Evaluation of the Competition Commission's past cases

Final report

January 2008

Preface

This report was commissioned internally by the late Chairman of the Competition Commission (CC), Paul Geroski. It is a review of four CC decisions, in the light of subsequent market developments.

Unlike many competition authorities, the CC has no ongoing monitoring role in regard to any sector of the economy. All of our work is specific casework and when the case is complete, the case team disperses to work on other inquiries. It is therefore particularly important, and valuable, for the CC to look back from time to time and review its work in the light of subsequent market developments. We have commissioned external reviews of our work in the past, but on this occasion the work was carried out internally. There are pros and cons to doing so: in conducting this analysis, staff will have learnt more than can be gained from reading an external report but it has been difficult to fit the work around their core responsibilities to ongoing CC inquiries. Our next such review will be commissioned externally and will begin in 2008.

Many staff economists at the CC were involved in the production of this report, analysing markets, interviewing market participants and writing or commenting on the reviews. I would like to thank all of them for their hard work. However, I would particularly like to thank Alan McNaboe for leading the study and coordinating the work of the many authors. I would also like to thank other staff and members of the CC, as well as external academic economist panellists, for comments on various drafts of this document. In addition, in the course of the review, a number of participants in the industries under consideration were interviewed, or commented on drafts. The work could not have been carried out without this extensive external involvement and we are grateful to all of these external participants for their help.

The views contained here are those of the authors—all present or former staff at the CC—and should not be taken as representing the views of the CC itself. Nor should it be assumed that any of the external participants who commented on versions of these reviews agree with the findings in this report. Nothing in this report has formal status that in any way amends the decision or views of the CC as expressed in the various CC reports being considered.

John Davies
Chief Economist
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1. Executive summary

1.1 This paper reports on an internal review of a selection of past CC cases. The purpose of the review was to evaluate the CC's performance in those cases. In particular we considered:

(a) whether the CC had made sound decisions, given the information available to it at the time;

(b) whether the reasoning behind these decisions was clear and consistent and

(c) whether the CC's views were borne out by subsequent market developments, and if not, what we could learn from this.

1.2 The project follows an earlier study by PWC for the CC, the Office of Fair Trading (OFT) and the Department of Trade and Industry (DTI)—*Ex Post Evaluation of Mergers*, March 2005) ('PWC report'). The CC has also carried out a review of the effectiveness of remedies in past cases (*Understanding Past Merger Remedies, report on case study research,* January 2007*)* and estimated the consumer benefits of more recent and current cases (*Estimated costs to consumers of mergers and market outcomes against which the CC took action between April 2006 and March 2007*, July 2007).

1.3 This report sets out our assessment of the following four cases:

(a) British United Provident Association Limited and Community Hospitals Group Plc: A report on the proposed merger;

(b) Lloyds TSB Group Plc and Abbey National Plc: A report on the proposed merger;

(c) AES and British Energy: A report on references made under section 12 of the Electricity Act 1989; and

(d) Reed Elsevier Plc and Harcourt General, Inc: A report on the proposed merger.

1.4 While the PWC report covered mergers which the CC had cleared, we report here on two blocked mergers (BUPA/CHG; Lloyds/Abbey National), one cleared merger (Reed Elsevier/Harcourt General), and a regulatory inquiry (AES/British Energy). We selected cases which had been completed between January 2000 and December 2002 to ensure that a reasonable period had elapsed for the effects of the CC's report to have played out in the markets concerned. As a result the review does not include consideration of any cases investigated by the CC under the Enterprise Act 2002. Within this time frame, we excluded those cases which were reviewed by PWC. While the choice of cases within this period was relatively limited, we tended to focus on those which had given rise to complex issues.

1.5 The pre-Enterprise Act 2002 focus also enables us to judge how our working practices have evolved in recent years. As this report shows, the CC has evolved considerably since these cases were completed. This partly reflects the fact that the CC always work to improve and refine its analytical and procedural techniques, but the Enterprise Act itself introduced fundamental changes in the CC's status and way of working. By transferring decision-making from Ministers to the UK competition authorities in all but exceptional cases, the Enterprise Act established a new institutional structure of independent and determinative competition authorities subject to specialist review by the Competition Appeal Tribunal. It also gave the CC

the task of developing and implementing remedies in merger and market investigations and formalised competition-based tests in the legal framework. This new regime has brought with it greater evidence-gathering requirements and an increased need for transparency in the CC's decision-making processes. These new obligations are reflected in our published guidance and in our decisions themselves.

1.6 The analysis was conducted in 2005 and 2006, with a separate team of CC staff economists working on each case. This work included background research and interviews with main parties to the cases, their customers, competitors, and other interested parties. As this was not a reference conducted using our statutory powers, the amount of data that could be collected was limited. We are grateful to the numerous representatives of companies and regulatory-bodies who assisted with the review.

1.7 As mentioned, the cases pre-date the Enterprise Act. They also pre-date the publication of the CC's guidelines. Much of what is in the guidelines reflects what would have been best practice prior to their publication. However, this is not always the case, and it would be unfair to measure the CC's performance against guidelines which did not exist at the time. Nevertheless, the review brought to light a number of points which could have emerged if the kind of thinking encapsulated in the guidelines had been applied to the cases at the time—we discuss these points in the Lessons section below.

1.8 We begin with a summary of the cases.

BUPA and CHG

1.9 The CC recommended the prohibition of the acquisition of Community Hospitals Group Plc (CHG) by British United Provident Association Limited (BUPA) in 2000. Its reasons for doing so included concerns that BUPA's increased share of the supply of private medical services (PMS) would enable it to charge insurers and patients higher prices; competition and choice would be diminished in areas where both BUPA and CHG operated hospitals; the vertical links between BUPA's provision of PMS and private medical insurance (PMI); and an increase in BUPA's market power as a PMI provider.

1.10 Since then, the market has undergone rapid change—and appears to have become more competitive—owing to the increase in private provision of NHS-funded operations through Treatment Centres. One of the operators of these centres is Capio, which bought CHG after BUPA's bid was blocked.

1.11 The CC's view, that BUPA's increased market power in PMS provision would act to reduce competition, appears to have been soundly based. The market appears to have changed more than even market participants expected at the time. While these changes have increased the overall level of competition in the market, the CC could not have relied upon them to do so when making its decision. However, the CC's thinking about the relevance of vertical links between PMS and PMI, and the effect of the merger on BUPA's market power as a PMI provider, could have been spelled out in more detail. It is possible that a more detailed analysis would have reduced the CC's concerns about these issues.

LloydsTSB Group and Abbey National plc

1.12 In 2001 the CC recommended the prohibition of the proposed merger between LloydsTSB and Abbey National, largely due to concerns about the merger's effect on

competition in the personal current account (PCA) market. The CC was concerned that the 'big four' clearing banks would continue to dominate the market, and that any increase in their share would exacerbate this effect due in part to tacit coordination.

1.13 The Group was unable to reach a conclusion as to the presence of pre-existing coordinated effects in the market. However, it was able to identify adverse effects of the merger without reaching such a conclusion.

1.14 In the event, HBoS, rather than Abbey National, emerged as the major competitor to the big four banks in the period following the merger. However, the review concluded that the Group could not have identified which, if any, of the ex-building societies would fill this role, or whether there would be more than one.

1.15 In our view, the Group's core expectations of developments in the market were realized. The arguments that led the Group to its adverse findings and recommended remedy were appropriate and robust to developments in the market.

AES and British Energy

1.16 In 1999 the Director General of Electricity Supply (DGES) proposed including a Market Abuse Licence Condition (MALC) in the licences of seven electricity generators, given concerns that these generators had the potential to exercise short-term market power in the period prior to the introduction of the New Electricity Trading Arrangements (NETA). Two generators refused to accept the licence condition. This was the subject of the reference to the CC by the DGES.

1.17 The CC rejected the application of this licence condition for those two generators (and the DGES withdrew the licence condition for all relevant generators). In part, the CC's reasons for rejecting the application related to the specific circumstances of the two referred generators. Other reasons were more generic. The CC noted that decreasing concentration in the sector made market power less likely, even at peak times, and that the NETA made manipulation of specific rules less likely to succeed. The CC also had concerns about the effect of such a power, stating that the MALC 'would cause uncertainty, because of the difficulty of distinguishing between abusive and acceptable conduct, and would risk deterring normal competitive behaviour'.

1.18 Concentration has indeed fallen and there has been significant overcapacity in the industry at times since the CC's report. Although the Office of Gas and Electricity Markets (Ofgem) has observed some behaviour that might have been covered by a MALC, the CC's view that industry trends rendered such power unnecessary in the immediate future does seem to have been confirmed in the years immediately after the CC inquiry.

1.19 However, the more competitive state of the industry also implies that the case for a MALC has not fully been tested. Even today, it does not seem clear whether 'normal' competition law would suffice to deal in an effective and timely manner with problems of market power in the electricity wholesale market. Experience from overseas (notably the problems in the electricity market in California) illustrates the rapid and huge impact that market power or manipulation of market rules can have, particularly when the capacity/demand balance becomes tight. The response in the USA has been to introduce powers that are similar to those rejected by the CC, although there has as yet been little experience of the effects of this regulatory change.

1.20 In summary, the CC's decision not to support the introduction of the MALC in 2001 seems well-justified by subsequent market developments in Great Britain. Equally,

however, Ofgem's view that such powers can be necessary in some circumstances also seems to be supported by subsequent developments overseas.

Reed Elsevier and Harcourt General

1.21 The CC recommended the clearance of the proposed acquisition of Harcourt General, Inc (Harcourt) by Reed Elsevier plc (RE) in 2001. The parties overlapped in the supply of Science, Technology and Medical (STM) publications—specifically journals in print and electronic form. At the time of the merger, the CC estimated that the parties had a combined share of supply of 32 per cent of the UK market for STM publications (an increment of 7 per cent).

1.22 The majority of the Group concluded that the merger would not act against the public interest, although concerns about future pricing and the bundled supply of electronic journals were highlighted. A dissenting report by one member placed greater weight on these concerns. The Group agreed that the market displayed 'unusual features' and suggested that the OFT carry out a market-wide review.

1.23 Prices have continued to increase since the merger, at much the same rate as before. The extent of bundling has also increased. However, there is no evidence to suggest that either has been due to or facilitated by the merger. Our review did not produce evidence that bundling adversely affects customers.

1.24 The OFT carried out a review of the market in 2002 but concluded that, while the market might not be working well, it remained to be seen whether market forces and technological change would remedy the problems identified. A House of Commons committee report from 2004 indicates that problems persist in the market.

Did we get it right?

1.25 In some cases, subsequent market developments threw very little light on the quality of the CC's decisions, for a variety of reasons, but others provided at least an indication that the CC's decision was sound:

- BUPA/CHG—the market changed considerably after the merger was blocked but there were clear reasons for this which were not the result of the CC's decision.
- LloydsTSB/Abbey National—competition remains limited in the market, which arguably justifies the CC's decision to prevent a merger which would have increased concentration among the big four suppliers.
- AES/British Energy—we saw no evidence that the removal of the MALC had led to abuse of market power by electricity generators.
- RE/Harcourt—we saw no evidence that the merger had reduced competition in the market.

1.26 In our view, the CC's decision in each of these cases was basically sound. Market developments are not always predictable and, while in one case (BUPA) the CC's expectation of the most likely future development of the market was not what happened, it is not clear that the CC's decision in this case would have been different had it expected the developments that actually occurred.

Lessons

1.27 We considered whether lessons could be learned from the cases we studied. The one general theme that emerged was the value to the CC of having published guidelines. Since 2001/02, when these four reports were produced, the CC has published guidelines on mergers and market cases, which consolidate its views on best practice. The present review was written in the light of those guidelines, and we identified a number of ways in which applying the guidelines, and more generally reframing the terms of the debate, could have produced clearer reasoning in the reports:

- BUPA/CHG—the CC's thinking about the relevance of vertical links between PMS and PMI, and the effect of the merger on BUPA's market power as a PMI provider, could have been spelled out in more detail. It is possible that a more detailed analysis would have reduced the CC's concerns about these issues.

- LloydsTSB/Abbey National—a distinction between the unilateral and coordinated effects of the proposed merger would have been helpful. A more systematic assessment of whether the conditions existed for coordination between the big four banks could have qualified the CC's final view.

- RE/Harcourt—the discussion could have been simplified by concentrating on the effects of the merger, rather than on the extent of competition in the market. The Group's reasoning could have been more clearly grounded in the economic analysis of the case. An explicit discussion of the counterfactual would also have been useful.

1.28 The project gives an indication of the possibilities, and limitations, of future work of this kind. On the whole we were able to reach a view as to how the markets affected had changed since the CC reported on them. However, the impact of CC decisions was not easily distinguished from other factors affecting the market. This is typical of competition enforcement which has effects which are easily swamped by other forces. Even when the CC's decisions may have had a strong effect on the market, other factors can prevent an accurate measurement of the effect.

2. BUPA and CHG: a report on the proposed merger, 7 December 2000

Summary

2.1 The CC recommended the prohibition of the acquisition of CHG by BUPA in 2000. Its reasons for doing so included concerns that BUPA's increased share of the supply of PMS would enable it to charge insurers and patients higher prices; competition and choice would be diminished in areas where both BUPA and CHG operated hospitals; the vertical links between BUPA's provision of PMS and PMI; and an increase in BUPA's market power as a PMI provider.

2.2 Since then, the market has undergone rapid change—and appears to have become more competitive—owing to the increase in private provision of NHS-funded operations through Treatment Centres. One of the operators of these centres is Capio, which bought CHG after BUPA's bid was blocked.

2.3 The CC's thinking about the relevance of vertical links between PMS and PMI, and the effect of the merger on BUPA's market power as a PMI provider, could have been spelled out in more detail, in what we would now call theories of harm. It is possible that a clearer analysis would have reduced the CC's concerns about these issues. However, the CC's view that BUPA's increased market power in PMS provision would reduce competition appears to have been soundly based. The CC could not have relied on changes in NHS policy leading to the increase in competition which appears to have transpired.

Facts of the case

2.4 The proposed acquisition of CHG was referred to the CC in June 2000.[1] BUPA had a 17.4 per cent share[2] of revenues in the private medical service market (36 hospitals) and was the number two player. The other major players were GHG (40 hospitals, 20.1 per cent share), Nuffield (40 hospitals, 11.7 per cent share) and CHG (22 hospitals, 5.1 per cent share.) Had the merger gone through, BUPA's market share in PMS would have increased to 22.5 per cent. Concentration in PMS had increased in the years prior to the report.

