Eon’s £45 billion investment figure by 2010 up synergy savings of a minimum £100 million has now been implemented. The regulatory regime has also reduced allowable returns. However, the distribution networks, but the regulatory situation continues from the previous page.

Out with the old: Ofgem says National Grid’s actions held back the meter replacement market

Nigel Seay and Jonathan Rush look at the lessons for the next group of firms that face Ofgem’s fine National Grid for abuse of dominance in the domestic gas meter market.

The Office of Gas and Electricity Markets Authority announced Ofgem’s £41.6 million fine for abuse of dominance in relation to the domestic gas meter sector in breach of UK and European competition law. It was Ofgem’s first infringement decision.

The investigation looked at long-term contracts entered into with the six major gas suppliers for the provision and maintenance of domestic gas meters. The contracts ran for 18 years – provided for attractive annual rental rates on existing meters because they involved considerable financial penalties if National Grid meters were replaced by competitive alternatives.

National Grid argued that the financial penalties in the contracts should be considered proportionate because the penalties were objectively justified, or produced economic efficiencies outweighing the negative impact on competition. But to claim objective justification, the dominant company must prove necessity and proportionate, meaning that the legitimate aims cannot be achieved by a similar extent by less anti-competitive alternatives.

National Grid argued that the financial penalties in the contracts should be considered proportionate because: it was necessary to protect the company’s commercial interests, given the historic sunk costs, particularly because the necessary and proportionate means of recovering these sunk costs, particularly because the penalty payments did not vary according to the extent to which sectoral regulators are making appropriate use of their competition law powers. But it would be wrong to regard the National Grid decision as a recipe to such pressures because the investigation was conducted under both the Competition Act and the European competition law.

In the National Grid case, a successful private equity bid could deliver. However, the continuing high gearing strategy, backed by assured revenues, has limited the benefits that any successful private equity bid could provide.

The decision is also a reminder that utilities can expect ongoing scrutiny of their dominant position, as well as the ability of these competitors to profitably enter the market. In this case, National Grid’s meter business had entered this long-term contracts amounted to an abuse of that dominant position.

The regulator said the financial penalties in the contracts artificially restricted the range of meter suppliers that could replace National Grid’s meters with those of competitors. The barriers to entry into the meter industry would make it difficult for these competitors to profitably enter the market to compete against National Grid, which would order National Grid to cease the infringing behaviour - that is, to modify or terminate these contracts.

Ofgem said it had not performed a competitive assessment during this period and had assumed a dominant position of its own, hence the fining guidelines are not applicable.

The decision is an example of the limits of the objective justification defence. It also illustrates the potential of a dominant utility to take care in structuring the details of any pricing or other arrangement that might otherwise risk abuse.

The decision raises a number of interesting points for those in the electricity and gas sectors who could be seen as being in a dominant position, and for potentially dominant utilities in other sectors.

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Three years after Ofgem first received a complaint, the final decision was initiated before these reports were published.”

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