



# Application to the Northern Ireland energy sectors

A Competition Act 1998 guideline

July 2001

OFT 437



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The Competition Act 1998 is applied and enforced by the Director General of Fair Trading and, in relation to the regulated utility sectors, concurrently with the regulators for telecommunications, gas, electricity, water and sewerage and railway services (under schedule 10 to the Competition Act). References throughout the guidelines to 'the Director General' should be taken to include the regulators in relation to their respective sectors.

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This guideline is issued in performance of the Director General of Fair Trading's statutory obligation to publish general advice and information about the application and enforcement of the Chapter I and Chapter II prohibitions contained in the Competition Act 1998. It is intended to explain the provisions of the legislation to those who are likely to be affected by them and to indicate how the Director General of Fair Trading expects the provisions to operate.

This guideline is not a substitute for the Competition Act 1998 nor for the regulations and orders which are made under it. It should be read in conjunction with the legislation. It contains a discussion of relevant principles of Community law. It should not be seen as a substitute for or as a definitive interpretation of Community law. Anyone in doubt about how they may be affected by the legislation should seek legal advice.

# 1 INTRODUCTION

- 1.1 The substantive provisions of the Competition Act 1998 ('the Act') came into force on 1 March 2000. The Office of Fair Trading ('OFT') and the sector regulators, including the Office for the Regulation of Electricity and Gas ('Ofreg'), will enforce the Chapter I and Chapter II prohibitions using their concurrent powers. Chapter I prohibits agreements between undertakings<sup>1</sup>, decisions by associations of undertakings or concerted practices which have the object or effect of preventing, restricting or distorting competition in the United Kingdom ('UK') (or a part thereof) and which may affect trade within the UK ('the Chapter I prohibition'). Chapter II prohibits conduct by one or more undertakings which amounts to the abuse of a dominant position in a market in the UK (or a part thereof) which may affect trade within the UK ('the Chapter II prohibition').
- 1.2 The Northern Ireland energy guideline (the 'guideline') provides advice and information about the factors which the Director General of both Gas and Electricity Supply for Northern Ireland ('the DG')<sup>2</sup> will take into account when considering whether, and if so, how to exercise his powers under the Act<sup>3</sup>. This guideline is not exhaustive. It will be necessary to consider the circumstances of each case on an individual basis, with reference to the guideline.
- 1.3 The guideline will need to be updated from time to time to take account of relevant developments in the Northern Ireland energy sectors. It will also need to take account of any changes in the other guidelines issued by the OFT and the sector regulators and the development of relevant case law

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<sup>1</sup> 'Undertaking' denotes the full range of business entities, including sole traders, partnerships, companies and groups of companies.

<sup>2</sup> The duties of the DG comprise the duties of the Director General of Gas for Northern Ireland and the Director General of Electricity Supply for Northern Ireland under the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992 respectively.

<sup>3</sup> These guidelines should be read in conjunction with the guidelines listed inside the front cover.

under the Act and under the EC Treaty. Consultation with interested parties, including the OFT and other sector regulators, will take place before making any changes to the guideline<sup>4</sup>.

- 1.4 Part 2 of the guideline sets out the legal context within which Ofreg will be operating. It explains Ofreg's powers under the Act and the relationship of these powers with other relevant legal provisions. Part 3 provides an economic analysis of the application of the Act, with reference to the specific economic characteristics of the energy sector. The process for carrying out investigations, and in particular, how Ofreg intends to use its powers under the Act, the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992 is discussed in Part 4. Part 5 describes Ofreg's approach to considering agreements covered by the transitional arrangements in Schedule 13 to the Act.

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<sup>4</sup> The latest version of the guideline will be kept in the Ofreg public register and will be available on Ofreg's web pages on the internet at <http://www.ofreg.nics.gov.uk> and on the OFT's website at [http://www.of.gov.uk/comp-act/technical\\_guidelines](http://www.of.gov.uk/comp-act/technical_guidelines).

## 2 LEGAL CONTEXT

### The Competition Act 1998

- 2.1 The Act replaces or amends legislation, including the Restrictive Trade Practices Act 1976, the Resale Prices Act 1976 and the majority of the Competition Act 1980. The Chapter I and Chapter II prohibitions of the Act are based on the provisions of Articles 81 and 82 of the EC Treaty. The Act gives the DG, in relation to the Northern Ireland energy sectors (gas and electricity), and the other sector regulators new concurrent powers with the Director General of Fair Trading. These new powers include the ability to impose financial penalties of up to 10 per cent of turnover on undertakings infringing a prohibition in the Act, for every year of the infringement up to a maximum of three years.
- 2.2 The Act amends the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992, so that, while Ofreg should continue to have regard to its sectoral duties when carrying out its utility functions, Ofreg should not do so when exercising concurrent powers under the Act. Ofreg may, however, have regard to matters covered by its sectoral duties provided they are matters to which the Director General of Fair Trading could have regard in exercising his powers under the Act. Annexe A sets out Ofreg's statutory duties under the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992.

### Community law – section 60

- 2.3 Section 60 of the Act sets out certain principles with a view to ensuring that the UK authorities (including the DG) handle cases in such a way as to ensure consistency with Community law.
- 2.4 The Act therefore places a dual obligation on the UK authorities (including the DG) in considering and dealing with the application of the Chapter I and Chapter II prohibitions. First, they must ensure that there is no inconsistency with either the principles laid down by the EC Treaty and the European Court or any relevant decision of the European Court. Secondly, the UK authorities (including the DG) must have regard to any relevant decision or statement of



the European Commission. The obligation to ensure consistency applies only to the extent that this is possible, having regard to any relevant differences between the provisions concerned.