2.5 BUPA's private medical insurance business had a 40 per cent share (1999 sales value), followed by PPP with 29 per cent, Norwich Union with 8 per cent, and Standard Life with 6 per cent. The PMI market had been characterized by rising premiums and declining rates of individual subscribers (and increasing self-pay by individuals) offset by increasing numbers of corporate subscribers.

The CC's decision and reasons

2.6 The CC recommended that the merger should be prohibited. The adverse finding was based on *direct effects* of the merger:

(a) the merged firm's increased market share;

(b) its increased number of 'solus' hospitals (ie private hospitals that were not near any other private hospitals);

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[1]Indirect means were used due to the fact that BUPA was operating under an undertaking barring it from acquiring any further interest in IBH (Independent British Health Care Ltd) which was now owned by CHG.
[2]By share of 1998 UK revenue.

(c) the increase in concentration in the PMS market (from four to three national providers);

(d) the elimination of an efficient competitor (CHG); and

(e) the planned price increases by BUPA at the former CHG hospitals.

And *indirect effects* of the merger, notably the expectation that BUPA's inter-market links would be further enhanced by the merger.

2.7 The CC found strong vertical links between the PMI and PMS markets, and the private consultant sector. The CC concluded that these were responsible for at least two key PMS entry barriers: first, listing in a PMI network was considered a prerequisite for entry of new hospitals in PMS; and second, it was imperative for a new hospital to attract a sufficient number of consultants, as consultants typically chose one or two hospitals in which to treat the majority of their private patients.[3] BUPA was the only firm active in both the PMS and PMI sectors.

2.8 The CC concluded that Chinese walls between the two businesses were ineffective, and the relationship could not be considered to be at arm's length, stating that '…all that is necessary is for them not to adopt the sort of rigorous bargaining stances when dealing with each other that they would adopt when dealing with other providers.'

2.9 The main adverse effects of the merger identified in the report were that:

(a) *The enhanced market power of BUPA PMS* would enable it to charge insurers more for serving their customers.

(b) *The enhanced market power of BUPA PMI* would enable it to pay hospitals less *for* serving BUPA's insurance customers. The CC's expectation was that these (non-BUPA) hospitals would in turn seek to raise prices to smaller PMI providers.[4] The CC expected that lower costs for BUPA PMI would not be passed on to BUPA PMI subscribers, particularly as BUPA was aiming to grow its premium revenues faster than growth in subscribers. This would make it easier for smaller PMIs to sustain their price increases.

(c) *The former CHG hospitals' prices would rise* to be brought in line with the rest of BUPA's *PMS* prices, to the detriment of insured patients and particularly self-payers.

2.10 Although a range of remedies was considered, including partial divestment, the CC found that the only remedy that would fully address the loss of competition was a complete separation of ownership and control of BUPA's PMI and PMS businesses. This option was unacceptable to BUPA, leaving the CC with no alternative to recommending the prohibition of the merger.

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[3]Patients generally accepted the consultant's guidance on which hospital to use, although in some cases they were limited by insurance cover to using network hospitals or hospitals falling within certain price bands (see paragraph 4.24).
[4]The report acknowledges that large PMI providers like PPP may be sufficiently strong to withstand similar pressures.

What happened next?

PMS market

2.11 The CC reached its decision in December 2000. In March 2001, GHG put in a bid to purchase CHG's hospitals. That bid was also referred to the CC. Before the case could be completed, in April 2001 Capio Healthcare, a Swedish firm, made a successful bid to acquire CHG. Capio is now the fifth-largest UK hospital group and by some accounts has been one of the most innovative in enhancing relations with consultants and PMIs.

2.12 The PMS market experienced substantial changes after the report was completed. The most significant change was the Department of Health initiatives of July 2000 (the 'NHS Plan'). The NHS Plan resulted in substantial amounts of NHS operations being contracted out through the use of Independent Sector Treatment Centres (ISTCs) and Diagnostic Treatment Centres (DTCs).[5] Under the new NHS model, a significant amount of patient care was procured publicly but delivered privately. A new type of PMS provider emerged in the form of these treatment centres, alongside the traditional NHS and independent acute hospitals.

2.13 Following the CC's report, BUPA ceased to pursue a growth strategy in the UK PMS market, and embarked instead on a policy of expansion overseas in PMI and PMS, and also into related UK product markets such as nursing and residential care homes and children's nurseries. In its UK PMS operations, BUPA announced a new restructuring strategy involving the sale of ten smaller hospitals aimed at lowering prices, offering more standardized treatments, and upgrading the remaining hospitals to be able to treat both private and NHS patients.[6] In July 2005, BUPA sold nine of its hospitals to Legal and General Ventures, to form the basis of a new private hospital company called Classic Hospital Group Ltd.

2.14 In 2004, Nuffield announced plans to implement some redundancies and cost cutting, to convert some hospitals to ISTCs and possibly to sell others, in order to place itself in a better position for NHS contracts.[7] In 2005 it announced that it would offer a smaller range of surgical procedures and impose greater restrictions on the ways in which its consultants worked in order to capitalize on scale economies generated by NHS contracts.[8]

2.15 In the first round of government tendering for ISTCs in September 2003, none of the major UK incumbents were successful in winning a share of the £2 billion worth of contracts. The contracts went instead to seven foreign companies, including Capio.[9]

2.16 The general consensus was that the market for PMS had become much more competitive in the period since the merger was blocked. New capacity was added and new providers entered the market. The primary force behind the improvement in competition and increased entry in PMS was the NHS Plan, which led to expansion in the overall size of the PMS market and further increased the attractiveness of new

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[5]The different types of treatment centres vary between privately-owned and -managed (ISTCs) to NHS-managed (DTCs) or private sector-NHS joint ventures. The treatment centres generally specialize in the more routine types of elective care outside the acute hospital setting.
[6]It announced a £100 million investment over three years in modernizing its 25 remaining hospitals, increasing throughput and improving scale economies. (*Daily Telegraph*, 18 July 2004.)
[7]*Consultants Sink or Swim*, presentation by Derek Machin, Chairman of BMA Private Practice Committee at Conference on UK Independent Medicine—Explosion or Implosion, 10 November 2004.
[8]*A question of capacity*, Health Insurance, May 2005.
[9]We were told that Capio initially lost the tender, but picked up some contracts after some of the winners dropped out.

entry.[10] NHS contracting-out also intensified PMS price competition, dampening the vertical effects of PMI networks and consultant referrals, while at the same time placing downward pressure on consultant fees and hospital charges.

PMI market

2.17 The PMI market also underwent change. BUPA and Norwich Union increased market share, while PPP lost market share. Royal Sun Alliance exited the PMI market in 2003 but Prudential entered the market in 2003, targeting a younger private insurance purchaser.

2.18 Third parties told us that demand for PMI had remained robust, and PMI premiums had continued to rise faster than the rate of inflation. Premium increases were principally driven by costs, as new technologies and treatments meant that more illnesses could be treated. Apart from IVF treatment and cosmetic surgery, the market for self-pay private medical care appeared to have peaked, in part due to natural levelling off, and also due to shorter NHS waiting times.

2.19 We were told that the market for PMI had been indirectly affected by the evolution of the PMS market since the time of the CC's report. PMI companies were pushing to get price concessions from PMS providers to move closer to NHS trust prices, although their success had been limited by the fact that the services they were buying (eg private rooms, short waiting times, choice of consultant) still remained differentiated from NHS purchases.

2.20 Still, the need to keep PMI costs low and to control premiums became even more pressing as NHS waiting times declined. BUPA's insurance business announced three new initiatives in October 2005 to help control costs and premiums.

Consultant sector

2.21 A new NHS Consultant Contract was agreed in June 2002, under which consultants agreed to some restrictions on their private practice within the NHS in exchange for a better pay package. Consultants were required to give the NHS first call on their free time before undertaking private practice.

2.22 There were also new rules governing the pricing of the use of NHS facilities and staff by consultants for their private practice. Consultants were forbidden from recruiting private patients during the course of their NHS work, and from discriminating against private patients wishing to return their treatment back into the NHS after having been treated privately.

2.23 The initiatives by BUPA PMI and other insurers to control costs (see paragraph 2.20) indicate a possible additional shift in power away from consultants and towards PMI companies.

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[10]New ISTCs were set up with five-year take or pay contracts on a high percentage of revenues, with provisions to treat private patients on the margins to boost profits, greatly reducing the riskiness of new entry. In addition, ISTCs were able to circumvent planning restrictions by securing land on an existing NHS site.

Vertical links

2.24 We were told that the vertical links between PMI and PMS had weakened in part due to the downsizing by BUPA PMS and the expansion of the NHS treatment centres, and the lower emphasis placed by PMI companies on network policies.

Evaluation of report

2.25 BUPA made a number of criticisms both of the case process and of the CC's reasoning and conclusions in the report. As many of the procedural issues are less relevant today under the Enterprise Act, we focus instead on the substantive criticisms of the report.

2.26 BUPA's substantive criticisms of the report can be summarized as follows:

(a) the correct geographic PMS market definition should have been local, rather than national markets; this led to insufficient consideration by the CC of the local divestment remedy;

(b) the lack of a completely distinct London PMS market definition may have subsequently led to PMS mergers in London going unchallenged, leading to possible excessive concentration and market power in London at present;

(c) BUPA's vertical links between PMI and PMS were not very relevant to the case, which was a hospital merger, yet they featured strongly in the report and its conclusions;

(d) the CC did not adequately understand and factor into the competitive analysis the fact that the payer of PMS (insurance companies) differed from the recipient of PMS (the patient) and from the individual choosing the PMS provider (the consultant)—we will refer to this feature as third-party purchasing and selection; and

(e) the CC report suffered from under-recognition of the role that Private Patient Units (PPU) within NHS hospitals played in the market, particularly in the market share analysis where they were excluded.

2.27 We also spoke to a number of third parties about their views on the report. These included the PMI provider PPP, the hospital group GHG, and industry consultants Laing and Buisson. The third parties generally agreed that the conclusions of the report were correct but there was some criticism of the report failing to adequately appreciate the impact of the momentous changes occurring in the PMS market due to NHS reforms. Some also expressed concerns raised by BUPA about the failure to define London as a distinct market, and third-party purchasing.

2.28 We had a separate concern of our own, which was not raised by any of the parties we consulted with. The CC argued that one adverse effect of the merger was that PMS companies would charge higher prices to smaller PMIs to compensate for the lower prices they would have to charge BUPA PMI as a result of BUPA PMI's increased market power due to the merger. We had some doubts whether such an effect would be likely to arise from the merger.

2.29 We evaluate each of these criticisms below.

Geographic market definition—local v national markets?

2.30 The report states that the 'PMS market should generally be viewed as national but with local aspects' citing the emergence of large national PMS providers, who by and large set prices nationally. However, it went on to assess the impact on competition both at the national and at the local levels. At the local level a number of areas were identified where competition might be affected by the merger, yet it was found that 'the primary effects of the merger occur at the national level.' The report also states that: 'The national PMS providers seek to maximise their value to PMI providers by offering wide geographical coverage and a degree of "indispensability" to PMI providers'.

2.31 In our interview, BUPA told us that patients seek health care locally, and for that reason the relevant PMS market was local, not national. It would be very unusual for a patient to travel far beyond his/her local area to obtain PMS. The report seems to agree with this idea, adding that consultants 'normally operate out of private acute hospitals that are close to the NHS hospital where they are based.' However, the report also states that pricing of hospital services by the four national PMS providers 'is largely, although not wholly, determined nationally rather than directly reflecting local conditions'. The report cited evidence from various PMIs that they generally negotiated national prices with PMS providers for any given procedure for *all* of their hospitals. The third parties we spoke to confirmed that this generally was and still is the case.

2.32 Since the choice of hospital is made at a local level, a local analysis such as the CC conducted was relevant to establishing whether the merger increased the number of local areas in which consultants faced no alternative to operating in a BUPA-owned hospital. If a PMS provider's market share is to have an effect on the price it can charge, the PMI provider (with whom the price is negotiated) must have some influence over the consultants' choice of which hospital to use. (In an extreme case, this influence could take the form of refusing to insure customers for treatment at certain hospitals.) We would expect that a PMS provider which was the 'only game in town' in a large number of local markets would have a stronger bargaining position in agreeing a national price with a PMI provider, than one which faced competition in most or all local markets, because in the former case the PMI provider would be less able to make a credible threat to influence consultants to avoid using the hospitals of that PMS provider. From this perspective, the analysis of local markets conducted by the CC does not conflict with the fact that prices are set nationally.

Geographic market definition—was London a different geographic market or a distinct national market segment?

2.33 We were told (by BUPA and PPP) that Hospital Corporation of America (HCA) now owns six of the eight major private London hospitals and this has left HCA with some market power in London. We were told that the CC's decision to define the geographic market for PMS nationally and its failure to define London as an entirely distinct geographic market may have contributed to the expansion of HCA in London going unchallenged.

2.34 In the BUPA report London was viewed as 'a distinct and separate segment of the PMS market' based on markedly different market conditions including a far greater number of teaching hospitals and PPUs than elsewhere in the country, a larger proportion of self-paying patients, different travel patterns and different disposable income.

2.35 BUPA took the view at the time of the report that London was not a distinct geographic market. However, it told us in our consultation that it believed London hospitals operated within local catchment areas but that the catchment areas in London were atypical due to the nature of the London conurbation. It said that in retrospect it considered that London should indeed have been treated as a separate market.

2.36 While the report does not define London as a completely separate geographic market from the rest of the UK, it argues that the competitive conditions in London differ markedly from the rest of the country.

2.37 The CC's analysis was not entirely satisfactory, in that it *(a)* relied on a discussion of distinct features of the London market, rather than assessing whether prices in London and outside London constrained one another, and *(b)* identified London as a 'segment', which is not a meaningful term for competition analysis purposes. We note that a different conclusion was reached in a subsequent OFT case, although we have not, for the purpose of this review, attempted to ascertain what the relevant market was in 2000.

