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Estimating damages from exclusionary practices: the case of National Grid

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In 2008 National Grid was fined £41.6 mln for abuse of dominance in the market for the provision of domestic-sized gas meters

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1

National Grid (NG) owns and operates gas and electricity transmission and distribution networks in the UK, and rents gas meters to domestic gas suppliers

2

In 2002 the meter market was open to competition and NG concluded special contracts with gas supplies to protect its investments in meters

3

Suppliers could replace only a certain number of meters each month otherwise they have to pay full monthly rental charge irrespective of the actual number of meters or even pay early replacement charges

4

The cumulative effects of these provisions was such that suppliers faced significant switching costs if they wanted to replace NG meters with meters offered by competing meter operators (CMOs)

Assessing the damage to a CMO: methodology

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Counterfactual volumes

What volumes of meters could the CMO install but-for the abuse?

Counterfactual prices

What prices could the CMO charge but-for the abuse?

Counterfactual financial flows

What would be the CMO's revenues, profits and cash flows but-for the abuse?

Time value of money

How to assess the damage in today's terms if the abuse affected past and future profits?

Damage

Assessment of but-for volumes

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- In 2003, following a public tender the CMO was appointed by a gas supplier to provide meters in a particular area of the UK
  - However, the amount of meters in the contract is 15% less than what was discussed in pre-contract negotiations
  - There is evidence that the supplier carried out various modelling exercise to assess whether they would pay penalties to NG and wanted to limit this exposure

- In 2006 (when the contract had already gone live), the CMO was informed that the volumes will be reduced even further

- In total, the CMO installed 70% of meters that it could have installed even though
  - The gas supplier had an incentive to pursue rapid meter replacement and install more technologically advanced meters offered by the CMO
  - The CMO had necessary funding in place to cover its capital costs

Assessment of but-for prices

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- Meter rentals in the actual contracts are 5% higher than those agreed during pre-contract negotiations in 2002
  - The defendant may use this to argue that the higher price to some extent represents compensation for lower volumes
- However, it is not clear that a 5% price increase is due to volume reductions
  - When firms face a reduction in demand they have an incentive to reduce (not to raise) prices to keep demand stable
  - The fact that the CMO, on the contrary, has increased its prices suggests that this is related to factors other than volume reduction
- There are good reasons the believe that prices would have been higher in any event
  - The supplier viewed CMO’s meters as technologically superior and was prepared to pay a premium for them, so increasing rental prices made perfect sense for the CMO

Assessment of but-for financial position

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- Given but-for prices and volumes it is possible to assess but-for revenues
  - This is valid to the extent that once the supplier installs a meter it pays its rental prices till the end of the contract in 2030
- But in reality customers may switch to other suppliers and rental prices for these alternative suppliers are likely to be higher
  - Higher rental charges on the churned meters act as revenue protection in case alternative gas suppliers replace a working CMO meter before the end of its useful life
  - Thus, such churn revenues need to be appropriately accounted for
- Once all revenues and costs are taken into account it is possible to compute but-for profits
  - However, cash flows may be a more appropriate measure of the CMO’s financial position as they better reflect damage in terms of forgone investment opportunities

Assessment of the time value of money

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- Lost profits and cash flows are accounted for on an annual basis from 2002 to 2030, but an economic assessment of damages in conducted in 2012
  - Past damages (prior to 2012) need to be uprated, whilst future damages (after 2012) need to be discounted
- This raises several important questions
  - Which interest rate to use (statutory vs WACC of the CMO)?
  - What approach to adopt (simple vs compound interest)?