- 2.5 The Competition Act guideline *The Major Provisions* contains further detail on how section 60 will be applied.

## EC directives

- 2.6 There are two EC directives, which are directly related to the electricity and gas industries. These are the EC Directive Concerning Common Rules for the Internal Market in Electricity<sup>5</sup> (the 'Electricity Directive') and the EC Directive Concerning the Common Rules for the Internal Market in Natural Gas<sup>6</sup> (the 'Gas Directive'). Both have already been implemented in Northern Ireland. There may also be other EC directives, which are relevant to the electricity and gas industries.

### THE ELECTRICITY DIRECTIVE

- 2.7 This directive provides a framework for EC member states to open up part of their electricity markets to competition. It addresses a number of issues, including:

- the role of public service obligations in a competitive market;
- open, non-discriminatory and transparent rules of access to electricity networks;
- transparency of vertically integrated electricity transmission or distribution companies (for example, through separate accounts) and;
- the interaction of electricity networks across the EC.

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<sup>5</sup> Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity.

<sup>6</sup> Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning the common rules for the internal market in natural gas.

## THE GAS DIRECTIVE

- 2.8 This directive provides a framework for EC Member States to open up part of their gas markets to competition. It addresses a number of issues, including:
- the role of public service obligations in a competitive market;
  - open, non-discriminatory and transparent rules of access to gas networks;
  - transparency of vertically integrated gas transportation companies (for example, through separate accounts); and
  - the possibility of making special provisions for undertakings adversely affected by long term take or pay contracts when competition is introduced.
- 2.9 Consistent with the principle of subsidiarity, each EC member state can determine how to implement these directives bearing in mind their particular circumstances.
- 2.10 Ofreg will take account of the provisions of the EC directives when applying the Act.

## **The Fair Trading Act 1973**

- 2.11 The Fair Trading Act 1973 allows scale or complex monopolies to be examined by the UK authorities (including the DG). A reference can be made to the Competition Commission in order to establish whether a monopoly situation exists, and if so, whether it operates, or may be expected to operate, against the public interest. Further details of the DG's powers under the Fair Trading Act 1973 are set out in the Competition Act guideline *The Major Provisions*.

### 3 ECONOMIC ANALYSIS

#### Context

- 3.1 Competition in the electricity and gas sectors in Northern Ireland is significantly less advanced than the equivalent sectors in the rest of the UK. Privatisation of the Northern Ireland electricity industry followed much later than privatisation in Great Britain. The generation business was sold in 1992, with Northern Ireland's Public Electricity Supplier (PES) passing into private ownership through a public flotation in 1993. Northern Ireland's natural gas industry is an emerging industry with interconnection with the UK grid only being completed in 1996 and the first customer receiving gas in the autumn of that year.

#### ELECTRICITY

- 3.2 The structure of the Northern Ireland electricity market, for example, its small size and its geographic location, coupled with privatisation occurring much later than the rest of the UK has meant that full market opening to competitive forces has been limited. Competition in the generation and supply of electricity has been constrained by contracts that were entered into at the time of generator sell off in 1992, albeit so far about 15% of Northern Ireland's peak generating requirement has been released to the competitive market as a result of the EC Directive Concerning Common Rules for the Internal Electricity Market which permits eligible customers (consumers of 1.33 gigawatt hours per annum) to purchase their supply from competing Second Tier Suppliers (STS). As part of the privatisation package all wholesale generated electricity was required to be sold to Northern Ireland Electricity (NIE), the incumbent undertaking before privatisation and now the privatised PES, for onward sale to customers. This requirement has now been considerably diluted and progress towards a fully competitive market is being made but until such time as all the contracts entered into in 1992 are amended or set aside, the electricity market in Northern Ireland will not be as competitive as the rest of the UK.

## GAS

- 3.3 Northern Ireland became interconnected with the UK gas grid in 1996 with construction and commissioning of the Scotland to Northern Ireland interconnector. Natural gas is currently only available to the Greater Belfast and surrounding areas with no guarantee that the gas market will be expanded to other parts of the Province.
- 3.4 As part of the agreement to get natural gas to the downstream market in Belfast, the licenses to convey and supply natural gas in the Greater Belfast area grant the licenceholder, Phoenix Natural Gas Limited, certain exclusive rights. These licence terms limit competition in the franchise market until the start of 2005 with competition only being currently available in the larger industrial sector (over 75,000 therms). Each industrial customer agrees to contract with Phoenix for three years from their date of supply or until 31<sup>st</sup> December 2004, whichever is earlier.
- 3.5 Northern Ireland is currently in the process of implementing the EC Directive concerning common rules for the Internal Natural Gas Market. One of the central requirements of the Directive is that at least 20% of the total annual gas consumption of the national market is open to competition. In Northern Ireland, this requirement is met through Ballylumford Power station which consumes approximately 90% of total volume. Since Ballylumford has the legal capacity to contract for the supply of gas their consumption is deemed to be competitive.

### **The importance of regulating dominant incumbents**

- 3.6 The scope of monopoly and of public ownership in the Northern Ireland electricity (and other utility) sectors prior to privatisation gave rise to patterns of activity that were not subject to normal market disciplines. Not only was there a lack of competitive pressures on cost and price levels, but related areas such as marketing methods, etc, tended to be relatively standardised, and incentives to respond to the varied requirements of different electricity customers were weak. The subsequent introduction of competition, albeit limited, has enabled a number of new suppliers (STS) to take advantage of the opportunities to better serve those customers in the eligible market by way of:

- lower costs and prices
- new tariff structures
- new marketing methods

3.7 Given the structure of the Northern Ireland electricity market and the limited competition therein, Ofreg believe that the Chapter II prohibition is more likely to be the area where infringements, if any, may occur. Therefore in its application of the Act Ofreg will be particularly vigilant in seeking to ensure that, most particularly in the electricity market, the conduct of dominant incumbent undertakings does not have an anti-competitive effect by restricting the opportunities for others to address markets in innovative ways. This could occur, for example, by preventing competitors in the energy field from introducing their products or services by artificially restricting or distorting the market by manipulating the tariff structure to favour the incumbent or a linked subsidiary.