2.38 We considered the argument that the CC's assessment may have contributed to increased concentration in London. HCA, in conjunction with PPP, purchased four major London hospitals in 1996. On 19 May 2000, it bought out PPP's share, and in June 2000, purchased two other London hospitals from St Martin's group of hospitals. The OFT reviewed and cleared this acquisition. The BUPA/CHG case was not referred to the CC until 12 June 2000.

2.39 In July 2001, HCA tried to acquire some significant interests in the London Heart Hospital (LHH). The OFT reviewed this deal, and identified London as a distinct geographic market. It referred the transaction to the CC, and HCA subsequently abandoned it.

2.40 Given that HCA's hospital purchases from St Martin's and PPP both preceded the publication of the CC's report, and indeed occurred around the same time as the reference was made to the CC, we see no evidence that the CC's views could have influenced the acquisition

BUPA's vertical links were not very relevant yet featured strongly in the report and conclusions

2.41 At the time of the report, BUPA did not consider itself to be a vertically integrated organization. It told us that it did not make any business sense for BUPA's hospital group to favour its own insurance group, or vice versa, as each only represented a minority share of the other's revenues and they could not afford to alienate their other customers. BUPA told us this was still true today.

2.42 The CC view was that BUPA had unique advantages arising from its presence in both markets. The insurance group held strategic information that was valuable to the hospital group, and even with the best of intentions BUPA could not completely stop the flow of information between the two groups. Further, if the negotiating posture between the two divisions were any less confrontational than that with outside companies, this would create preferential treatment for BUPA relative to its rivals. The CC's view was that the two branches of BUPA could not be considered to be at arms' length as long as they operated under the same parent company.

2.43 At the time of the case, numerous third parties expressed concerns about the strength of BUPA's position because of its presence in both PMI and PMS markets, and most felt these vertical links would be exacerbated by the merger.

2.44 Many of the third parties we spoke to no longer considered BUPA's dual presence to be an advantage of any significance. We were told that today, BUPA PMI did not show any bias towards BUPA PMS. It provided consultant bonuses for any network hospital, not just its own, and the data system for referrals was arranged alphabetically. In fact, third parties told us that maintaining the Chinese Walls placed BUPA in an 'impossible situation' being both competitor and supplier or customer to its rivals. Inevitably, decisions were made by top management for one business that had an impact on the other.

2.45 We note that BUPA PMS was subsequently considerably smaller (with about 25 hospitals) than the merged firm would have been (with 58 hospitals if there had been no divestments). A much smaller BUPA PMS, operating in the context of a larger market due to the NHS reforms, is far less likely to present the vertical concerns that the merged firm would have presented at the time of the report.

2.46 BUPA's view was that many third parties exaggerated the impact of its dual market presence because of their motivations to see the merger blocked, and that the CC was unduly influenced by these opinions. This view would be consistent with third parties no longer being concerned about BUPA's vertical links.

2.47 In our view, the CC was correct to take account of BUPA's presence in PMI in evaluating possible effects of the merger. However, it could have been more explicit in setting out how this vertical link might be expected to have an anti-competitive effect, and how this effect would have been exacerbated by the merger. In addition, it did not consider whether the vertical link between BUPA's PMS and PMI provision might have the benefit of removing a 'double marginalization' problem (ie that if the two are separate, the PMS provider sets prices without taking account of the effect of these prices on PMI costs, PMI prices, and hence demand for PMI; but if it provides both PMS and PMI, it has some incentive to charge lower prices for PMS in order to keep PMI costs and prices down and increase demand).

Third-party payment and selection not adequately understood and incorporated into analysis

2.48 The report explicitly identifies and discusses the separation of payment from consumption. The role of consultants in the choice of hospital is also discussed at length. The presence of these features of the market seems to have been fairly clearly expressed in the report; whether they were given sufficient attention in the competitive analysis is less clear.

2.49 In particular, it is not certain whether PMIs had any influence over consultants (although, as discussed in paragraph 25 above, they seem to have some influence now). If PMIs could not influence the choice of hospitals, it may be that the PMS provider's prices to PMIs were only constrained by the fact that, at a certain price level, customers would opt out of private medical insurance. Assuming that most of these customers would switch to using the NHS (ie opt out of the PMS market) rather than self-paying, this would ultimately lead to a loss of revenue for the PMS provider.

2.50 A larger PMS provider could in principle be more constrained in its pricing than a smaller one: the larger its share of the market, the more it will be affected by a fall in market demand. To illustrate, consider a case in which a PMS provider imposes higher prices on the insurer, and the insurer responds by raising premiums to all its

customers, some of whom respond in turn by cancelling their insurance. The PMS provider captures the benefit of having a higher price, but the cost (fewer PMI customers and therefore less demand for PMS) is spread across the whole PMS market. A larger PMS provider would pay a greater proportion of the cost, and so would have a weaker incentive to raise prices (or a stronger incentive to lower them) From such a perspective, an increase in concentration in the PMS sector could potentially have led to lower prices.

Under-recognition of the role of PPUs

2.51 BUPA and a third party told us that the report had under-recognized the competitive role of NHS-provided PPUs, which represented about 15 per cent of the PMS market. But another PMI provider told us that PPUs did not compete with private hospitals in any meaningful way.

2.52 BUPA also told us that 'one of the inconsistencies in the CC's analysis at the time was that although the market definition included PPUs, they were excluded from the market share analysis'. We note that the CC included PPUs in the calculations of market shares by private acute beds and revenues, but excluded them for the share of private acute hospitals as the PPUs are not located in private acute hospitals. This seems to us to be the correct approach. In the calculation of market shares by revenue, which the report states is the preferred measure of market shares, PPUs are included in the calculations.[11]

Under-recognition of the impact of NHS reforms

2.53 The report identified the potential for the NHS Plan to increase public sector demand for PMS (paragraph 4.19).[12] However, the Plan was seen to relate to a five-year period, requiring considerable time to be implemented—while not explicitly stated, this time period was presumably seen to be extending beyond the period of analysis for the merger.

2.54 It is clear the report does not demonstrate an expectation of the full extent of the substantial changes that the PMS market would experience as a result of the NHS reforms. What is less clear is how much of this impact was predictable at the time of the report.

2.55 BUPA told us that there was no way at the time to reasonably anticipate the evolution of the PMS market into its subsequent structure.[13] GHG disagreed, and told us that the main mistake of the report was viewing the PMS sector as merely a niche market within the overall health care market, when the blurring of these distinctions had already begun at the time of the report. PPP told us that this blurring of boundaries should not be overstated, as the DTCs and ISTCs still tended to compete with the private sector principally for the easier and more routine procedures.

2.56 Virtually all of the published press commentary on the development and impact of NHS trusts dates after the publication of the report. Yet Capio made its decision to purchase CHG only four months after the report was published, with a clear statement that it planned to use the CHG hospitals to gain Department of Health

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[11]PPUs were excluded from the analysis of discharge data but this does not appear to have had an impact on the CC's conclusions.
[12]In particular, the report cited that the Plan allowed for the NHS to make greater use of private hospital facilities and capacity where this 'provides value for money and maintains the standards of patient care'.
[13]They also told the CC this at the time. The report states '…BUPA had no explicit view or proposals on how this [NHS concordat with private providers of healthcare] might work'. (5.90).

contracts. Capio told us that 'the speed of change in the NHS has surprised most operators in the sector. Capio saw the development and this was one reason for its acquisition of CHG, but the pace of the change has been faster than anticipated'.

2.57 In all, the view that emerges is that this was a very rapidly changing situation, and in our view the CC could not have reasonably anticipated the magnitude of the impact the NHS reforms would have at the time the report was being completed. Nor could it have reasonably relied on this possibility of a future increase in competition as grounds for clearing the merger.

Additional adverse effect on smaller PMI providers

2.58 In determining adverse effects of the merger, one of the effects identified by the CC was that, if the merger gave BUPA PMI more power to bargain down the prices it paid to other national PMS providers, these PMS providers would in turn increase the prices they charged to smaller PMI providers to compensate for the fall in revenues from BUPA PMI.

2.59 BUPA argued (2.180 (c)) that 'any lower prices BUPA PMI might secure from PMS providers…would be passed on in lower prices in the PMI market'. The CC rejected this argument. It noted that BUPA PMI had forecast growth in premium revenues over and above growth in subscriptions. BUPA PMI's premiums would have to rise to achieve the growth targets, so BUPA could not be expected to lower its premiums. In the CC's view, increases in BUPA's premiums would in turn facilitate premium increases by other smaller PMI providers.

2.60 We note that:

(a) It is possible that an ability to 'self provide' (BUPA-insured patients using BUPA hospitals) put BUPA in a stronger bargaining position when dealing with other hospital groups. However, BUPA's ability to self provide was limited, and would have continued to be so after the merger (ie the merger would not have given it a hospital network with national coverage). We question whether the increase in BUPA's hospital coverage post-merger would have put it, as an insurer, in a significantly stronger position with regard to other hospital groups. The CC's analysis does not demonstrate that it would.

(b) BUPA's forecast premium increases were not conditional on the merger going ahead, so the effects of these increases on customers, and on the pricing incentives of smaller suppliers, should not have been seen as effects of the merger.

(c) If the merger had increased BUPA's bargaining power in PMI, and hence lowered the marginal cost of insuring, this would have given it an incentive—other things being equal, and notwithstanding BUPA's targets for premium growth—to sell more insurance contracts (ie to reduce its premium).

(d) If a hospital group were already achieving profit-maximizing prices from smaller insurers (having regard to the respective bargaining power of the hospital group and the insurer, and the price elasticity of the insurer's customers), it is not clear that a reduction in the price which the hospital group achieved from BUPA PMI would change its optimum price with regard to these smaller insurers, which would be determined by the marginal cost of providing PMS to the smaller insurer's customers. In other words, if hospital groups could have charged more to smaller insurers, they would have done so even without the merger.

2.61 In conclusion, this appears to be a valid criticism from BUPA, although in our interpretation the CC's overall decision would have been the same even if it had had a different position on this point.

In retrospect would the merger of BUPA and CHG have acted against the public interest?

2.62 In the years after 2000, the UK health care market changed dramatically with central procurement of NHS contracts. This makes it impossible to predict how the markets might have evolved if the acquisition had proceeded.

2.63 Capio told us that if the merger had been permitted, BUPA would have become the largest private hospital group, and that potentially the market would have polarized between BUPA and GHG. One possible argument is that leaving CHG available for Capio to acquire enabled market entry. However, Capio told us that the UK market was a key market in achieving its aim to be the largest pan-European provider of health care services. Therefore, it would have found an alternative way to enter the market.

2.64 Capio told us that the CC's decision to block the merger had 'very little' effect on subsequent changes to the level of competition in the market, which had come about through changes in government policy towards the NHS.

2.65 We considered whether the NHS reforms might have dampened some of the adverse effects of the merger, had it been allowed to go ahead. We note that the DTCs and ISTCs initially competed with the acute private hospitals over a narrow subset of health care products, and tended to specialize in the more standard procedures. Even within the overlapping procedures, NHS trusts do not always offer the full range of differentiated health care products sought by PMIs (private rooms, choice of consultant, etc). As such, even with substantial entry by DTCs and ISTCs, the merged firm could still have been able to exercise market power in those product areas which do not overlap with those provided by the NHS trusts.

2.66 The report predicted that market entry would not occur, whereas in fact there has been substantial entry. How this would have been affected by the merger is unclear. However, it seems unlikely that BUPA's increased share of PMS would have given it the power to deter entry. If the merger had given BUPA more market power, and thus an incentive to raise prices in the short term, any such price increase might have stimulated market entry. However, such considerations are speculative, and it seems safest to assume that the merger would not have had a large impact on the rate of market entry.

Conclusion

2.67 The CC's thinking about the relevence of vertical links between PMS and PMI, and the effect of the merger on BUPA's market power as a PMI provider, could have been spelled out in more detail. It is possible that a clearer analysis would have reduced the CC's concerns about these issues. However, the CC's view that BUPA's increased market power in PMS provision would reduce competition appears to have been soundly based. The CC could not have relied on changes in NHS policy leading to the increase in competition which appears to have transpired.

3. LloydsTSB Group and Abbey National plc: a report on the proposed merger, 10 July 2001

Summary

3.1 In 2001 the CC recommended the prohibition of the proposed merger between LloydsTSB and Abbey National, largely due to concerns about the effect on competition in the PCA market. The CC was concerned that the big four clearing banks would continue to dominate the market, and that any increase in their share would exacerbate this effect due in part to tacit coordination.

3.2 In our view the Group's expectations of developments in the market were generally realized. The arguments that led the Group to its adverse findings and recommended remedy appear to have been appropriate and robust to developments in the market.

3.3 In the event, Abbey National did not emerge as the major competitor to the big four banks; that role was filled by HBoS. However, it was not obvious in advance which of the ex-building societies would fill this role, or whether there would be more than one. It is arguable that if the merger had gone ahead then HBoS may not have competed as actively with the big four.

Facts of the case

3.4 In November 2000 Abbey National started talks with Bank of Scotland (BoS) about a possible merger. In early 2001 LloydsTSB made a hostile bid for Abbey National. Talks with BoS were broken off (BoS subsequently merged with Halifax). The CC considered Abbey National to be a viable independent competitor (its activities had been reasonably profitable).

3.5 LloydsTSB and Abbey National overlapped in the provision of financial products for personal customers (personal current accounts, mortgages, savings accounts); banking for SMEs; banking for large firms; and wholesale banking. The last two of these were not investigated as these were believed to be competitive markets, and no third parties raised concerns about the merger.

3.6 The report concentrated on PCAs because mortgages and savings accounts were seen as much more open to competition. There was an adverse finding with regard to small- and medium-sized enterprises (SME) banking; Abbey National was involved in this market to a very limited extent (its products only covered sole traders and partnerships of up to two) and the primary concern was about the potential for Abbey National to develop into a serious competitor. Further, the SME banking market was subject to a simultaneous market inquiry. It would be impossible to distinguish the effects of the merger prohibition from the wider market impacts of the market inquiry. In view of the above, we concentrate on the provision of PCAs. These were seen as a gateway to selling other financial products such as loans, mortgages, and savings accounts.

3.7 The PCA market in the UK consisted of the four large established branch-based banks (Barclays, Natwest, LloydsTSB and HSBC), a number of ex-building societies that had entered the PCA market and had a considerable branch network (including Abbey National, but also Halifax, Nationwide and Alliance and Leicester), some Internet and telephone-based banks without branches, and a fourth class of minor banks.

