



Competition Authority Submission

Submission to the Review of the Non-Daily Metered Retail Gas Market

November 2012



The Competition Authority
An tÚdarás Iomaíochta

RESPONSE TO CONSULTATION QUESTIONS

Respondents are invited to comment on the CER's proposal outlined in this section to define a national market for the retail supply of natural gas to Non-Daily Metered residential customers. Are you in favour of this proposal? Outline your reasons for agreement or disagreement.

- 1.1 The Competition Authority is in favour of the proposals to facilitate more competition among retail gas suppliers and believes them to be timely. The Authority also welcomes the opportunity to comment on the CER's review of the gas sector as part of its roadmap for deregulation.
- 1.2 The CER's general approach to market definition appears to be based on EU guidance on market definition. In the EU Commission Notice on the definition of relevant market for the purposes of Community competition law a relevant product market is defined as follows: "*A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.*"¹ For the purposes of this consultation, the CER's approach may well be appropriate for establishing the appropriate domain for ex-ante regulation. Accordingly, the Authority is in favour of the proposed definition.
- 1.3 Markets are typically defined on a case-by-case basis by the Competition Authority and while there has been a convergence in the methodology applied by competition authorities throughout the world when defining a market, it should be borne in mind that market conditions change over time. Changes in consumer preferences and technological progress may affect the dynamics of demand side substitutability. Similarly the definition of the relevant geographic market may evolve over time from the State to encompass at least the island of Ireland.

Respondents are invited to comment on the CER's proposal that BG Energy's market share is presumptive of dominance, pending the examination of other economic factors. Outline your reasons for agreement or disagreement.

- 1.4 Market share is acknowledged as an important, but not by itself a sufficient, indicator of dominance in competition law cases. The holding of a dominant position is not, in itself, anti-competitive. Competition law enforcement is concerned with instances where a firm abuses its dominance by either acting unilaterally or by acting collusively with other competitors with the object or effect of harming consumers by distorting the competitive process.
- 1.5 The main indicator of dominance on a market is a firm's market share, and European Court of Justice case law has established certain market share thresholds which are indicative of dominance. Very high market

¹ EU Commission Notice on the definition of relevant market for the purposes of Community competition law, *Official Journal C 372*, 09/12/1997 P. 0005 - 0013

shares in excess of 70% are held in themselves to constitute evidence of a dominant position (Case 85/76, *Hoffmann-La Roche & Co AG v. Commission*). Market shares above 50% raise a rebuttable presumption of dominance (Case C-62/86, *AKZO Chemie BV v Commission*). Market shares below 50% rarely indicate the presence of dominance, unless other aggravating factors are present.

- 1.6 Since the earliest competition law cases the European Court of Justice (ECJ) has indicated that a number of factors must be considered in assessing dominance. In its judgment in *Hoffman La Roche*, the ECJ stated "*The existence of a dominant position may derive from several factors which taken separately are not necessarily determinative but among these factors a highly important one is the existence of very large market shares*".²
- 1.7 Ongoing market monitoring is therefore an essential feature of all utility regulation regimes as the physical and economic characteristics of the sector require ongoing supervision of market participants in order to mitigate the threat of any single supplier or a group of suppliers acting anti-competitively to the detriment of consumers.
- 1.8 Careful market monitoring is of critical importance during the transition from a regulated monopoly to a fully competitive market as the threat of an incumbent abusing its dominance can be sufficient to deter entry by rivals. Therefore, accurate, timely data about the nature and intensity of industry competition will allow regulatory policy to adjust quickly to changes in industry conditions.
- 1.9 It is not at all contradictory to suggest that although market opening should ultimately lead to reduced regulatory oversight and control, more pronounced market monitoring and regulatory oversight may be required on an interim basis to ensure that nascent competition is protected.
- 1.10 In this respect, the Competition Authority wishes to note the CER's approach which acknowledges the importance of examining "other economic factors" in conjunction with market share before reaching any presumptions of dominance.
- 1.11 The Authority therefore concludes that, in line with European case law, BG Energy's market share as set out in the Consultation Paper is presumptive of dominance.

Respondents are invited to comment on the CER's assessment of economies of scale and of scope. Outline your reasons for agreement or disagreement.

- 1.12 The lack of economies of scale in Ireland would suggest that in the short term at least, high concentration will remain a feature of the Irish market. However a small number of suppliers in a market does not indicate a lack of competition provided customers can switch easily between suppliers and barriers to entry are minimised
- 1.13 Dual fuel offerings of gas and electricity are motivated by the search for "synergy", i.e. direct economies of scope in the supply of different

² Hoffmann-La Roche & Co. AG v Commission of the European Communities, Case 85/76.

services to the same group of customers. While the presence of economies of scope and consumers' convenience (e.g. from the "single-bill" for a bundle of utility services) seems to be a strong argument in favour of dual fuel, nevertheless regulating a dual fuel supplier also has its challenges.