3.8 However given the relative infancy of the Northern Ireland natural gas industry, the licence terms for Belfast and the absence of a licence for other areas, currently define the competition opportunities for the province.

### **Characteristics specific to the Northern Ireland gas and electricity sector**

3.9 Application of the Act to the Northern Ireland gas and electricity industries will raise a number of challenges associated with the specific economic conditions to be found in the sector. It may take some time for the sector specific case law to develop. Where appropriate, Ofreg will ensure that it applies its powers under the Act in a manner that is consistent with relevant EC jurisprudence on corresponding questions in relation to competition from other sectors.

3.10 Ofreg believes that there are a range of characteristics of the Northern Ireland gas and electricity industries, which, when taken together, affect how the Act is applied to the energy sector as compared to other sectors in Northern Ireland and the rest of the UK. The relevant factors include:

- the relative infancy of the gas industry;

- the recent limited emergence of competition in the electricity market as a result of the EC Directive Concerning Common Rules for the Internal Electricity Market;
- the importance of business separation, divestment and structural change more generally in the transition from monopoly to competition across a range of activities;
- the existence of monopoly providers in both gas transportation and electricity transmission and distribution, whose networks are unlikely to be replicated due to the cost conditions faced by any undertaking seeking to duplicate such networks (including the costs arising from planning and environmental constraints);
- the extent of incumbent market power in parts of the gas and electricity industries, including generation, supply, metering, meter reading and connections;
- the existence of price controls for electricity transmission, distribution, supply and procurement;
- the existence of price controls for gas conveyance and the provision for a price control in the supply of gas;
- the limited storability of electricity, and to some extent gas, which restricts the opportunities to substitute between time periods on either the supply side or the demand side;
- the low elasticity of demand for electricity and gas, particularly over short periods;
- the relative inelasticity of supply at some periods, in particular in electricity;
- the existence of long-term generator contracts;
- the presence of an interconnector with Great Britain for the supply of gas;
- the existence of interconnection with the Republic of Ireland for the supply of electricity;
- the proposed introduction of interconnection with Scotland for the supply of electricity;
- the economic linkages between different parts of the networks, which imply that the existence of market power in one set of activities or markets can have substantial effects on other (related) activities or markets; and
- the significance and complexity of the various codes and agreements, which govern connection to and use of electricity and gas systems, and which are required to ensure the safe, secure and effective operation of

those systems, for example, the Grid Code and the Use of System Agreement.

3.11 All of these factors may not be relevant for every case that Ofreg considers under the Act. For example, the limited storability of electricity, the low elasticity of demand for electricity, particularly over short periods, the relative inelasticity of supply for electricity at some periods and the complexity of the long-term generator contracts are likely to be factors that are highly relevant to an investigation of electricity generation activities.

3.12 Ofreg will not adopt approaches to applying the Act that are different from those set out in other Competition Act guidelines and most specifically those of the Great Britain energy regulator, Ofgem, albeit given the competitive structural constraints that currently exist in the Northern Ireland electricity and gas markets. The particular characteristics of the energy sector identified above, will, however, affect the emphasis that is placed on, and the weight given to, particular aspects of the analysis set out in other guidelines.

3.13 Ofreg considers that, in enforcing the Act, the specific economic conditions of the energy sector (including the recent introduction of competition) will give rise to a particular emphasis on certain issues connected with:

- pre-emptive behaviour by dominant incumbents;
- the effects of agreements covering the use of networks;
- the effects of long-term generator contracts; and
  
- the effects of conduct in relation to one activity or market on other related activities or markets.
  
- (this could be in relation to NIE using mkt power in franchise market to affect their eligibly customers)

3.14 These economic conditions and issues will affect at least six main aspects of the application of the Act:

- market definition;

- the assessment of market power<sup>7</sup>, and in particular, the assessment of dominance, including joint dominance;
- the assessment as to whether an abuse of a dominant position has occurred;
- the assessment of whether a dominant incumbent is engaging in pre-emptive behaviour;
- the assessment of agreements between undertakings, decisions by associations of undertakings and concerted practices under the Chapter I prohibition; and
- the exclusion from the Act's prohibitions, for services of general economic interest, under Paragraph 4 of Schedule 3 to the Act.

3.15 The remainder of this part of the guideline explains how Ofreg intends to approach these issues when applying the Act to the specific combination of circumstances in the gas and electricity industries, identified above.

### **Market definition**

3.16 In considering whether one of the prohibitions of the Act has been infringed it is necessary to define a relevant market or markets, since European competition law has required this in similar cases. A market definition normally contains at least two dimensions: a product and a geographic area.

### **Sequencing in the analysis**

3.17 At an early stage of any investigation under the Act, and on the basis of the information then available, Ofreg will arrive at a preliminary view of the scope of the economic issues involved and of the analysis that will need to be done. It will then proceed to more detailed consideration of the various conditions of demand and supply that are relevant both to assessing competitive pressures on the undertaking(s) concerned and to evaluating the effects of the relevant conduct, including the appreciability of those effects. In the course of the investigation, as the detailed analysis proceeds, it may be appropriate to revisit the question of the scope of the economic issues involved.