Uprating and discounting: an illustration

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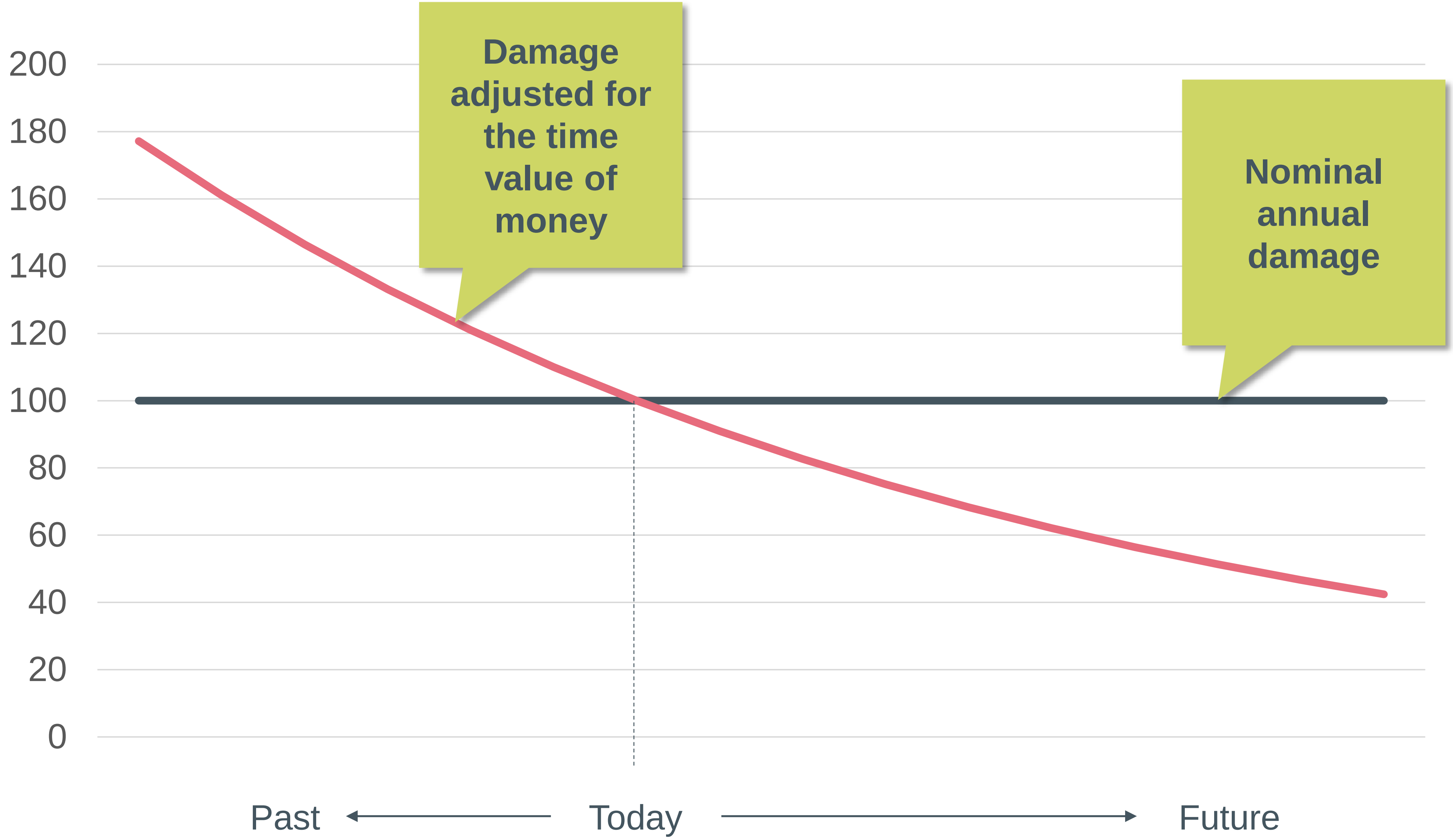

In conclusion…

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Sophisticated financial and economic

modelling may be required

to assess damage

correctly

A specialised economic consultancy, focusing solely on competition law matters

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Our team

- 100 economists
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Our core offering

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- Regulatory risk assessment

Our economic expertise

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- Merger control
- Dominance and monopoly inquiries
- Vertical / distribution agreements
- Cartels, horizontal agreements, information exchange
- Private litigation and damages