- 1.14 For example, a regulated firm operating in a competitive sector might allocate costs within its activities so that inert customers in the regulated sector are effectively subsidising the firm's activities in competitive sectors. Allowing a regulated firm to use part of its assets to compete in competitive segments might give this firm an advantage over its rivals, or it might leverage its large market share to acquire customers at lower cost than its competitors.
- 1.15 EU Directives on energy markets stress that integrated firms should at least create separate accounts for their business units operating in different sectors. The problem with these policies is that, almost by definition, economies of scope cannot be properly attributed to single activities and separated in different books.³
- 1.16 Whether the economies of scope related to dual fuel offerings are passed on to consumers or captured by the suppliers in the forms of higher profits depends on the contestability of the market. It is therefore important that search costs are minimised to ensure consumers are well informed and are able to easily switch supplier.

Respondents are invited to comment on the CER's assessment of the extent to which customer switching constitutes a barrier to entry or expansion. Outline your reasons for agreement or disagreement.

- 1.17 Competition works best when consumers actively search for better offers and make informed choices to secure value for money. While a high level of switching is not an essential prerequisite for competition, a credible threat that enough consumers are able to switch should incentivise energy suppliers to offer consumers competitively priced energy and an acceptable level of service.
- 1.18 It is notable that despite the entry of new suppliers, BG Energy's share of gas customers has remained high at around 70% despite the availability of cheaper alternatives. This indicates that a significant cohort of consumers is unaware of rivals' offers or they are encountering some other impediment to switching.
- 1.19 The reasons for this reluctance to switch, collectively known as "consumer inertia", are complex and often interact. To focus on each component individually, or assume that only one problem is responsible for the inertia, is likely to miss these interactions and may misdiagnose the problem. Consumers may, for example be deterred not only by switching costs, but also by search costs, which are the costs in both time and money of looking for and comparing packages offered by alternative suppliers. Incumbents can reduce levels of switching by increasing search costs, for instance by designing tariff packages which are difficult to compare with competitors' packages.

³ The Third Energy Package for Electricity & Gas markets:
http://ec.europa.eu/energy/gas_electricity/legislation/third_legislative_package_en.htm

- 1.20 The CER should conduct further study of consumer attitudes and switching behaviour to ascertain whether other factors which may be *behavioural* in nature may inhibit consumers from switching supplier even when it is beneficial for them to do so.

Respondents are invited to comment on the CER's assessment of the impact of dual fuel offerings on competitive conditions in the retail gas market. Outline your reasons for agreement or disagreement.

- 1.21 Electricity and gas are physically different products, yet they are increasingly bought together by consumers in a bundle commonly referred to as "dual fuel". One of the main effects of dual fuel pricing is that it allows companies to price discriminate in order to sort consumers according to their willingness to pay.
- 1.22 There is no presumption under competition law that discriminatory pricing is abusive. It is generally accepted that price discrimination has ambiguous effects on competition and consumer welfare. Therefore price discrimination must be judged on a case-by-case basis.
- 1.23 The CER has raised the concern that because of its presumptive dominance in gas, BG Energy has the incentive and information at its disposal to exploit inert customers by raising prices on those who have shown themselves to be unwilling or unable to switch supplier. Alternatively, there is the possibility that once tariff regulation is removed, BG Energy may offer selective discounts to win back consumers who have switched at the expense of those who did not switch.
- 1.24 The persistently high market share of BG Energy in gas despite the availability of cheaper alternatives and the generally less intense nature of competition for gas-only customers raises concerns for the welfare of consumers if full tariff deregulation was lifted from BG Energy at this time.
- 1.25 The causes of BG Energy's persistently high market share should be investigated further and measures introduced to ensure consumers are well informed and are able to switch their service provider easily.

Respondents are invited to comment on the CER's assessment of the significance of branding as a barrier to entry and expansion. Outline your reasons for agreement or disagreement.

- 1.26 The findings of the Consumer Survey regarding brand recognition of BG Energy versus ESB is not surprising given that all Irish households (approximately 1.6 million) use electricity and were until recently ESB customers while BG Energy's footprint was smaller given that NDM gas customers (628k) are largely concentrated in urban areas along the east coast.
- 1.27 While brand recognition of all energy companies has increased due to the intense promotional activity by competing energy suppliers it is noteworthy that awareness of the different roles of BG Energy and BG Networks is higher among those who have switched from BG Energy indicating that some customers who have stayed with BG Energy may

be unaware of the separation in functions. This lack of knowledge could lead to the perception at least among some consumers that their energy supply quality of service could be adversely affected if they switched from BG Energy.

