Reckon LLP

Data analysis | Economic regulation | Competition law

Presentation to the Distribution Charging Methodologies Forum

Franck Latrémolière

19 June 2008

What is exploitative abuse?

- Infringement with direct impact on a customer
  - Not necessarily anti-competitive conduct
  - Distinct from exclusionary or discriminatory abuse
- United Brands (ECJ) / Napp (CAT) formulation
  - “has made use of the opportunities arising out of its dominant position in such a way as to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition”
- Identify market features to show difference from normal and sufficiently effective competition

Does the price control not address these problems?

- The price control prevents overall exploitation
- But competition law protects each customer
  - cf. English Court of Appeal in Napp:
    “the Tribunal convincingly demonstrated that the [Pharmaceutical Price Regulation Scheme] outcome, precisely because of its "portfolio" base, is irrelevant in the case of over-pricing of any particular product”
- No “State action” defence
  - Ofgem does not direct use of any charging method

LRMIC example

- Load: 49 MVA. Capacity: 50 MVA. Cost: £5m.
- Growth 0.25%: 8 years to go. PV of cost: £3m.
- Additional 1 MVA adds £2m of PV (£5m – £3m)
- Annualise over 40 years: £150/kVA.
- Would imply charges of more than £5m a year.
- Might a large customer on this circuit complain that this seems higher than a reasonable return?

Why is stand-alone rebuilding cost relevant?

- Find market features which restrict competition
  - Planning, wayleaves, special rights in licence, etc.
- Imagine that these market features do not apply
  - i.e. anyone can build distribution network elements
- Identify evidence of exploitative abuse
  - i.e. if the market features lead to higher prices
  - The relevant benchmark is a price that gives a reasonable return on the stand-alone cost of rebuilding the network elements

Might there be an objective justification?

- Even if the price is higher than in the hypothetical more competitive market, it might be justified
  - Investors are entitled to a reasonable return
  - DNOs are entitled to apply incentives on customers
- Justification is subject to proportionality
  - Only to the extent necessary to achieve objectives
  - For example, price control revenue target (fair return) does not justify large locational differences
- For LRMIC: look for necessary incentive effect

LRMIC as justification?

- Marginal change in present value amount reflects expenditure caused by sustained change in load
  – Sensible basis for an incentive
- LRMIC examples spread the present value of all investment on increment between now and 2048
  – Only load at the time of reinforcement affects cost?
  – No good reason found — this is fatal to justification
- Reasonable incentive could not have been greater than return on stand-alone rebuilding cost

Can FCP lead to similar issues?

- FCP uses foreseeable expansion expenditure, spread over total load, over fixed 10-year window
  - Past load is deemed to have paid its fair share
  - Time profile seems arbitrary — but is it reasonable?

- Excessive geographical differentials very unlikely

- Theoretical risks are in the opposite direction
  - Could connected customers close to GSP complain?
  - Is there dominance / relevant market features?
  - Possible justifications, e.g. smooth transition?