The CC's decision and reasons

3.8 The CC considered that the merger would have an adverse effect on the public interest, largely on the basis of concern about the potential for coordinated effects. The CC considered divestment of subsidiaries (Cheltenham and Gloucester or Cahoot), divestment of branches, controls on products and prices, and requirements to give customers information about how LloydsTSB's products compared with others in the market. However, none of these were considered appropriate or adequate, and the CC recommended blocking the merger.

3.9 The following impediments to competition were identified:

(a) entrenched power of the big four;

(b) switching PCAs was seen as difficult and unrewarding by customers (because of fears regarding credit status, relationship with PCA provider, and inconvenience);

(c) as a result, market entrants had grown only slowly despite aggressive marketing to win customers; and

(d) customers relied on having a branch network, and banks wishing to enter or expand through telephone or Internet banking, to date, had limited success.

3.10 For these reasons any well-established rival to the big four was seen as important. The CC considered Abbey National to be a viable independent competitor (its activities had been reasonably profitable). The report argued that Abbey National and Halifax particularly had the capability and staying power to win a share in the PCA market. They had been innovative, and might have merged in the future to become stronger. Efforts to get people to switch PCAs relied on there being a choice of providers, especially national branch-based providers. The Group concluded that if LloydsTSB acquired Abbey National it would reduce incentives to innovate or seek new customers. It also would remove one of the main two sources of actual and potential competition to the big four.

3.11 The CC saw some signs of development in PCA competition—the entry of the new Internet banks and the provision of PCAs (with much more attractive pricing) by the old building societies. However, these were not sufficient to meet its concerns over the merger.

3.12 The CC concluded that PCAs were vulnerable to tacit collusion on pricing, for the following reasons:

(a) the large banks held a very substantial market share, and there was very little customer switching between suppliers;

(b) PCAs were largely homogenous products, and prices (interest rates and charges) were transparent. For PCAs, customers had no buyer power and so there was no discounting;

(c) demand was stable over time;

(d) the big four banks had broadly similar sizes and costs; and

(e) past behaviour had shown little innovation or deviation from standard pricing and terms among the big four.

In the CC's view, the scope for coordination would tend to exacerbate any adverse effects on competition arising from the loss of a significant bank.

3.13 The Group also found that Abbey National was a major emerging competitor in SME banking. The merger would therefore increase prices and cut innovation.

3.14 Lastly, the Group concluded that any efficiency gains would not be passed through to customers.

3.15 Divestment of branches, or businesses (eg Cheltenham and Gloucester), or the control of products and prices were all seen as unsatisfactory remedies.

What happened next?

Market shares

3.16 Table 1 shows market shares as reported by the CC for 2000, and some subsequent analysts' reports. The different sources and methods mean that small changes cannot be detected. But it is clear that the big four continued to dominate the market in the years following the CC inquiry. LloydsTSB lost some market share: Mintel notes that LloydsTSB closed 800 branches between 1995 and 2002, largely as a consequence of branch duplication following the merger of LloydsTSB with Trustees Savings Bank in 1995. As the table below illustrates, market share appears to be closely correlated with the number of branches.

3.17 While Halifax Bank of Scotland (HBoS) increased its market share, it appears that the other ex-building societies, new Internet banks, and other minor players did not gain significant market share.

TABLE 1 **Estimated PCA market shares and branch numbers**

	Market share %				*Branch numbers*
	CC 2000	*Mintel 2000*	*Mintel 2003*	*Datamonitor 2003*	*2002*
Barclays	18.2	17	18	16.3	2080 (including 395 Woolwich)
HSBC	13.8	11	14	14.8	1615
LloydsTSB	22.0	24	19	20.8	2263 (including 207 C&G)
RBS/Nat West	18.1	18	18	19.7	2258
Total (big four)	72.1	70	69	71.6	
Halifax and BoS	7.0	8	11	10.3	1150
NAB	3.7	5	3	(see others)	
Alliance and Leicester	3.4	3	3	2.9	310
Abbey National	5.1	5	6	5.0	766
Nationwide	2.9	3	3	4.1	?
Others	5.8	5	5	6.1	
Total	100	99	100	100	

Source: CC report table 4.1, Mintel, Datamonitor.

Innovation and competition

3.18 Providers offer many features on current accounts as standard, without an initial charge, which is not the case in many European countries. The facilities offered on current accounts are generally seen as essential and universal; there is some bundling of other features in packaged accounts (eg insurance, roadside assistance). However, in the main there is little competition in terms of innovation of product features. The move to Internet and telephone banking demonstrates innovation in delivery, but as discussed elsewhere, most customers value the branch network. So despite the cost advantages of these channels for providers, only a small proportion of customers make use of them.

3.19 Current accounts have traditionally been considered a 'free service', at least in terms of withdrawing cash, writing cheques and automated transactions, but other services have always incurred charges. Following the inquiry, some price competition materi-alized in the form of lower rates for authorized/unauthorized overdrafts and interest rates on credit balances. The 'big four' typically only paid 0.1 per cent on balances.

3.20 Other providers, particularly the Internet banks, offered more generous interest rates. In 2001, Smile offered 4.25 per cent, IF 4.65 per cent, and Cahoot 4.9 to 6.0 per cent. The ex-building societies varied on their standard current accounts: Abbey National offered 0.1 per cent, Alliance and Leicester 0.25 per cent, Nationwide 1.0 per cent, and Halifax 4.0 per cent (if £1,000 a month credited to the account).

3.21 All the big four standard accounts continued to pay 0.1 per cent. Abbey offered an option of 0.1 per cent credit interest but a low overdraft rate, or 2.53 per cent with a higher overdraft rate (both requiring £1,000 a month), Alliance and Leicester 2.12 to 3.75 per cent depending on monthly amount credited, Halifax between 0.5 to 3.04 per cent depending on amount credited and whether there was a cashback facility, and Nationwide 3 per cent.

3.22 A report by Datamonitor noted that HBoS, largely through its Halifax brand, had been at the forefront of price-led competition, and that it aimed to target the switcher market aggressively through a combination of strong marketing and a highly competitive current account package. HBoS claimed to have won 25 per cent of account switchers in both 2002 and 2003.

3.23 Thus more of the second tier used price to attract new customers. The big four appear to have relied on their existing customer base, or their extensive branch networks and brands to attract and retain customers. However, there is some evidence that the big four are moving on interest rates in order to compete for new customers. This follows changes in the banking code which make it easier to switch accounts. Which? also told us that the big four were segmenting the market and offering better rates to switchers. New LloydsTSB customers could obtain a 3.55 per cent interest rate on their Classic Plus current account given certain eligibility criteria (the account must be accessed online six times every three months, and a minimum monthly deposit of £2,000 was required), while customers with an original Classic account still received only 0.1 per cent on their balance.

3.24 All the big four banks now offer fee-based packaged accounts. These bundle better overdraft rates and credit rates with travel insurance, purchase protection, discounts on other financial products. The aim is to increase loyalty and maximize cross-selling opportunities, although monthly fees appear to form substantial income streams in their own right. Such accounts form around 10 per cent of PCAs according to Mintel research. The mix of fees with better interest rates makes price comparisons difficult,

although Which? argued that these accounts provided poor value for most customers.

3.25 Figure 1 shows average interest rates for credit balances and authorized overdrafts across all PCAs on the market, ignoring fees and minimum payment requirements. Table 2 shows this data and other fees and rates. This suggests that the market became more price competitive following the CC inquiry. The average credit interest rate rose from 0.5 per cent in 1999 to 1.64 per cent in 2003, while the average authorized overdraft rate fell from 14.5 to 9.4 per cent over the same time scale. However, these results are not weighted by customer numbers, and thus reflect the better rates available on packaged accounts and from the smaller and Internet suppliers. The great majority of PCA holders remained with the big four on accounts paying 0.1 per cent credit interest.

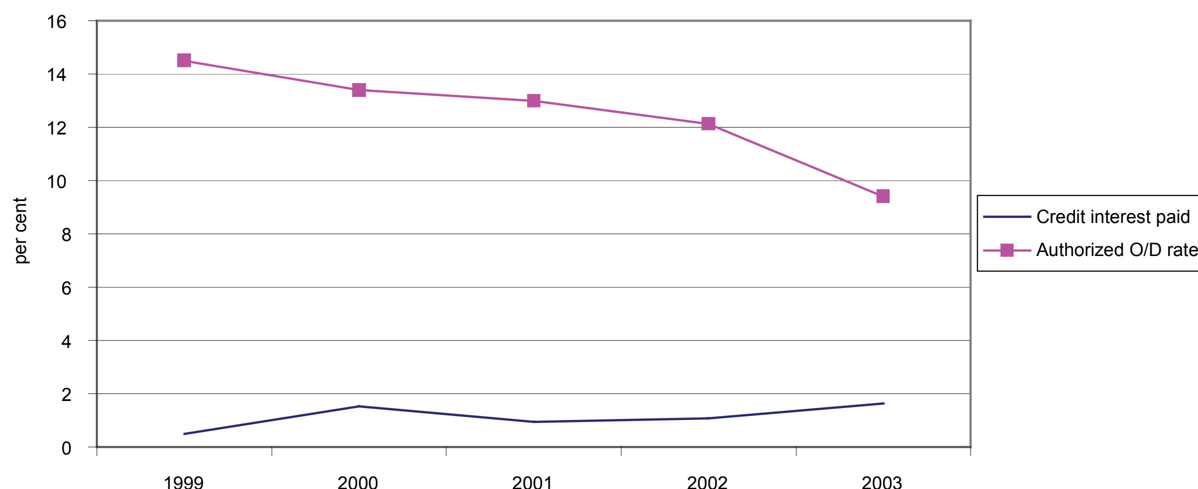
TABLE 2 **Unweighted average of interest rates and fees for all PCAs**

%	*1999*	*2000*	*2001*	*2002*	*2003*
Credit interest paid	0.5	1.5	1.0	1.1	1.6
Authorized O/D rate	14.5	13.4	13.0	12.1	9.4
Unauthorized O/D rate	29.5	28.3	27.1	26.2	26.2
Annual O/D usage fee	£1.34	£2.15	£0.70	£0.72	£0.32

Source: Datamonitor, Moneyfacts.

FIGURE 1

Unweighted average interest rates for deposits and authorized overdrafts for all PCAs



Source: Datamonitor, Moneyfacts.

3.26 Some commentators expected that the number of switchers, and hence competition, would increase. Mintel found that 13 per cent of survey respondents said they might change provider in the next couple of years, and obtaining a better interest rate was cited as the main reason. This could be seen as a low figure, especially if survey respondents are over-reporting their propensity to switch. On the whole, Datamonitor anticipated that switching rates would remain low despite improved arrangements to facilitate account mobility. Convenience and personal recommendations appeared to be more important in customers' choice of bank than interest rates (which could reflect a lack of difference in rates), and the decision to switch in the first place was

more likely to be driven by dissatisfaction with service standards at the old bank than by the attractions of alternative offers.

3.27 Which? conducted a consumer survey in 2007: of those surveyed, 61 per cent used one of the big four banks. Which? noted that the big four offered only 0.1 per cent on credit balances for most of their current accounts.

Entry and expansion

3.28 No major entry to the UK PCA market occurred subsequent to the report. Access to a branch network appeared to be the main entry barrier. Mintel's consumer research (August 2003) asked customers why they chose their main bank: 41 per cent said it was because of the location of the branch, whereas only 9 per cent mentioned interest rates and 6 per cent special offers and inducements. Datamonitor research showed that the majority of consumers preferred to make their transactions in a bank branch: 60 per cent of current account customers either always or usually made transactions in a branch, while another 30 per cent made occasional use of a branch.

3.29 Datamonitor (page 45) noted a:

> clear and undeniable link between the number of high street branches and the number of current account customers a bank has. Geographical location and branch presence have traditionally been significant factors in the decision consumers make in choosing a bank. Having a large number of well-located branches has therefore been a crucial factor in building a large customer base, with the current account the traditional 'gateway' product through which banks can look to cross sell other financial services.

3.30 Mintel stated that there had been a re-evaluation by banks following the branch closures at the end of the last decade and the start of this (where around 3,000 branches were closed). The move to new technology-based delivery channels had not been well received by many consumers, and as a result the wholesale branch closure programmes across the industry had been put on hold and providers had again emphasized the advantage of a strong branch network (pages 17 to 18).

Switching

3.31 Rates of PCA switching remained low. Which? told us this was a particular problem, even though the actual experience of switching was much easier and quicker than was usually anticipated. The Banking Code from March 2003 required banks to waive charges caused by errors or delays in switching, and to transfer customer details within three days; it says that the whole process should take no longer than five weeks.

3.32 Nonetheless, Mintel found that consumers still perceived switching accounts as a threat to their credit status and not worth the inconvenience. Mintel found only 9 per cent of PCA customers had changed provider in the previous three years, and other sources suggested the number might be lower still. Data from MORI Financial Services shows that switchers might account for only 1 per cent of the total number of current accounts in the market.

3.33 In addition, the five-year trend showed no significant increase in the proportion switching. As Mintel noted, this was an interesting finding, given the time and effort that several banks invested in the acquisition of these customers. Many banks and

building societies had targeted churn business by setting up dedicated business units and creating transfer packs that smoothed the process. This competition for potential switchers had led to better interest rates being offered, but the large banks tried to offer these rates to potential switchers only.

Development of LloydsTSB and Abbey

3.34 As noted above, LloydsTSB appeared to have lost significant market share in PCAs, although this may have been partly explained by its closures of overlapping Lloyds and TSB branches, which had since stopped. Mintel reported that LloydsTSB was looking to redress this situation by aggressively targeting new customers.

3.35 Abbey National had a difficult period in 2002 and 2003. First-half pre-tax losses were £144 million for the first six months of 2003 (compared with profits of £412 million in 2002). It announced a £30 million rebranding exercise (to 'Abbey') and a shake-up of the business seeing 700 of its branches refurbished and a reduction of the organization's product line-up. Abbey warned that revenues from personal financial services could fall a little further as the company continued to dispose a further £20 billion in non-core assets. Abbey was acquired by Grupo Santander in 2004.

Evaluation of report

Were our expectations correct?