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<sup>7</sup> The concept of market power is not part of the statutory framework of the Act, but it is a useful tool in assessing potentially anti-competitive behaviour.



- 3.18 Among the factors that will be considered during the investigation will be the demand and supply side substitution possibilities that are relevant in defining markets. Since these substitution possibilities are also directly relevant to the analysis of market power, market definition and the assessment of dominance will be overlapping exercises in Chapter II cases. New information obtained during the investigation about, say, demand conditions, might potentially affect the final conclusions reached in either or both of these exercises, for example.
- 3.19 Evaluation of the economic effects of the conduct of concern will also be undertaken as the investigation proceeds. In Chapter II cases, however, only after the market definition and assessment of dominance exercises have been completed, and only if the undertaking or undertakings has or have been found to be dominant, will conclusions be reached on whether or not the prohibition has been breached, that is, whether a dominant position has been abused.

### Related markets

- 3.20 It is recognised in competition law that in many situations there may not be a single relevant market. An important class of cases concerns behaviour in one relevant market or market segment that may have anti-competitive effects in other related markets or market segments. Such cases are likely to be particularly important in gas and electricity markets, bearing in mind the economic linkages between the different activities in the sector. For example, a particular entry point on a transportation network may initially be defined as a relevant market because customers using that particular entry point are likely to have limited substitution possibilities. The effects of conduct .at that entry point, however, are likely to have economic effects on other parts of the network. In such circumstances it is appropriate that any market definition exercise does not unduly restrict the scope of an investigation and that it takes fully into account all of the relevant economic effects.

3.21

- 3.21 As explained in the Competition Act guideline *The Assessment of Individual Agreements and Conduct*, there will also be cases where undertakings may be able to leverage market power in a relevant market or markets to abuse

their dominance in another market. Again, such cases are likely to be particularly important in the Northern Ireland gas and electricity markets.

3.22 Ofreg will therefore have regard to the actual or potential effects of a firm's conduct on different activities, in deciding the scope of an investigation and in defining relevant markets. Often the behaviour of competitors will provide practical examples of the relevant activities to consider in an investigation.

### **The assessment of market power, and in particular, the assessment of dominance, including joint dominance**

3.23 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'<sup>8</sup>. Dominance may involve more than one undertaking ('joint dominance'). One important indicator of dominance on the supply side is to consider whether a firm or firms has or have the ability persistently to raise prices above competitive levels. In cases involving a potentially dominant buyer, the test is reversed by considering whether a firm or firms has or have the ability persistently to reduce prices below competitive levels.

3.24 When considering whether undertakings can act to an appreciable extent independently of their customers and competitors, Ofreg will look at a range of factors including:

- customers' behaviour and options (for example, awareness of competition, the extent to which alternative providers are chosen, the extent to which substitutes are available, consumers' willingness to switch);
- competitors' behaviour and capacities (for example, their range of offers, their ability to increase output within the relevant time period);
- market operation (for example, the extent of barriers to entry and exit); and
- market share<sup>9</sup>.

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<sup>8</sup> Case 27/76 *United Brands Co. v Commission* case [1978] ECR 207, [1978] 1 CMLR 429.

<sup>9</sup> In Case 85/76 *Hoffman-La Roche & Co. AG v Commission* [1979] ECR 461, [1979] 3 CMLR 211, and a number of other cases, the Court and the Commission have considered other factors as well as market share when determining dominance, including competitors' positions; barriers to entry; the resources, size and commercial superiority of

Consistent with the Competition Act guideline *Assessment of Market Power*, Ofreg considers that market share on its own will only be an indicator of dominance but would not be considered sufficient evidence on its own to determine whether an undertaking or group of undertakings is or are dominant, not least because the economic implications of any market share are likely to be heavily conditioned by a range of other relevant factors, including the magnitudes of demand and supply elasticities. In general, Ofreg will seek, wherever possible, to assess both substitution possibilities and actual behaviour directly, rather than rely on proxies, such as market share.

### **The assessment of whether an abuse of a dominant position has occurred**

- 3.25 It is the abuse of, not the existence of, a dominant position that is prohibited by the Act. Therefore, where an abuse of a dominant position is alleged or suspected and it is found that an enterprise or group of enterprises has the ability to act, to an appreciable extent, independently of its customers and competitors (as manifested, for example, by an ability to raise prices above competitive levels to an extent that can cause significant harm), Ofreg will investigate further, to determine whether or not any infringement has occurred. Such an investigation will focus on the commercial conduct of the relevant enterprise(s) and on the effects of that conduct, or agreements entered into by undertakings, on customers and on competition. The Competition Act guideline *The Chapter II Prohibition*, discusses the types of conduct that may breach the prohibition. Ofreg's approach to considering predatory pricing, which is one possible infringement, is set out below.
- 3.26 As noted earlier, unlike many sectors in the UK, Northern Ireland's electricity sector is characterised by the widespread presence of historic incumbent dominance or market power, which previously was promoted as a matter of public policy. The Northern Ireland natural gas market is currently an emerging market with limited competition opportunities. Although competition has been introduced into part of the electricity market, the issues of incumbent dominance and market power remain in the Northern Irish market. Ofreg, will therefore, pay particular attention to the possibility

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the undertaking; and technical superiority and the possession of know-how and intellectual property.

of pre-emptive<sup>10</sup> behaviour by incumbents, designed adversely to affect the development of competition in, for example, the relatively newly opened electricity markets. Pre-emptive behaviour may also occur through actions in related markets, for example, electricity distributors may use their dominance in these markets to prevent, restrict or distort competition in the provision of metering, meter reading or the development of alternative fuel sources. This again highlights the importance of considering the effect of actions across all the potentially affected activities.

