem's consideration of the contract to date, it has reviewed the current draft and has elicited from National Grid certain points of clarification which addressed any *initial* concerns it had. By way of example, Ofgem ensured that National Grid

¹ Now Article 102 of the Treaty on the Functioning of the European Union.

² All relevant documentation regarding the litigation can be found at: <http://www.catribunal.org.uk/237-661/1099-1-2-08-National-Grid-PLC.html>

³ As to the latter, we have regard in particular to the CAT's ruling in *Pernod Ricard v Bacardi* [2004] CAT 10, paragraph 253 "we regard the failure to allow Pernod to make observations before closing the file on its complaint as a breach of the principle of administrative fairness". In principle that procedural right applies to the directly affected parties (in particular the CMOs) in respect of any comfort Ofgem is to give as regards the final form of the MSAs.

undertook not to seek to “backdate” the higher P&M rental (as compared to the void Legacy MSA) nor to backdate any reduced rental (compared to the P&M rate) in the alternative Legacy MSA. While it is open to parties to negotiate lower prices on a forward looking basis, the “backdating” of charges in such a manner would, as a matter of commercial reality, amount to a very significant financial inducement to enter into the new MSAs. Rather than competing on the merits, this risked being an abuse of dominance on the part of National Grid as the “rebate” would be a very significant inducement to parties to take all or a large part of their needs in the market from the dominant undertaking.

Associated documents

Attention is drawn to the decisions of the Authority, of the Competition Appeal Tribunal and the Court of Appeal. These are available at:

<http://www.catribunal.org.uk/237-661/1099-1-2-08-National-Grid-PLC.html>.

1. Process of Limited Consultation

Parties to be provided with the draft contract on a confidential basis

1.1. The process of consultation will be as follows:

1. Ofgem has a copy of the proposed National Grid contract which has been minimally redacted in such a manner that unnecessary commercially confidential details (such as pricing) are excluded. It nonetheless remains commercially sensitive, and any party receiving it may only use it for the purpose of responding to this consultation⁴.
2. All parties to the original CAT litigation will be provided, along with this consultation document, a copy of the proposed new MSA contract.
3. It is assumed that any potential counterparty will already have sight of the proposals (including price) and so they will only be provided with the relevant copy on request.
4. Finally as regards recipients of the draft contract, any other parties able to establish a sufficient interest (such as those able to demonstrate a likelihood of economic effects, for example arising out of impending entry into the domestic gas meter market), may write to Ofgem (in confidence or otherwise) explaining their interest. Ofgem will consider those representations and may provide a copy on a confidential basis (that is to say, neither NG nor any other party may be informed – in particular if the interest arises from potential new entry – and, likewise, the recipient will be bound by statutory obligations of confidentiality³).
5. Responses will be due 4 weeks from the date of this consultation document.

Issues on which views are invited

1.2. First, Ofgem will not be able to entertain any argument by third parties on matters which are *res judicata* (that is to say, already decided by a court of law such as the Competition Appeal Tribunal). As such, parties are expected to consider carefully the effect of the ruling of the Competition Appeal Tribunal in particular (and the Court of Appeal where any differences in interpretation arise).

1.3. By way of an example that has arisen in discussions to date, the Competition Appeal Tribunal addressed its mind to whether the N/R MSA contracts are unlawful (in breach of

⁴ The Enterprise Act 2002 ss237-245 applies such that further disclosure or use for any other purpose is likely to be an offence and may lead to imprisonment and/or financial penalty.

the competition rules) as part of the contractual matrix and found that they were not. It is not open to Ofgem to now to seek to re-open that issue.

1.4. Secondly, Ofgem is aware that there are ongoing disputes as to the default position in the period since the Legacy MSAs were first signed, given the result of such contracts (or at least relevant parts of them) are void *ab initio*. Our view is that this is a matter of contract law and/or commercial negotiation. While it is understandable that potential counterparties may seek to raise this as a competition concern with Ofgem, in doing so they will be expected to explain why, in the absence (in particular) of a threat to backdate to 2004, which Ofgem has already extracted from National Grid, this issue is a live competition concern.

1.5. Ofgem seeks views as to whether:

- Any aspects of the new proposals, viewed in their commercial context, are arguably contrary to the Competition Rules.
- If so, what is the nature of the alleged breach, particularised by reference to the approach taken by (and citing relevant paragraphs in the judgments of) the Competition Appeal Tribunal (or the Court of Appeal if different).

Potential results following consultation

1.6. While Ofgem has considered the contract, and extracted certain amendments to ensure there is no *obvious* breach of the competition rules when judged against the relevant court judgments, it is mindful that participants in the market may on occasion have different (and useful) perspectives.

1.7. In the event that a credible potential breach is alleged, Ofgem is likely to seek to meet with the party concerned. It is possible it will further “market test” facts and analysis by seeking views of other parties.

1.8. If, after any necessary further consideration it appears to Ofgem that there is at least a *prima facie* argument for a breach, it will invite National Grid to make representations to it on the issue. It is anticipated that the identity of the “complainant(s)” will remain confidential.

1.9. If National Grid agrees that there is a *prima facie* “competition risk”, then it may either decide to proceed without any amendment, and take the risk that Ofgem or others pursue the breach in due course, or it may amend the proposed contract. If an amendment is proposed, Ofgem will again consult the affected party as to the sufficiency of the proposed amendment.

1.10. Ofgem is of course not bound to accept the views of third parties at any stage; on the contrary, it will fully examine any arguments put to it and may reach a different

conclusion to the “complainant” (or indeed to that put by National Grid in response). In such a case, Ofgem will inform relevant parties as to its conclusions, with brief reasons.

1.11. However, reaching such a position would be most unfortunate: Ofgem has pursued a case to infringement in this area already, and the courts have substantially upheld our views. In light of that, the anticipated final result is that National Grid will only proceed if Ofgem agrees that there is no credible risk that the proposals breach the competition rules, as judged in particular against the clear terms of the ruling of the Competition Appeal Tribunal and the Court of Appeal. Provided that position is reached, Ofgem will write a public letter to that effect.

Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from the parties involved in the litigation before the Competition Appeal Tribunal on the issue of the MSAs.

1.2. We would especially welcome responses to the specific questions which we have set out above.

1.3. Responses should be received by 26 August 2011 and should be sent to:

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1.4. Given the nature of the subject matter, it will be assumed that responses (and more particularly the identity of respondents) are confidential, and that each respondent wishes to rely on its rights under the Enterprise Act 2002. If for any reason Ofgem seeks further limited disclosure of the response (for example, on an anonymised basis), then it will seek consent from the author, and take into account any representations made as to necessary redactions.

Appendix 2 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. Please add any further comments.

1.2. Please send your comments to:

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