3.36 Largely, the Group's expectations were realized. The big four remain in a dominant position in PCAs. There have been some inroads from the ex-building societies and the new Internet banks, but this effect has been very small. Which? believed that the market was, and continues to be, characterized by tacit coordination, although it acknowledge that there are signs of more active competition emerging for switchers.

3.37 Rather than Abbey, HBoS has emerged as the fastest-growing and most innovative and active competitor. This would seem to be for reasons that were not predictable.

Coordinated effects

3.38 The treatment of coordinated effects (tacit collusion) in this case pre-dated the CC guidelines and does not accord with the method of analysis which is now recommended, but rather merely notes market features and conduct consistent with coordination. Nor does the report answer the question as to whether there were pre-existing coordinated effects.

3.39 Subsequent to the report the CC published its guidelines, including conditions which facilitate coordination. We now consider how the conditions would have applied to this case:

(a) *Deviations from the coordinated outcome are observable to competitors:* The guidelines note that this primarily requires the market to be sufficiently concentrated. We note that concentration in the PCA market was relatively high. In addition, terms and conditions on PCAs were freely available and there was virtually no negotiation on these terms.

(b) *Deviations from the coordinated outcome can be punished by competitors.* Suppose that one of the big four deviated by raising interest rates on its current account. Given customer inertia, it would win only a small proportion of customers from other big four banks. As such, the other three would have limited

incentive to respond by also raising interest rates. On the other hand, if the rate increase could be targeted at (the small group of) potential switchers, the cost of such an increase would also be small. In practice, the big four responded to the marketing of competitive offers (mostly from smaller firms) by offering targeted interest rate increases.

(c) *Relatively weak competitive constraints from other firms in the market*. A substantial competitive fringe exists including smaller high-street banks, telephone/Internet banks, and building societies. While these providers lack the advantage of a branch network, they are likely to provide some constraint to the big four. In particular, one could argue that the more rate-sensitive customers, ie those most likely to leave the big four, are also more likely to be willing to do without an extensive branch network.

3.40 An explicit application of the guidelines may (hypothetically) have led the CC to conclude that the conditions for coordination were met. However two questions arise:

(a) given the degree of customer inertia, could one argue that the danger of switching (within the big four) was so low that the big four did not really need to coordinate to prevent it?; and

(b) was there any benefit to the big four in coordinating their offers to the small proportion of potential switchers who did exist, given that a large number of other providers were in the market and making competitive offers to this group?

3.41 Direct evidence of tacit coordination can be hard to find. The prices and products offered by firms in a coordinated market will tend to be similar, but so will those in a competitive market. High profits, along with parallel movements in prices and product offers, could tend to indicate coordination (although high profits might be the result of other market features). The CC did not carry out detailed profitability analysis of the four major banks, and such an analysis may have been difficult given the multi-product nature of banks. The CC did not make a definite pronouncement on whether coordinated effects had existed prior to the proposed merger.

Conclusion

3.42 Which? endorsed the conclusions of the report, that a merger would have reduced the incentives on LloydsTSB, and the rest of the big four, to respond to any competitive threat arising in the market. As long as Abbey remained a significant force with a substantial branch network it was a threat. If the merger had gone ahead, and if HBoS was seen as the only serious competitor outside the big four, LloydsTSB and others would have had more incentive to seek to retain and cross-sell to their existing customers than to compete aggressively. Which? also supported the view that the market was vulnerable to tacit collusion, and suggested that absent the merger, HBoS might have been more content to emulate the actions of the big four and not risk provoking retaliatory action.

3.43 In our view, this case is an example of how the CC's guidelines can help to clarify the economic analysis of a case. The report could have benefited from having a separate assessment of unilateral effects (ie that, other things being equal, firms will tend to charge higher prices in a more concentrated market than in a less concentrated market). It may have concluded that, because the increase in market share that the merger would have caused would have been small, the unilateral effect would also have been small.

3.44 As mentioned, consideration of the tacit coordination argument in the light of the CC guidelines (which set out conditions for coordination) raises some questions. In particular, the competitive fringe could arguably be more important in preventing coordination than the CC believed. More generally, one could argue that, with sufficiently high barriers to switching (even if these barriers are only a customer perception), an individual firm's behaviour and pricing can approach that of a monopolist, and both the unilateral and potential coordinated effects of increased concentration will have limited effects on its incentives.

3.45 Finally, we are not aware of any criticism of the conduct of the case, although Which? noted the limited scope of a merger inquiry, and argued that a market inquiry was warranted (which would not be a decision for the CC), because the real issues were about competition in the market generally.

4. AES and British Energy: a report on references made under section 12 of the Electricity Act 1989, 31 January 2001[14]

Summary

4.1 This chapter reviews the CC's approach in its inquiry into the Director General of Electricity Supply's[15] proposal in 1999 to include a Market Abuse Licence Condition in the licences of seven electricity generators believed to have substantial market power. Two generators refused to accept the condition and were referred to the CC by the DGES. The CC rejected the application for those two generators, and the DGES withdrew the licence condition for all relevant generators.

4.2 Because the CC rejected the application, there is no direct evidence on which to base a review of the decision. However, we can observe developments in the market in the absence of a MALC, and consider whether or how they would have been different had the CC accepted the licence condition. We can also consider evidence from other jurisdictions, both on direct experience of instruments similar to a MALC and also for more indirect evidence on whether the particular physical characteristics of the electricity industry make such instruments necessary.

Facts of the case

4.3 The England and Wales[16] electricity market was privatized and began trading under a system of uniform price auctions—the Pool—in March 1990. Under the Pool, the transmission company—National Grid Company (NGC)—forecasted demand and accepted bids from generators according to a least cost schedule. Broadly speaking, the system price was determined by the most expensive accepted supply bid. In addition, generators received a 'capacity payment' for available generating units. While all electricity was required to be traded through the Pool, in practice most of it was hedged with contracts fixing a price for a year or longer.

4.4 The nature of the Pool made it susceptible to market abuse even by small generators. Generators could profitably withdraw capacity close to real time by manipulating Pool rules. In any case, the structure of the industry was highly concentrated, with the bulk of generating capacity in the hands of just two companies (National Power and PowerGen). Pool prices began to increase in 1991. The Pool faced several regulatory and Government interventions, including an informal price cap applying to 1994/95 and 1995/96, along with agreements by National Power and PowerGen to divest plant (which they did in 1996 and in 1998). Partly in response to high Pool prices, a number of new entrants to the UK generation sector[17] constructed new plant, almost all of them Combined Cycle Gas Turbines (CCGT). The newly elected Labour Government imposed a moratorium on new CCGT licences in 1997, and began a wider review of the electricity wholesale market in 1998.

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[14]http://www.competition-commission.org.uk/rep_pub/reports/2001/453elec.htm#full.

[15]Although the DGES was at the time the relevant legal entity (now GEMA—the gas and electricity market authority), in the remainder of this chapter this energy regulator will normally be referred to as Ofgem—the Office of Gas and Electricity Markets (which supported the DGES and now supports GEMA), although we use DGES when discussing references to the DGES in the CC report.

[16]At the time of the CC report, England and Wales was subject to separate regulatory arrangements (and had a very different market structure) to Scotland. Since 2005, the markets have been unified through the BETTA programme (Northern Ireland remains separate, and subject to different arrangements). In this chapter, the market described is invariably England and Wales prior to 2005 and Great Britain subsequently.

[17]Including overseas power companies, and subsidiaries of regional electricity companies which had been privatized without transmission-connected generation assets.

4.5 The 1998 market review led to the creation of the New Electricity Trading Arrangements which went live on March 27 2001. Under NETA, participants are free to contract for electricity sales in a variety of different ways, instead of making all sales through a centralized Pool. NGC balances any residual requirements through bilateral balancing services contracts and through the 'Balancing Mechanism' where any generator or supplier whose actual metered production or demand differs from its notified final contractual position is charged an imbalance price reflecting the costs NG incurs in balancing energy on the transmission system. Generators short of power are required to buy electricity at the system buy price and those with a surplus get paid the system sell price; the system buy price is generally much higher than the system sell price.

4.6 In addition to these regulatory changes, the industry experienced significant structural change throughout the 1990s. Partly as a result of divestments by National Power and PowerGen, and partly because of new build (almost exclusively of gas-fired CCGT plant) by new entrants, the industry was significantly less concentrated by 2000 than it had been at privatization.

4.7 In response to a further pool price investigation in 1999, Ofgem decided it was necessary to introduce a licence modification, termed the Market Abuse Licence Condition, on seven generators who met the criterion of at least a 5 per cent share both of output and price-setting in the Pool.[18] This condition would oblige the generators not to engage in abuse of market power. Ofgem could, in extremis, revoke the licence of a generator in breach. Under the Utilities Act, which was due to come into effect shortly after the CC's inquiry, Ofgem could also impose financial penalties for breaches of licence conditions (similar to the financial penalties they could already impose under the Gas Act for licencees such as gas shippers).

4.8 The MALC defined substantial market power as 'the ability to bring about, independently of any changes in market demand or cost conditions, a substantial change in wholesale electricity prices'. Abuse was not directly defined in the MALC, but accompanying guidelines provided examples, including acting to prejudice the efficient and economical balancing of the transmission system, withholding capacity or generation without good cause and setting prices that differ unduly between times when demand and cost conditions were similar.

4.9 It was not entirely clear how long the MALC would have applied. A provision in the MALC stated that it would cease to apply just over a year after the introduction of NETA, if the DGES had not made a reference to the CC during that year. However, under the Utilities Act, the DGES had the power to recommend licence changes to the Secretary of State for Trade and Industry, and told the CC during the inquiry that, subject to taking account of the CC report, he intended to recommend the inclusion of a MALC in the standard licence conditions of all new generators and suppliers.

4.10 Subsequently, London Electricity grew to meet the criterion through an acquisition. Although five of the seven, plus London Electricity subsequently, accepted the condition, AES[19] and British Energy (BE) refused to accept it and the DGES applied to the CC to modify their licences without their consent.

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[18]It is worth noting that Ofgem did not have concurrent powers under competition law at this time. Subsequently, concurrent powers to apply the 1998 Competition Act have come into effect and in addition *(a)* Ofgem has been designated as a national competition authority for purposes of applying EU competition law and *(b)* the Enterprise Act 2002 empowers Ofgem to make market investigation references to the CC.

[19]AES Corporation, a US company. In fact, separate licences were held by several separate AES subsidiaries in the UK, each responsible for a single power station.

The CC's decision and reasons

4.11 The CC rejected the DGES's application, overturning the MALC for BE and AES. It cited a variety of reasons for this decision.

4.12 Some were very specific to the circumstances of the two companies concerned. A large proportion of AES's output was sold on long-term contract at a fixed price, diminishing AES's incentive to manipulate market prices. British Energy, as a predominantly nuclear generator (with one large coal-fired plant), had relatively inflexible plant compared to its competitors, diminishing its ability to withdraw capacity.

4.13 Other reasons were more generic. On the likelihood of market power arising, the CC noted the decreasing concentration of the sector, a trend that it expected to continue. On the potential for manipulation of market rules, it felt that the introduction of the new trading markets under NETA would provide new circumstances under which existing forms of market manipulation might no longer apply, and that new governance arrangements should enable any new forms of manipulation to be addressed through rule modifications. It therefore saw the MALC as unnecessary. However, in its report the CC went beyond this when discussing market power and concluded that the MALC 'would cause uncertainty, because of the difficulty of distinguishing between abusive and acceptable conduct, and would risk deterring normal competitive behaviour'.

4.14 The CC therefore concluded that the existing licence conditions of AES and British Energy did not operate against the public interest. It did not study the possibility of abuse by generators who were not referred to it in the case as it was not within its remit. Following the CC's decision, the DGES removed the condition from the licences of all affected generators on the grounds of not discriminating between competing generators through its selective application.

Scope of the CC's analysis and decision

4.15 To assess the analysis in the CC's decision, it is important to understand the legal framework within which the CC conducted that analysis. The CC was required to determine whether the unmodified provisions of the licences of the generators named in the reference operate or may be expected to operate against the public interest. This is narrow in two key respects. First, it relates only to the two referred companies. Second, it involves some assessment of risk: 'may be expected to'. We discuss below the manner in which these constrained the CC's decision-making and analysis.

Was the CC limited to considering only the two referred companies?

4.16 As noted above, the CC cited reasons that were specific to the two companies involved in the reference, along with more general reasons, for its decision. It could be argued that the CC report can only be now assessed with respect to the specific, and relatively unusual, circumstances of those two generators. This point was put to us by staff from Ofgem who were involved in the MALC reference, during the course of this review. This raises the question of whether a different decision might have

been reached if a different set of generators, or the whole generation sector, had been referred.[20]

4.17 Clearly, the decision itself is solely concerned with AES and British Energy. In the conclusions section, paragraphs 2.315 to 2.317 and 2.336 specifically state that the CC did not regard the possible effects on the non-referred generators as being within its remit.

4.18 However, although the formal decision was inevitably narrow, it also seems clear that the CC considered much wider issues in its analysis. Throughout the CC report, analysis is carried out and conclusions reached on matters that are not limited to British Energy and AES but relate to the market as a whole. Examples from Section 2 of the report include, *inter alia*:

(a) an assessment of trends in pricing, at paragraphs 2.159 and 2.160;

(b) discussion of market power and the MALC, in paragraphs 2.170 to 2.200, which nowhere mentions AES or British Energy, and subsequent discussion of an event involving Edison and another involving an unnamed generator;

(c) discussion in general terms of 'the likelihood of manipulation and abuse' under NETA at paragraphs 2.237 and 2.238;

(d) the effects of additional uncertainty on generator behaviour and investment, at paragraph 2.259, which does not appear to relate principally to AES and BE;

(e) discussion of 'other factors' at paragraph 2.329, which specifically mentions just the two referred companies but then refers to 'deterring normal competitive behaviour' and states that 'competition should be given the opportunity to work', neither of which would seem to apply if considering just two generators within the market; and

(f) discussion of 'manipulation under NETA', which similarly mentions the two companies but then makes a general statement about the unsuitability of the MALC for dealing with manipulation of market rules.

4.19 In its conclusions, the CC identified AES's long-term contract[21] and BE's inflexible nuclear plant[22] as making it unlikely that either would abuse market power, and that of the two only BE had even a limited incentive to manipulate market rules. These factors alone would seem to be decisive, and do not depend upon all the previous analysis (although much of that analysis is relevant). Given this, the fact that the CC chose to report on wider market matters, implies that it thought those wider market matters important and that it was considering issues beyond the minimum required to deal with the specific questions affecting BE and AES.