The CER is proposing that BG Energy remains dominant in the relevant product market for the retail supply of natural gas to Non-Daily Metered residential customers, due to its continuing high market share and the absence of factors which would significantly reduce its market power. The CER recognises that dual fuel supply may potentially mitigate market power to some extent. Respondents are invited to comment. Outline your reasons for agreement or disagreement.

- 1.28 There is no clear definition of dominance from an economic perspective so the definition most frequently referred to by regulators is the legal concept as set out by the ECJ in the landmark case, *Hoffman La Roche*. In its judgment in this case, the ECJ defines dominance as "*the power (of a firm) to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers*". It is important to reiterate that competition law does not seek to punish dominance, only the abuse of this position.
- 1.29 In practical terms the process of finding dominance involves the assessment of a number of economic factors such as comparative market shares, barriers to entry, countervailing buyer power etc. which coalesce to form a picture of a firm's market power.
- 1.30 However the EU Commission has recently reiterated its view established in competition case law that a dominant firm may have a "special responsibility" in its conduct and so aggressive commercial practices which might be permissible when conducted by its competitors might not be necessarily permitted when conducted by the dominant firm.⁴
- 1.31 One key aspect of all energy markets is the role of customers in mitigating the market power of dominant incumbents through their ability to switch to rival suppliers. In a truly contestable market with a homogenous good such as gas any significant price differences should trigger switching to rivals. The persistently high market share of BG Energy in retail gas when other lower offers are available strongly suggests that there may be barriers to switching, whether real or perceived, which inhibit consumers from getting the best value.
- 1.32 In this context the existence of dual fuel offerings may to some degree mitigate the power of BG Energy in retail gas as the switching activity of these customer signals to the market as a whole that there are other offers available.

⁴ See Guidance note on enforcement priorities in applying Article 82 EC <http://ec.europa.eu/competition/antitrust/art82/index.html>

Respondents are invited to comment on the CER's proposal that the overall criteria taken to define a competitive market are still valid. Outline your reasons for agreement or disagreement.

- 1.33 As stated previously, the CER's approach is appropriate for establishing the appropriate domain for *ex-ante* regulation. Markets are typically defined on a case-by-case basis by the Competition Authority and it should be borne in mind that market conditions change over time.

Respondents are invited to comment on the CER's analysis of the relationship between branding and market share. Outline your reasons for agreement or disagreement.

- 1.34 Any actions by the CER regarding rebranding should be based on empirical evidence that gauges the strength of energy incumbents' brands. Therefore it is appropriate that the findings of consumer surveys should inform the CER's decision making in this regard.

Respondents are invited to comment on the level of BG Energy's market share which, when combined with the other competition criteria, could be considered to define a competitive market. Outline your reasons for agreement or disagreement.

Respondents are invited to comment on the CER's identification and assessment of three regulatory options. Outline your reasons for agreement or disagreement.

- 1.35 Dual fuel offerings have brought a new dynamic to competition and have been enthusiastically adopted by a certain section of Irish consumers who have made the choice to switch to rival suppliers. However it appears that a sizeable cohort of the population are not as engaged with the market as they might be and as a result are missing out on the savings that competition can deliver.
- 1.36 It is not clear that the emergence of dual fuel can sufficiently constrain BG Energy with its large legacy market share from the temptation to raise prices on customers who are either unwilling or unable to switch to a competitor.
- 1.37 The economic effects of bundling two products such as electricity and gas together are ambiguous as they depend on a detailed evaluation of conditions in the specific market. In the context of energy, the specific conditions that must be examined such as the ability of consumers to respond to price increases by their current supplier (known as "the price elasticity of demand") and the cost of searching for a better deal subsequently switching to another supplier.
- 1.38 While the CER's objective is for market forces to replace regulatory oversight in the retail gas market there is a concern that a considerable degree of consumer inertia is evident among a considerable segment of gas customers and this may leave customers vulnerable to higher prices in the event that BG Energy was fully deregulated.
- 1.39 Measures to remove barriers to entry and give consumers the information and power to discipline suppliers typically are better

methods for fostering vigorous long-term competition than interventions that favour or disadvantage one supplier over another.

- 1.40 The causes of what is collectively known as “consumer inertia” are complex and often interact. To focus on each component individually, or assume that only one problem is responsible for the inertia, is likely to miss these interactions and may misdiagnose the problem. The CER should further investigate the causes of consumer inertia among gas customers and introduce measures policies that help to ensure consumers are well informed and are able to switch their service provider easily can stimulate vibrant, enduring competition that may ultimately substitute for regulatory oversight.