### **The assessment of whether a dominant incumbent is engaging in pre-emptive behaviour**

3.27 In markets which were previously dominated by incumbent suppliers, it is possible that in the face of increasing competition the firms in question will introduce a range of initiatives which may benefit consumers. Bearing in mind incumbent suppliers' possible dominance, however, it is important for Ofreg to consider whether such initiatives are merely a response to competition that could be expected in any industry and which will benefit customers, or pre-emptive behaviour designed to prevent competition developing or continuing to develop, and to prevent new entrants establishing themselves in the market. It is necessary to consider incumbents' behaviour in each individual case, bearing in mind the circumstances of the initiative.

3.28 One example of such pre-emptive behaviour is predatory pricing. Ofreg will follow the approach set out in the Competition Act guideline ***Assessment of Individual Agreements and Conduct***, when assessing whether a dominant undertaking is engaging in predatory pricing. That guideline explains that in considering predatory behaviour, three factors will be considered:

- the intentions of the undertaking alleged to be engaging in predatory pricing;
- the feasibility of the undertaking recovering the losses it incurs when engaging in predatory pricing; and
- the level of the undertaking's prices relative to its costs.

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<sup>10</sup> 'Pre-emptive behaviour' describes abuses by dominant incumbents in markets that are being opened to competition or are relatively newly opened to competition, which are designed to adversely affect the development of competition.

3.29 Bearing in mind the particular concerns about pre-emptive behaviour particularly in the electricity industry, Ofreg considers that it will be appropriate in considering whether undertakings are covering their avoidable costs which, depending on the timeframe used, may include some fixed costs that would not be included in an average variable cost test. Ofreg will follow the approach set out in the Competition Act guideline *Assessment of Individual Agreements and Conduct*, paying particular attention to whether undertakings are covering their *avoidable costs*, which include elements of costs that are often described as fixed costs that would not be included in a variable cost test.

### **The assessment of agreements between undertakings, decisions by associations of undertakings and concerted practices under the Chapter I prohibition**

3.30 Chapter I of the Act prohibits those agreements between undertakings, decisions by associations of undertakings, and concerted practices which may affect trade within the United Kingdom and which prevents, restricts or distorts competition, or are intended to do so. The Act includes a list of illustrative examples of agreements, decisions or practices, which:

- directly or indirectly fix purchase or selling prices or any other trading conditions;
- limit or control production, markets, technical development or investment;
- share markets or sources of supply;
- apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and
- make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations, which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

3.31 There are a number of problems that arise in the Northern Ireland gas and electricity markets as a result of the statutory requirements for arrangements to ensure safe, secure and efficient operation of gas and electricity networks that are used by many market participants. These arrangements may involve

- restrictions on competition to achieve their objectives in relation to safety, security and efficiency.
- 3.32 As a result of their contribution to safety, security and efficiency, such agreements may qualify for exemption from the Chapter I prohibition. The criteria for exemption are set out in section 9 of the Act. All of these must be satisfied. The agreement must not impose on the parties restrictions which are not indispensable to achieving the desired effects ('the indispensability test'). More specifically, since a variety of different types of agreement may serve to achieve safety, security and efficiency objectives, and since different agreements may have different implications for competition, simply demonstrating that a particular agreement will achieve the stated objectives will be insufficient to warrant exemption. The agreement should constitute the least restrictive means of achieving its aims.
- 3.33 Ofreg can consider agreements involving 'dominant' undertakings under the Chapter II prohibition, subject to any exclusions that may apply.
- 3.34 Under section 5 of the Act, the DG can cancel an individual exemption, or vary or remove any condition or obligation of an individual exemption, or impose additional conditions or obligations of an individual exemption if<sup>11</sup>:
- the DG has reasonable grounds for believing that there has been a material change in circumstances since the individual exemption was granted; or
  - the DG has a reasonable suspicion that the information on which the decision to grant an individual exemption was made, was incomplete, false or misleading in a material particular.

### **The exclusion from the Act's prohibitions for services of general economic interest, under paragraph 4 of Schedule 3 to the Act**

- 3.35 Neither the Chapter I prohibition nor the Chapter II prohibition of the Act applies to an undertaking entrusted with the operation of *services of general economic interest* or having the character of a revenue-producing monopoly in so far as the prohibition would obstruct the performance, in law or in fact,

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<sup>11</sup> The provisions for exclusions for agreements that were covered or would be covered by the Restrictive Trade Practices Act within the Northern Ireland gas and electricity industries are discussed in Part 5.

of the particular tasks assigned to that undertaking. Ofreg will therefore be required to assess whether or not, in a particular case, this exclusion is applicable.

- 3.36 As explained in the Competition Act guideline *Services of General Economic Interest*<sup>12</sup> for the exclusion to apply the undertaking must have been *entrusted*<sup>13</sup> with the relevant task. Ofreg will apply this first test strictly. This is consistent with EC jurisprudence.
- 3.37 The second test that Ofreg will apply in addressing the issue is whether the application of the prohibition would obstruct the performance of those tasks. This will be assessed by the extent to which a restriction on competition is necessary in order to be able to perform the task of general economic interest. Again, Ofreg will take a strict approach to the question of necessity.

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<sup>12</sup> The Competition Act guideline *Services of General Economic Interest* is to be published later in 2001.

<sup>13</sup> Case 127/73 BRT v SABAM [1974] ECR 313, [1974] 2 CMLR 238.