4.20 In short, while the decision was concerned solely with the two referred companies, the CC clearly conducted analysis and reached conclusions on broader matters (partly as a pre-condition for analysing the specific conditions of those two companies). It is that analysis that is the principal concern of this review.

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[20]This would now be possible, under the Utilities Act: GEMA could make a collective licence modification that would apply to all generators that would have triggered a reference of the entire sector (or could make a market reference under the Enterprise Act).
[21]Paragraph 2.325.
[22]Paragraph 2.327.

The significance of 'may be expected'

4.21 The test that the CC is required to apply under the Electricity Act—'may be expected to operate'—could be construed as requiring the CC to reject the MALC unless the CC believed that abuse of the sort that it was intended to prevent was more likely than not, absent the MALC.

4.22 Paragraph 2.141 of the CC report sets out the CC's conclusion on this issue. Although it states that 'it is normally our practice to consider whether there is a likelihood (that is a more than 50 per cent probability) of adverse effects occurring', it goes on to note an exception, namely that 'where the adverse effects are so serious that any risk of their occurring is itself against the public interest, it may be appropriate for us to take a different position'.

4.23 The CC seems here to be stating that it did not simply decide the case on the basis of whether abuse (by the two firms) was more likely than not. Rather, the question was whether the *risk* is more likely than not to operate against the public interest. This is perhaps similar to deciding whether the risk of fire makes it more worthwhile than not to buy an insurance policy—which is not the same as to say that the risk of fire is greater than 50 per cent.

4.24 In summary, for this section:

(a) although the CC's *decision* must be interpreted solely as relating to the two referred companies, the analysis as reported in many places in the CC report seems to be more general in scope; and

(b) the CC appears to have decided the case on an assessment of the likely cost of the risk of abuse, not on an assessment of whether abuse was more likely than not.

What happened next?

4.25 Before examining the CC's decision in retrospect, we consider market developments in the UK in general since the investigation.

4.26 The new Electricity Trading Arrangements came into effect on 27 March 2001. There is considerable evidence that the wholesale market has operated in a more competitive fashion in the period since 2000 then it did in the 1990s. In part, this reflects a continuation of a trend that began before the introduction of NETA, but several commentators argue that NETA itself partly explains this.[23]

4.27 Although there has not been any formal competition investigation of the wholesale electricity market, apparent evidence of more competition can be found by examining:

(a) prices;

(b) measures of concentration;

(c) general statements by Ofgem and by industry commentators; and

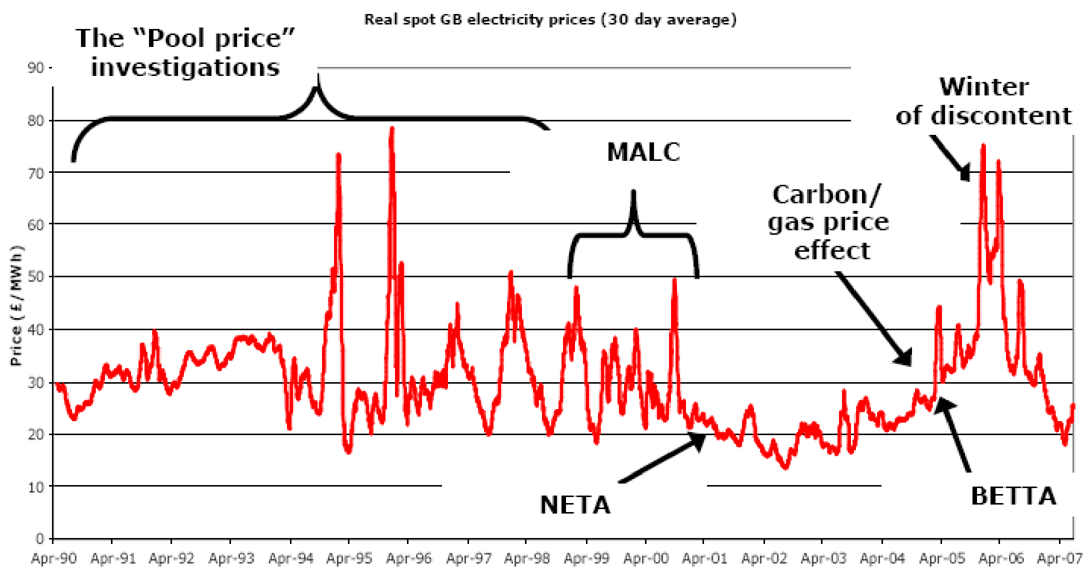
[23] A National Audit Office report assessed the competing explanations and concluded that 'that NETA has, at the very least, facilitated the fall in prices'. See http://www.nao.org.uk/publications/nao_reports/02-03/0203624.pdf.

(d) the fact that no formal complaints have been made to Ofgem under the 1998 Competition Act, relating to the electricity wholesale market.

4.28 *Prices* were much lower than they previously had been, immediately after the introduction of NETA compared with the Pool,[24] and for several years afterwards. More recently, they have risen sharply, but this increase is correlated with significant increases in fuel prices, particularly gas, coal and oil and the introduction of a carbon price through the European Union Emissions Trading Scheme (EU ETS). It therefore seems likely that wholesale price-cost margins (once the carbon price is removed[25]) are lower than they were at the time of the CC inquiry, indicating a more competitive market. A number of factors seem to have been responsible for this fall in prices, with commentators divided as to the weight to be attached to market structure, on the one hand, and the new trading arrangements on the other.[26]

FIGURE 2

Electricity wholesale prices (England and Wales to 2005, then GB)



Source: Presentation by Stephen Smith, Ofgem (2007).[27]

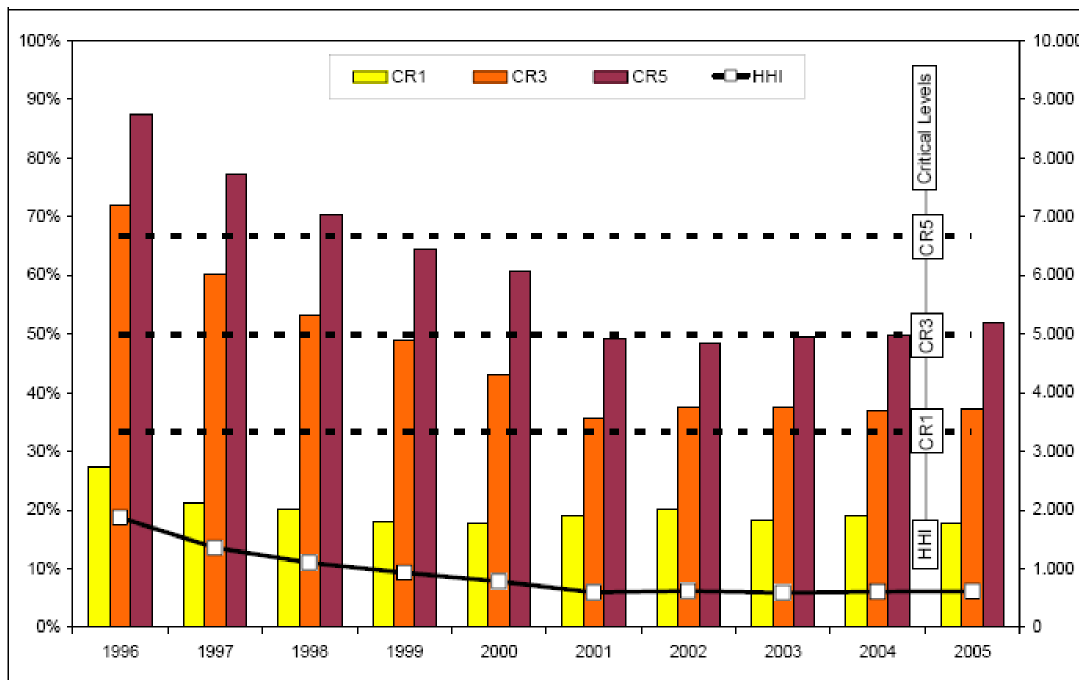
4.29 *Measures of concentration* also indicate that the electricity wholesale market is likely to have been significantly more competitive since 2000 than it was in the 1990s. Although such broad-based measures are very imperfect measures of the potential for market power in electricity generation (for the reasons explored in detail during the CC's investigation), there is nonetheless clearly a more fragmented industry structure than—for example—the post-privatization tri-opoly. It should be noted, however, that most of this structural change seems to have happened before the

[24]Comparisons are not entirely straightforward. See, for example, *Why did British electricity prices fall after 1998?*, Green and Evans (2005), available at ftp://ftp.bham.ac.uk/pub/RePEc/pdf/2005netaprices.pdf.
[25]Margins might be higher than before, but there is an opportunity cost for carbon that is priced in but does not reflect cash costs for most generators, who received permits for free.
[26]See, for example, the report of participants' views at an Ofgem/LBS seminar assessing the impact of NETA in 2003, at http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Archive/3702-sem_summary.pdf.
[27]Available at http://www.rpieurope.org/2007%20Conference/Stephen%20Smith%2002%2007%2007.pdf.

CC's report, with relatively little change in aggregate measures[28] of concentration since.

FIGURE 3

Measures of market concentration for the UK electricity generation sector



Source: Matthes, Grashof and Gores (2007).

4.30 *Ofgem* itself has stated that it considers the British electricity generation market to be more competitive than it was. More generally, Great Britain is considered to have a highly competitive wholesale electricity market by international standards (admittedly, many foreign comparators exhibit little or no competition whatsoever). For example, the EU sector inquiry into gas and electricity markets[29] refers several times to Great Britain as one of the more competitive electricity markets.

4.31 It therefore seems reasonable to conclude that the electricity wholesale market in England and Wales has been significantly more competitive since 2000 than it was in the previous decade. This is not to suggest that the market is perfectly competitive, or that there are no remaining (or new) problems. But it does imply that it is not to be expected that the alleged abuses that characterized the market in the 1990s will necessarily have continued. MALC was intended to operate when generators had the ability and incentive to exercise market power. It seems likely that opportunities for doing so have been scarcer since 2000 than they were before it.

4.32 This has two implications for this review of the CC's investigation. First, it provides some support for the CC's conclusion that MALC was not necessary to protect the public interest. To some extent, the CC's decision can be characterized as relying on an argument that Ofgem should wait and see whether continuing structural change and the changes associated with NETA led to a more competitive market in which

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[28]There has been a lot of M&A activity resulting in changes of ownership, but nothing like the significant divestments by major players that occurred in the 1990s.
[29]http://ec.europa.eu/comm/competition/sectors/energy/inquiry/full_report_part2.pdf.

MALC was not necessary. Without forming a judgement at this stage as to whether the increased competition has been such as to render MALC unnecessary, these developments do provide some support for that view.

4.33 Second, however, a reasonably competitive generation market renders assessment of the decision more difficult. A clear experimental test of whether a MALC was necessary would have arisen only in a fairly uncompetitive market. If, in such a market, the new trading and governance arrangements, and the operation of 'normal' competition law had worked to prevent abuses of market power, then clearly MALC would have been unnecessary. Equally, of course, if significant abuse had occurred then it would be relatively straightforward to consider whether powers conferred by a MALC could have prevented or ameliorated them. In the absence of such 'stress testing' there is unlikely to be any very direct evidence to allow a firm conclusion to be reached.

4.34 Furthermore, even if this 'stress testing' were possible, it would only provide evidence on whether MALC would have had positive benefits. There is, inevitably, no direct evidence at all on the 'counterfactual' question, of whether a MALC might actively be against the public interest, deterring investment by creating regulatory uncertainty as the CC suggested.

4.35 In the remainder of this paper we therefore consider:

- the limited experience of alleged abuse since 2000, to examine whether it provides indications on how effectively a MALC would have worked;
- a subsequent academic evaluation of one of the cases of alleged abuse considered in the CC inquiry;
- recent precedents in the application of competition law in the energy sector, to re-examine the argument as to whether normal competition law is adequate in this unusual market; and
- the debate, and experience, of the USA in introducing regulatory arrangements that are in some ways similar to MALC.

Experiences of alleged abuse in the electricity wholesale market

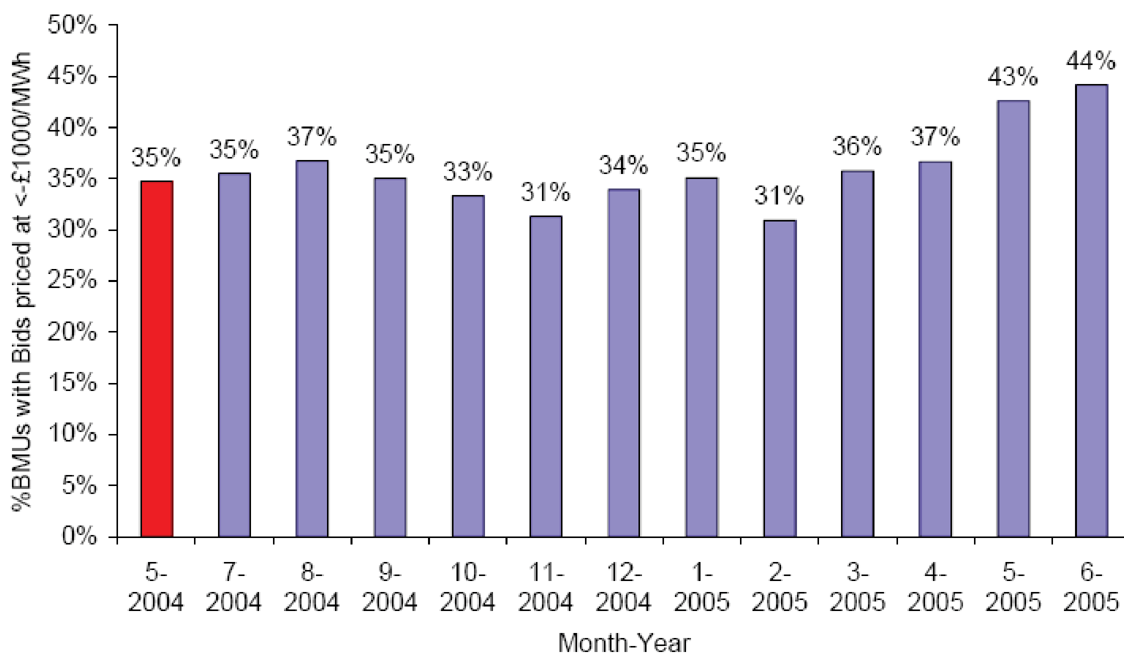
4.36 Since the 2001 MALC case, there were a few instances in which generators may have acted in a manner that might have been investigated or prevented under the MALC. An example can be documented with data, which Ofgem provided to the CC. This example is a result of the practice of so-called sleeper bids, ie bids (and offers) by generators into the Balancing Mechanism, unchanged over long periods of time, to supply electricity (or withdraw generating capacity) at very high prices (or very low negative prices, respectively[30]) that NGC in rare circumstances has to accept. This may result in very high system buy prices in the Balancing Mechanism and therefore in settlement.[31] According to Ofgem, at any point in the Balancing Mechanism, a substantial fraction of bids/offers amount to sleeper bids. Ofgem understands that in some circumstances a very high price bid is a legitimate signal to NGC that plant is only available in extreme conditions. The following figures (due to Ofgem) show the percentage of balance mechanism units (BMUs) and of generation volume priced at

[30]ie high in absolute value.
[31]There are also sleeper bids on the demand side, ie not changing bids to reduce output at very high negative prices.

less than (minus) £1,000 per MWh[32]—well in excess of prices in normal circumstances. These can presumably be regarded as 'sleeper bids'.

FIGURE 4

Percentage of BMUs with bids priced at less than -£1,000/MWh

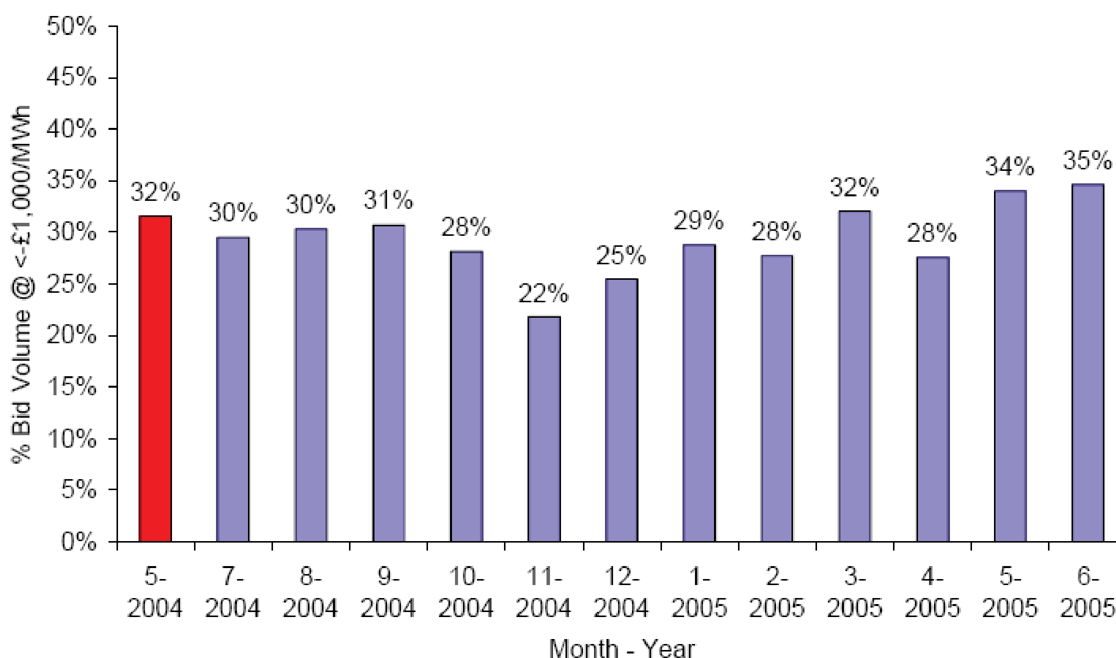


Source: Ofgem (2005).

[32]A BMU represents an association of generating equipment or electricity consumption. For example, a generation BMU may represent a discrete unit of generation plant at a power station, while a consumption BMU may comprise one or more consumption sites.

FIGURE 5

Percentage volume of all bids priced at less than -£1,000/MWh

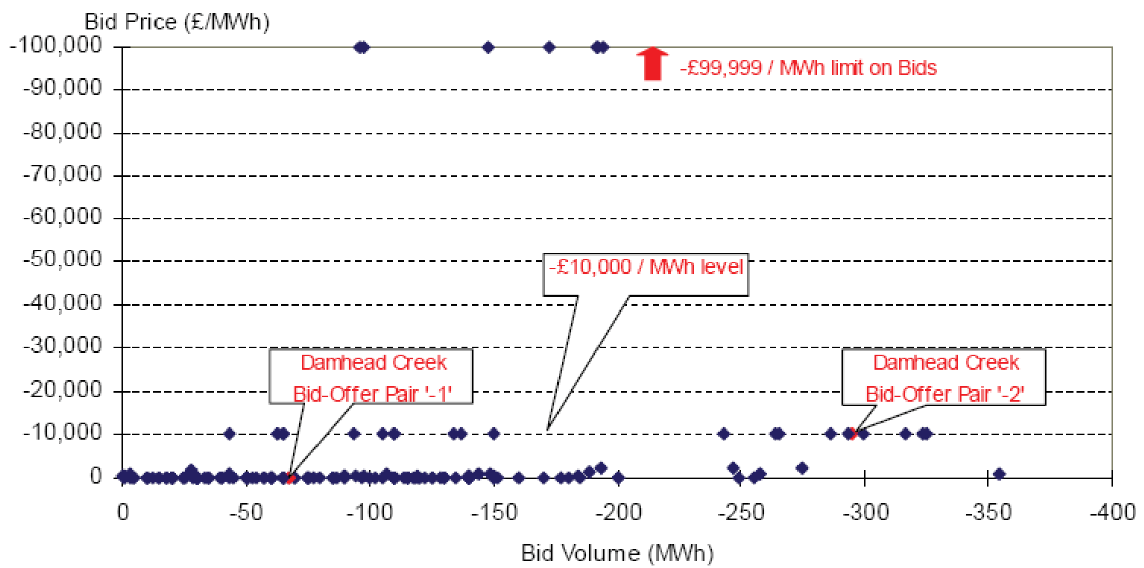


Source: Ofgem (2005).

4.37 The problems that such sleeper bids can cause was illustrated in one instance that involved the Damhead Creek power station, on 19 May 2004, when this power station unexpectedly had to be taken off the network, due to technical reasons. Sleeper offers set the system sell price for two half-hour settlement periods and led to very high costs for electricity suppliers. The system sell prices in these two periods were £-96.68 and £-5870.87 per MWh, which compares with previous sell prices of £14.99 and £14.95 per MWh. A total of 623MWh of energy generation was exposed to this price. This induced Balancing Services Use of System (BSUoS) charges of £22.62 and £73.67 per MWh, compared with £0.44 per MWh in the preceding settlement period. A total of 37,351 MWh of energy generation was exposed to this charge. Ofgem said that this instance may have led to British Gas incurring costs of about £1 million. The following graphs provide further evidence of the practice of sleeper bids.

FIGURE 6

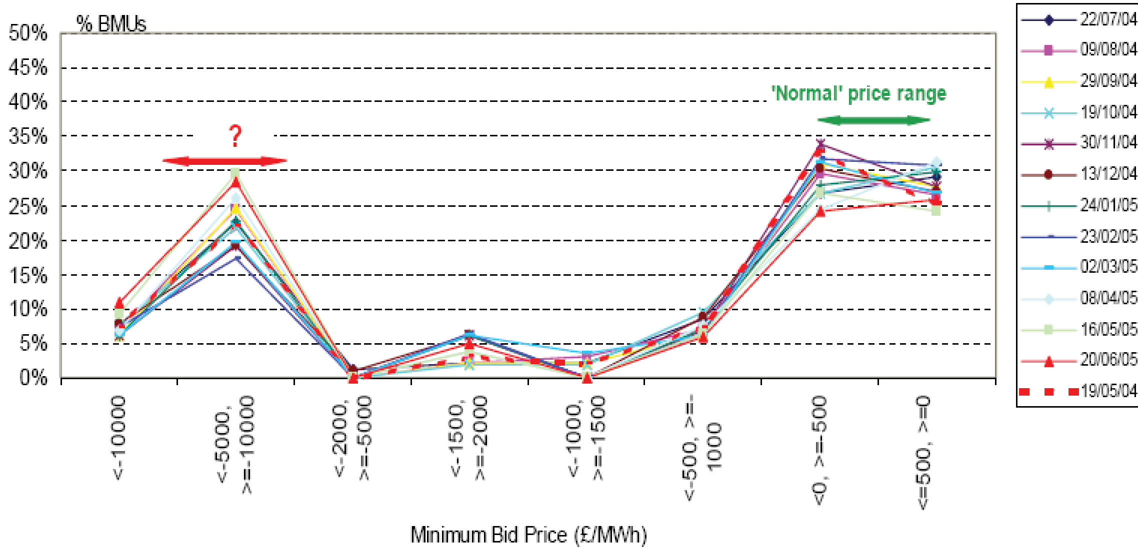
19 May 2004—bid price v bid volume



Source: Ofgem (2005).

FIGURE 7

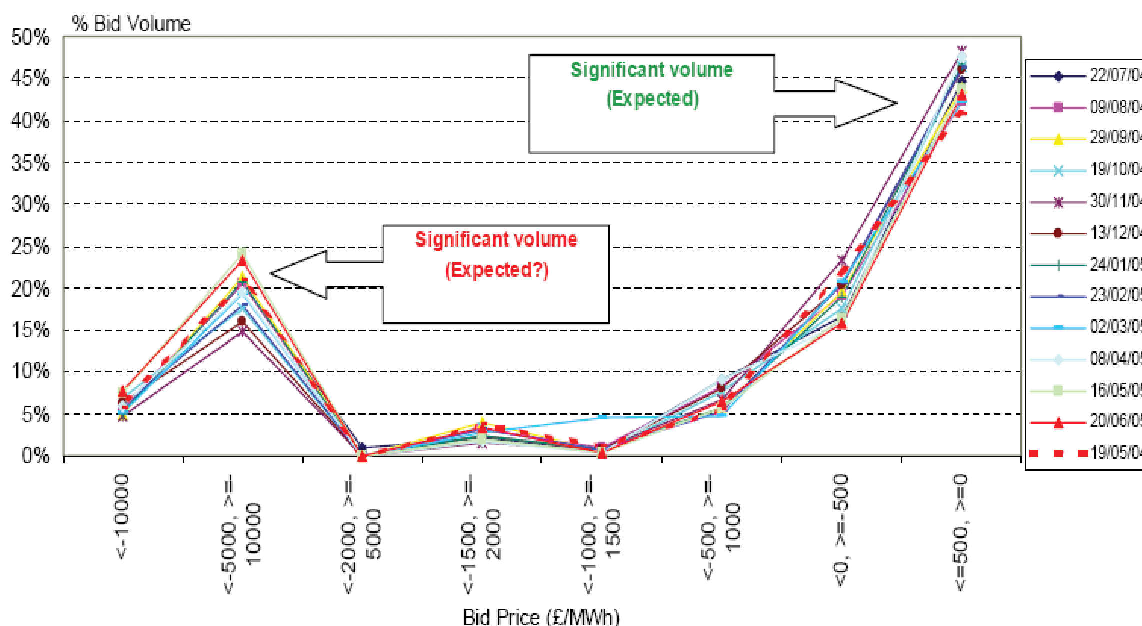
Percentage of BMUs with minimum bid prices



Source: Ofgem (2005).

FIGURE 8

Total bid volume in bid price range



Source: Ofgem (2005).

4.38 In another instance a generator whose sleeper bid NGC had to accept could not deliver the amount offered into the Balancing Mechanism, but nonetheless got paid its high offer price. Under the NETA rules, the system buy price is not set on the basis of the marginal offer,[33] so the generator will have been paid the high price but will have settled its position at a lower price. One could argue that this is a case of 'deficient market rules', but Ofgem's argument was that the rules will never be perfect and it can take significant time to change them.[34] Ofgem has suggested that any delay can harm the competitive process by damaging suppliers (particularly small, new entrant suppliers) and generators who are out of balance, and customers if suppliers are able to pass these costs on to customers. The rules associated with sleeper bids have now been modified.

4.39 Ofgem therefore told us that, both because of deficient market rules, and more fundamentally because of the characteristics of the industry, MALC could have prevented or ameliorated abuse on occasion even in the relatively competitive period in the years immediately following the CC's report. More generally, Ofgem's view is that the case for a MALC remains. Its statutory duty is to protect customers' interests, on the grounds that rules take time to change and international experience (see below) shows that, given the physical characteristics of the electricity supply industry (most notably the inability to store electricity in the short run and inelastic demand and supply), reliance on antitrust remedies that can take some time may not be adequate to prevent harm to competition and adequately protect customers' interests.

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[33]Under NETA, the system buy (sell) price is the volume-weighted average of accepted offers (bids).
[34]There is a provision for urgent rules changes, but even these might take time because of, for example, implementation of IT system changes.

4.40 Apart from these isolated historic instances of problems with the market rules emerging, there may be some concern about potential future problems, arising from potential transmission constraints; for example, between the transmission systems in England and Wales and Scotland.[35]

4.41 Despite the less concentrated market, there may still be incentives to withhold capacity for portfolio generators, the largest of which hold about 20 per cent of capacity. In a 'tight' winter, this clearly confers market power in peak periods, in that the larger generators remain 'pivotal' (able in principle to cause a shortage of electricity through unilateral action). According to NGC, the British plant margin was about 27 per cent in 2007/08.[36] However, this margin will not always all be available. For illustration, NGC suggests considering only 85 per cent of capacity as being available. In this purely illustrative case, the true 'spare' capacity of the system would be only around 8 per cent. Taking this as the threshold for being 'pivotal', four companies would meet the threshold in Great Britain in 2007/08.

4.42 This is a very crude illustration. It could be argued that the true threshold is higher (because in very peak periods more than 85 per cent might be available, because of demand response and because even pivotal generators might not find it profitable to withdraw *all* capacity). On the other hand, some generation is inflexible and there are occasional regional constraints, so even generators with smaller total market shares might be pivotal. But the example serves to illustrate that market power, expressed as the ability profitably to affect the market price, may well persist in British electricity generation.