## 4 PROCESS FOR INVESTIGATION

### Sector specific regulation

- 4.1 Unlike most sectors covered by the Act, undertakings' behaviour in the Northern Ireland gas and electricity markets, including that of dominant companies, is regulated by sector specific Orders in Council that have created a licensing regime, as explained in Annexe A. Among other things, these Orders and the licences regulate and attempt to prevent various types of anti-competitive behaviour that may have detrimental effects on gas and electricity customers. This includes restrictions on some undertakings' level and structure of charges and the prevention of unduly discriminatory behaviour by network operators and dominant suppliers. The Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992 set out the factors the DG should consider when deciding whether to use his powers under these Orders to address anti-competitive behaviour. In particular, the DG may not take enforcement action under the sector specific Orders if he is satisfied that it would be more appropriate to address the issue under the Act.
- 4.2 Ofreg believes that the provisions of the sector specific forms of regulation are generally consistent with the Act and Ofreg will continue to use them to fulfil its statutory duties and obligations under the Gas (Northern Ireland) Order 1996 and Electricity (Northern Ireland) Order 1992. When applying the Competition Act 1998 the DG can only take account of his duties under the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992 to the extent that they are factors of which the Director General of Fair Trading could take account when applying the Act.
- 4.3 The following part of this guideline is about how Ofreg will distinguish between complaints that are trivial and non-trivial in nature. It also explains how the DG intends to use his powers under the Gas (Northern Ireland) Order 1996, the Electricity (Northern Ireland) Order 1992, the Fair Trading

Act 1973 and the Act to ensure that any anti-competitive behaviour is most effectively addressed without undertakings facing 'double jeopardy'.<sup>14</sup>

## Guidance for the Northern Ireland gas and electricity sector - trivial or non-trivial complaints

- 4.4 Once it has been decided that Ofreg is responsible for a case<sup>15</sup>, Ofreg will attempt as quickly as possible to determine whether the complaint is trivial or non-trivial in nature. As part of this process, Ofreg will consider whether the requirements of section 25 of the Act, that is, that there are reasonable grounds for suspecting that one of the prohibitions has been infringed, has been met and the potential economic effect of the agreement or conduct in the particular case. To the extent that it is relevant, Ofreg will use its existing knowledge of the issues to determine the nature of the complaint. If there is a doubt about whether the complaint is trivial or non-trivial that cannot be resolved quickly by Ofreg, it may seek information from undertakings to determine whether to commence an investigation.

### Information gathering

- 4.5 When investigating suspected infringements under the Act, the Gas (Northern Ireland) Order 1996, the Electricity (Northern Ireland) Order 1992 or issues under the Fair Trading Act 1973, Ofreg may need to seek information from various undertakings. When requesting information, Ofreg will specify the suspected infringement it is investigating and which of the power(s) available it may use. Where more than one of the powers explained in Part 2 of this guideline (competition law powers) or Annexe A (sector specific powers) are considered to be potentially appropriate, it is likely that Ofreg will specify all the relevant powers. It may not be possible for Ofreg to decide which specific power(s) are likely to be the most appropriate to address the suspected infringement at the commencement of an investigation.
- 4.6 If it becomes clear to Ofreg when conducting its investigation that a particular power is no longer appropriate to the particular case, it will cease

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<sup>14</sup> 'Double jeopardy' would occur where an undertaking faced the possibility of being subject to a penalty more than once for the same infringement.

<sup>15</sup> See the Competition Act guideline *Concurrent Application to Regulated Industries*.

to request information under the respective power and inform the undertaking concerned. Also, Ofreg will inform an undertaking if a new

infringement is suspected after the investigation has commenced, which may affect the powers Ofreg considers could be appropriate to address the suspected infringement(s).

- 4.7 Where information has been gathered using powers under one of the Orders described in Part 2 (competition law powers) or Annexe A (sector specific powers), Ofreg may use information gathered to investigate other matters under the Act, the Gas (Northern Ireland) Order 1996, the Electricity (Northern Ireland) Order 1992 or the Fair Trading Act 1973, subject to and in accordance with the provisions of these various Acts.

## Consultation

- 4.8 *The Director General of Fair Trading's Procedural Rules* set out the procedures to be followed when deciding whether or not to consult on decisions made under the Act. In any event, Ofreg would normally expect to consult affected parties on decisions following non-trivial complaints, own initiative investigations or notification of agreements.

## Enforcement action and the imposition of penalties

- 4.9 As early as possible in the course of an investigation where infringements of more than one provision are under consideration, Ofreg will determine the most appropriate power to remedy the anti-competitive behaviour identified. Article 19 of the Gas (Northern Ireland) Order 1996 and Article 28 of the Electricity (Northern Ireland) Order 1992 require the DG not to make a provisional or final order or confirm a provisional order under either sector specific Order, if he is satisfied that the Act is the most appropriate way of proceeding to address the issue.
- 4.10 The DG is required to have regard to the Director General of Fair Trading's guidance on the appropriate level of a penalty, prepared under section 38 of the Act, when setting a penalty, after an undertaking has been found to have infringed the Act. When setting penalties under the Act, the DG will not have the ability to take into account his duty under the Gas (Northern

Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992 to have regard to the ability of licensees to finance their activities, to the extent that this is not a factor to which the Director General of Fair Trading could have regard when applying the Act.

- 4.11 When publishing any decisions following investigations, Ofreg will have regard to the need to maintain propriety with regard to market sensitive information when deciding on the timing of announcements, as is currently the case for some announcements, for example, price control proposals. This is in accordance with standard London Stock Exchange rules and regulations.

## Compliance

- 4.12 When setting penalties, in accordance with the Director General of Fair Trading's guidance, Ofreg will consider the extent to which the undertaking has taken reasonable steps, bearing in mind its resources, to put in place programmes to ensure compliance with the requirements of the Act. The OFT has produced a range of material to assist companies in developing compliance programmes<sup>16</sup>.
- 4.13 Ofreg expects companies within the gas and electricity sector to implement corporate compliance programmes if they do not already have them. Ofreg expects that such programmes will minimise the risk of infringing the prohibitions by systematically ensuring that all relevant employees are sufficiently knowledgeable about the provisions of the law, and that they will put that knowledge to good effect.
- 4.14 The details of compliance programmes are likely to vary between companies, particularly with regard to their resources. A minimum programme might be expected to comprise at least four elements, with the depth with which each element is covered being dependent on a company's resources. The four elements are described below:
- support and personal commitment from senior management, both visible and continuous, will be essential to ensure that compliance is treated with the importance it deserves and to ensure acceptance by other

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<sup>16</sup> These can be obtained directly from the OFT.

employees who will be more receptive to an initiative which is seen to be applied equally to senior managers;

- appropriate compliance policy and procedures will include a clear policy commitment to comply with the legislation by not engaging in anti-competitive behaviour or condoning such behaviour in other parties. This policy could feed through into personal development performance objectives, contracts and disciplinary arrangements. Procedures could include a framework within which employees can check whether or not a particular contract or deal is in breach of the law. This might involve a nominated expert or compliance officer. An effective mechanism to communicate the policy and procedures supported by a review process is a necessity, part of which is likely to be a manual or handbook provided to all relevant staff;
- training will form an essential aspect of any compliance programme. It should be designed to ensure that all relevant staff are given proper training on both the law and the company policy and procedures. It will not be sufficient to limit training to the implementation phase. It must be offered on a regular basis to reinforce and update the message. Such training is likely to be an essential element of any induction programme for new staff; and
- evaluation of the effectiveness of the overall compliance programme is the final essential ingredient. This might include informal feedback at an individual level and perhaps as part of individual performance appraisal. At a broader level formal audits, both with and without warning, could be undertaken. A transparent approach to the correction of any revealed infringements would serve as a constant reminder to employees that their business dealings are subject to review and will thereby deter complacency.

## 5 TRANSITIONAL ARRANGEMENTS

5.1 Provisions for the transition from existing competition law to the Act are set out in Schedule 13 to the Act. Those provisions are described further in the Competition Act guideline *Transitional Arrangements*. Certain provisions in Schedule 13 to the Act relate particularly to provisions of the Gas (Northern Ireland) Order 1996 or the Electricity (Northern Ireland) Order 1992. There are no transitional periods available in respect of the Chapter II prohibition, which applies to the behaviour of dominant undertakings immediately from 1 March 2000.

### Agreements benefiting from the transitional periods

5.2 Schedule 13 to the Act provides for transitional periods for particular agreements in the electricity and gas industries. In summary, the existing arrangements under the Restrictive Trade Practices Act will be retained for a further five years from the starting date, in that agreements currently exempt from the application of that Act and similar future agreements will benefit from transitional periods excluding them from the Chapter I prohibition during that period.

5.3 There are three categories of agreement that will benefit from the transitional periods in the gas and electricity industries:

- agreements to which, immediately before 1 March 2000, the Restrictive Trade Practices Act does not apply by virtue of section 100 of the Electricity Act 1989, also applicable in Northern Ireland, or Article 41 of the Gas (Northern Ireland) Order 1996 respectively, or Orders made thereunder. These agreements will receive a five year transitional period from 1 March 2000;
- agreements made during the five year period beginning on 1 March 2000 which are of a type such that, even if the Restrictive Trade Practices Act had not been repealed, it would not have applied to them because they would have been like those agreements in the category above, and agreements, whether made before or after the starting date, that are varied to become of that type in the five year period. These will receive

a transitional period applying from the date that the agreement or variation is made and for the remaining part of the five year period; and

- agreements of a description specified in a transitional order by the Secretary of State. These will receive a transitional period beginning at such time as is specified in the order and, again, applying for the remaining part of the five year period beginning on 1 March 2000.

- 5.4 The benefit of these transitional periods will be lost if the agreement is varied in such a way that it ceases to be one to which the Restrictive Trade Practices Act would not have applied or one to which a transitional order applies.
- 5.5 The question of whether or not the Restrictive Trade Practices Act does or does not apply to an agreement requires, in some instances, an assessment by the DG of the extent to which an agreement is likely to have a significant effect in preventing, restricting or distorting competition<sup>17</sup>. In making such assessments during the transitional period the DG will, to the extent appropriate, take into account matters addressed in this guideline, and particularly, the issues raised in paragraphs 3.30 to 3.34 above.

### **Extending or terminating the transitional period**

- 5.6 The DG may extend for up to six months the transitional period during which the Chapter I prohibition will not apply to an agreement. He may do so either on application by one of the parties to the agreement or on his own initiative. More details of the procedures in relation to the extension of transitional periods are given in the Competition Act guideline *Transitional Arrangements*.
- 5.7 It is unlikely that an agreement, which the DG considers would infringe the Chapter I prohibition of the Act, would be granted an extension of the transitional period unless there are good reasons why an extension is required – for example, the agreement is being re-negotiated or is due to expire shortly after the end of the unextended transitional period, or the parties have a legitimate need for more time to prepare a notification. In deciding whether to extend the transitional period the DG will apply the

approach described above and set out in the Competition Act guideline *Transitional Arrangements* and the issues discussed in paragraphs 3.30 to 3.34 above.

- 5.8 The DG may by direction terminate the transitional period in relation to any agreement if either:
- he has required any party to that agreement to give him such information about that agreement as he may require and, at the end of the period specified in the *Director General of Fair Trading's Procedural Rules* for providing such information, any party has failed, without reasonable excuse, to do so; or
  - if he considers:
    - that the agreement would, but for the transitional period, infringe the Chapter I prohibition; and
    - that he would not be likely to grant the agreement an unconditional individual exemption.
- 5.9 Any direction terminating a transitional period is subject to revocation, before it takes effect, either by the DG or the Secretary of State for Trade and Industry.

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<sup>17</sup> For example, the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996, SI 385/96 or the Electricity (Restrictive Trade Practices Act 1976) (Exemption) Order 1993, SI 912/93.



## ANNEXE A

### NORTHERN IRELAND GAS AND ELECTRICITY SECTOR REGULATORY LAW

A.1 This annexe sets out the DG's duties and powers under the Gas (Northern Ireland) Order 1996 and the Electricity (Northern Ireland) Order 1992.

#### **The Electricity (Northern Ireland) Order 1992**

A.2 The general duties of the Director General of Electricity Supply for Northern Ireland ('the DGES for NI') are set out in Article 4 of the Electricity (Northern Ireland) Order 1992, and his functions are set out in Articles 6 and 50 to 53. The DGES for NI must exercise his functions in a manner he considers is best calculated to secure that all reasonable demands for electricity are met, that licence holders are able to finance their activities, and to promote competition in the generation and supply of electricity.

A.3 Subject to these primary duties, the DGES for NI also has a duty to exercise his functions in the manner he considers is best calculated to protect the interests of customers, to promote efficiency on the part of transmission and supply licence holders and the efficient use of electricity. In doing so, he has to take into account the effect on the environment of activities connected with the generation and supply of electricity, as well as the health and safety of those employed in the electricity industry.

A.4 The DGES for NI has the power to obtain information from licensees and others in relation to potential breaches of licence, under Article 28 of the Electricity (Northern Ireland) Order 1992. However, the DGES for NI cannot require information to be produced, which the holder of that information would not be required to produce in civil proceedings in court. A person who refuses to comply with a notice requiring information to be furnished to the DGES for NI is liable on conviction to face a fine and a court order to provide the information.

## **The Gas (Northern Ireland) Order 1996**

- A.5 The general duties of the Director General of Gas for Northern Ireland ('the DGG for NI') are set out in Article 5 of the Gas (Northern Ireland) Order 1996. The DGG for NI must exercise his functions in the manner he considers is best calculated to promote the development and maintenance of an efficient, economic, and co-ordinated gas industry in Northern Ireland, and also to secure that licence holders can finance their licensed activities.
- A.6 Subject to these primary duties, the DGG for NI also has a duty to exercise his functions in the manner he considers is best calculated to protect the interests of gas consumers in terms of price, service and continuity of supply, to promote efficiency and economy on the part of licence holders and to facilitate competition in the conveying, storing, and supplying of gas. In doing so, he shall take into account the effect on the environment and the need to protect the public from the dangers of supplying gas.
- A.7 The DGG for NI has the power to obtain information in relation to potential breaches of licence under Article 30 of the Gas (Northern Ireland) Order 1996. However, the DGG for NI cannot require information to be produced, which the holder of the information would not be required to produce in civil proceedings in court. A person who refuses to comply with a notice requiring information to be furnished to the DGGS is liable on conviction to face a fine and a court order to provide the information.

## **The Electricity (Northern Ireland) Order 1992 licensing regime**

- A.8 Section 10 of the Electricity (Northern Ireland) Order 1992 allows the DGES for NI to grant licences for transmission, generation and supply activities. These licences impose a number of obligations on their holders. Where the DGES for NI is satisfied that a licensee is contravening, or is likely to contravene, a licence condition, the Electricity (Northern Ireland) Order 1992 requires him (except in certain specified circumstances) to issue an enforcement order against the licensee. Failure to comply with the order can expose the licensee to action (including a claim for damages) by any person who suffers loss or damage as a result of that failure.
- A.9 The Electricity (Northern Ireland) Order 1992 empowers the DGES for NI to modify the conditions of a licence with the licensee's consent (and after consultation).

- A.10 The DGES for NI may also refer to the Competition Commission questions as to whether any matters relating to a licence operate, or may be expected to operate, against the public interest. In certain circumstances the DGES for NI may, following a report from the Competition Commission, modify that licence.
- A.11 The transmission, generation and supply licences include conditions requiring the licensees to provide information requested by the DGES for NI to fulfil his duties under the Electricity (Northern Ireland) Order 1992 and to enforce the requirements of the licences.

### **The Gas (Northern Ireland) Order 1996 licensing regime**

- A.12 The Gas (Northern Ireland) Order 1996 provides for the licensing of public gas conveyors and suppliers. These licences impose a number of obligations on their holders.
- A.13 Where the DGG for NI is satisfied that a licensee is contravening, or is likely to contravene, a licence condition, the Gas (Northern Ireland) Order 1996 requires him (except in certain specified circumstances) to issue an enforcement order against the licensee. An enforcement order may include a requirement for the licensee to pay a monetary penalty of an appropriate amount. Failure to comply with the order can expose the licensee to action (including a claim for damages) by any person who suffers loss or damage as a result of that failure.
- A.14 The Gas (Northern Ireland) Order 1996 empowers the DGG for NI to modify a licence with the licensee's consent (and after consultation). The DGG for NI may also refer to the Competition Commission questions as to whether any matters relating to a licence operate, or may be expected to operate, against the public interest. In certain circumstances the DGG for NI may, following a report from the Competition Commission, modify that licence.
- A.15 The conveyance and supply licences include conditions requiring the licensees to provide information requested by the DGG for NI to fulfil his duties under the Gas (Northern Ireland) Order 1996 and to enforce the requirements of the licences.