Subsequent analysis of specific cases considered by the CC

4.43 The CC's report considers an example of the MALC in operation in some detail: Ofgem's 2000 investigation of a possible breach of the MALC by Edison. (CC report, 2.214 ff).

4.44 Edison had closed 500 MW of coal-fired plant at the end of March 2000, arguably because it expected prices to be too low to render generation from this plant profitable. Wholesale prices subsequently rose by more than 10 per cent over 47 days due to higher capacity payments, and Ofgem launched an investigation (15 June). Ofgem argued that this price rise was a result of Edison's substantial market power and that Edison's avoidable costs were lower than its revenue would have been in the absence of the capacity withdrawal. Edison's counter-argument was that the unit's generation was not contracted and therefore driven to zero, but that the unit resumed generation in July once its generation was contracted. The CC emphasized that the critical question in assessing Edison's strategy—and therefore whether a MALC would be effective in this circumstance—was whether or not the price rise could have been anticipated.

4.45 Green (2006)[37] points out that there was a second, less publicized instance, in which TXU withdrew 2GW capacity at the same time as Edison, but returned one quarter of this (ie 500 MW) on 15 June. The relevant paragraphs of the public version of the CC report are subject to excision. Green speculates that TXU may have had discussions with Ofgem similar to the ones Ofgem held with Edison and, in consequence, may

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[35] The British Electricity Trading and Transmission Arrangements (BETTA) integrated the previous England and Wales market with the Scottish market.

[36] This is slightly higher than the 25 per cent at the time of the CC investigation, a figure the CC in its report described as 'high'.

[37] Green, RJ (2006) *Market power mitigation in the UK power market*, Utilities Policy, Vol 14, No 2, pp76–89, http://dx.doi.org/10.1016/j.jup.2005.09.001.

have re-dispatched capacity. This might be interpreted as evidence that a MALC might have been an effective regulatory tool.

4.46 However, these examples seem to illustrate specific manipulation of the capacity payment rules, subsequently abolished by NETA, rather than general abuse of market power. Green concludes that deliberate capacity withdrawal as a device for exercising market power seems to have been very rare in the 1990s. If this technique were only rarely used even in the 1990s, when concentration was high, it seems reasonable to assume that it would be still less of a problem in the less concentrated market from 2000 onwards.

4.47 In contrast to Green, Burns, Huggins and Lydon (2004) do argue that strategic capacity withdrawal would have been profitable for the larger generators for much of the 1990s. They report results from a game-theoretic modelling approach based on optimizing the dispatch of individual generating units for the period 1990 to 2000.

4.48 However, even this more 'hawkish' study notes that:

> These figures also indicate that the scope to mark-up prices collapsed from 1999 onwards, and even a game involving four strategic players was unable to arrest the decline. After this period, the scope for any two players to systematically raise prices was virtually eliminated, and any scope for holding prices above marginal cost relied upon more than two strategic players.

4.49 The authors conclude an account of the MALC investigation by noting:

> Our analysis supports the view taken by the Competition Commission, that MALC was not required at that time. In summary, it seems that for much of the period between 1996 and 2001, both the threat of entry and the threat of regulatory intervention were much more limited than in the earlier 1990s.

The DTI's consultation on licence amendments

4.50 Following the CC's decision, Ofgem advised the Department of Trade and Industry (DTI)[38] that more-focused alternative conditions were necessary. The DTI consulted on introducing two licence modifications, using powers created by the Utilities Act 2000. In its first consultation paper,[39] the DTI stated that 'The first obligation would prohibit prejudicing the economic and efficient balancing and operation of the transmission system.[40] The second would prohibit short run limiting of generation capacity availability without good cause'. A one-year 'sunset clause' would have limited the duration of the amendments. We understand that many electricity industry respondents objected to the amendments in similar terms to those that objectors to the MALC had employed. However, the Energy Intensive Users Group representing large customers supported the amendments (and objected to the sunset clause).

4.51 Green and Trotter, in a review of UK electricity regulation,[41] report that (following a second consultation paper in August of 2001)

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[38]Since 2007, the Department for Business, Enterprise and Regulatory Reform (BERR).
[39]Proposed modifications to licence conditions, DTI Consultation 28 March, 2001
[40]Ofgem noted that this proposed condition mirrors an existing one for gas shippers, that remains in gas shipping licences and has been used as a regulatory tool.
[41]Chapter in CRI regulatory review 2002/03, available at http://www.bath.ac.uk/cri/pubpdf/regulatory_reviews/2002-2003.pdf.

> In December 2001, the government quietly announced that it did not believe that it was "at present … necessary or expedient to use the secretary of state's NETA power in this area". By that time, it was clear that wholesale prices had fallen to very low levels, and the return of market power seemed a remote prospect.

4.52 We have not been able to find any published reasons for the DTI's decision. However, Green and Trotter's implication seems plausible. By the end of 2001, wholesale prices had fallen so far as to be causing several power generators distress. It might have seemed odd to introduce an amendment limiting market power, particularly one with a limited duration, at such a time.

4.53 By implication, the DTI's decision confirms the CC's finding that MALC was unnecessary, at least in the short term. However, the unusual (highly competitive) conditions prevailing at the time also make that decision less relevant as far as the longer term is concerned. Once again, the case for or against a MALC (or similar) in principle can only properly be established in conditions in which market power exists—and such conditions obviously did not apply in late 2001.

The treatment of electricity wholesale markets in competition cases

4.54 A key element in Ofgem's argument for a MALC was that 'normal' competition law may not be well-suited to dealing with abuse of market power in electricity wholesale markets. This argument had two main components. First, there was a concern that it might be difficult to bring a case of abuse under Article 82 (or the UK domestic equivalent Chapter II of the Competition Act 1998) against generators with relatively small market shares, but that such generators might nonetheless possess substantial market power by being 'pivotal', especially at peak times. Second, there was a concern that any action under competition law might simply be too slow, given the large potential for increasing prices and harm to competition and customers in very short timescales.

4.55 As an economic proposition, there would be no difficulty in arguing that a small generator might have substantial market power at peak times. Economists define market power as the ability to mark prices up over competitive levels (or more generally to act to some extent without the constraint provided by competition). Clearly, if (in an extreme case) one generator possessed all the uncommitted capacity, that generator would have the power to raise the price very significantly, even if the volume of generation involved was very small. The question is therefore solely whether *legal* precedent would in some way constrain competition authorities in looking at this question—for example, by requiring a finding of 'dominance' based on market share thresholds in a broadly-defined wholesale markets.

4.56 In general, European and other competition policy has increasingly moved away from rigid adherence to form-based measures of concentration, to 'effects-based' assessment of abuse. In principle, this would remove the concern that a small generator capable of producing a clear 'effect' would somehow fall through the net. In the UK, the OFT's guidelines on assessment of market power[42] state clearly that there are no market share thresholds for assessing dominance. Subsequently, it notes (when considering the role of market shares):

> suppose an undertaking operates in a market where all undertakings have limited capacity (eg are at, or close to, full capacity and so are

[42] http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft415.pdf.

unable to increase output substantially). In this case, the undertaking would be in a stronger position to increase prices above competitive levels than an otherwise identical undertaking with a similar market share operating in a market where its competitors were not close to full capacity.

This would seem to address the 'pivotal generator' problem.

4.57 However, specific precedents establishing that such players might be considered to possess, and abuse, substantial market power is lacking. This might introduce sufficient uncertainty about a judgment that affected parties would at least appeal, potentially slowing down the application of competition law. We have conducted a brief, non-exhaustive review of energy sector decisions by competition authorities since the CC's investigation. There seems to have been little direct precedent either establishing or contradicting the proposition that small generators might possess market power at certain times of day. Mergers, for example, have typically been considered according to broad market shares.[43] However, unless the problem of pivotal players with small overall market shares had been raised as a specific concern, this is perhaps unsurprising.

4.58 There are examples of competition authorities taking the specific characteristics of electricity wholesale markets into account. For example, the merger guidelines of the US Federal Energy Regulatory Commission (FERC) distinguish between peak and off-peak periods for market definition. The European Commission noted in the Vattenfall/Elsam[44] decision that antitrust boundaries can vary according to whether interconnector capacity is congested or not. Several decisions by national competition authorities, most notably the NMa's decision on Nuon/Reliant in the Netherlands,[45] have used the outputs of supply function simulation models to assess market power. Such models should pick up 'pivotal' market players, regardless of their market shares, if they exist.[46] In 2004, the Spanish competition authorities found that four electricity producers had abused their positions in the market on the basis of behaviour over just three days of network congestion.[47] In 2005 a sector investigation by the Italian competition authority[48] used a direct measure of the number of hours within which a given operator was 'pivotal' to help assess market power. However, it also noted that being 'pivotal' in this sense was likely to fall short of 'dominance' as traditionally applied in EU competition cases.

4.59 The 2007 Energy Sector Inquiry conducted by DG COMP also appears to be ambiguous on this question. There is considerable discussion of the market power created by 'large' market shares (understandably, given the market shares of the largest generators in some European markets). However, the report also explicitly describes the 'pivotal generator' problem, at paragraph 408 and subsequently. However, the report does not then consider the implications for the application of competition law.

4.60 In the absence of a clear precedent, some doubt must therefore remain as to whether a market player that could unambiguously be identified through *economic* analysis as abusing market power could in some way escape the application of

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[43]For example, the European Commission's decision relating to Verbund/EnergieAllianz in Austria in 2003 refers to (large) overall generation and retail market shares.
[44]Case NO COMP/M.3867 2005.
[45]http://www.nmanet.nl/nl/images/11_25355.pdf.
[46]But we note that the NMa's decision was overturned on appeal.
[47]Empresas Electricas, Tribunal de Defensa de la Competencia, 552/02, 07/07/2004 cited in van der Woude p340 'The Spanish temporary congestion case' in Jones (ed) (2007) *EU Energy Law* (Second Edition).
[48]Summarized at http://law.bepress.com/wilmer/papers/art16.

competition law. On balance, developments in the sector and in competition law generally would seem to make this somewhat less likely today than it was in 2001.

4.61 Ofgem's concern that competition law would be too slow to prevent many of the consequences of abuse of market power is clearly correct. However, the same could be said of most other markets to which competition law applies. To take two cases that were in the news at the time of writing this chapter, the European Commission's Article 82 investigation of Microsoft's alleged abuse of its dominant position in the operating system market took five years from 1999, with a further three before it was upheld at appeal in 2007. Also in 2007, the OFT published its statement of objections relating to possible price fixing of dairy products in 2002/03.

4.62 Arguably, competition law almost always operates after the fact and might therefore be expected to have beneficial effects principally through deterrence, rather than redress.

Overseas experience

4.63 Finally, in this section we consider developments in the USA.[49] The process of reform of electricity supply in the USA began later than in the UK, and proceeded at a variable pace across the different states (and groupings of states by electrical zone). Unlike the UK, US states typically had to deal with an existing private sector structure that operated largely without competition, rather than beginning from 'scratch' with a system privatized to a deliberate design. The UK experience was typically studied in US reform programmes, with perhaps less of a flow of information in the other direction (ie the UK was seen as being ahead).

4.64 However, around 2000, the US reform process took a turn that the UK has not experienced. One of the most prominent reforming states—California—experienced significant problems manifesting themselves in insufficient supply leading to blackouts and high prices. Problems had emerged in 1998 and 1999 but truly merited the term 'crisis' in summer 2000. These problems were very widely publicized, and (fairly or unfairly) can probably be considered to have tarnished the reputation of liberalized electricity markets in the USA and indeed worldwide.

4.65 The largely unrelated collapse of Enron compounded the problem, as Enron was found to have 'gamed' the Californian market, deliberately withholding supplies from out of state, in order to increase prices.

4.66 Thus, in simple terms, California can be seen as a real-life example of what were perhaps Ofgem's two concerns at the time of the MALC report: the abuse of market power (in a tight market, especially at peak) and the manipulation of specific market rules.

4.67 This is not the place for a detailed examination of what happened in California. There is a huge academic and regulatory literature on the subject and opinion is strongly divided as to the causes of problems (in particular, it is worth noting that environmental and 'NIMBY' concerns around the construction of new generation had

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[49]There have also recently been developments in Germany, where in January 2008 amendments to competition legislation are due to come into effect to strengthen the Bundeskartellamt's (BKA's) ability to act against energy firms. Where the BKA suspects that energy prices might be 'unduly inflated' the BKA can check if a company is abusing its market power through excessive pricing using comparable firms (from the same industry or from other industries) as a benchmark. We understand that the effect of this legislation is to shift the burden of proof to the energy company, to justify charges, once such a finding that prices are 'unduly inflated' has been made. However, we have not examined these amendments in detail, and they have not yet come into effect.

resulted in a very tight margin). Several commentators have identified flaws in market design that a better-designed market could simply have avoided, lessening the need for regulatory intervention. However, it seems likely that even a well-designed market would have experienced some problems of market power and manipulation of market rules, given the overall supply-demand balance.

4.68 Three forms of regulatory response are worth noting.

4.69 First, in December 2001, the FERC adopted new rules for the conditions under which it would approve mergers and grant utilities the right to trade power in the wholesale market. These new rules were based on a market power screen using 'supply market assessments' which measure a company's importance in serving peak loads. Such assessments seem to be aimed specifically to capture the 'pivotal generator' concept discussed above. It is notable that the FERC saw the need for additional regulatory specification of this rule, rather than simply relying on normal procedures of merger control.[50]

4.70 Second, the FERC has adopted new rules under which authorization to set market-based (ie unregulated) tariffs would be conditioned 'to include provisions prohibiting the seller from engaging in anticompetitive behaviour or the exercise of market power'. These terms are remarkably similar to Ofgem's proposed MALC. They provide a regulatory mechanism (withholding approval to set tariffs freely) to enforce broadly defined competition concepts. In a further parallel with the CC decision, the US Federal Trade Commission (FTC), the principal competition policy body in the US, commented unfavourably on the FERC's proposals, arguing that they would prohibit some conduct that would not violate antitrust laws. The FTC stated that 'the cited rules may chill procompetitive behaviour, as defined by the antitrust laws, may distort investment, output and pricing decisions and result in serious adverse consequences for consumers'.[51]

4.71 Third, the US Congress has subsequently passed a law that provides the FERC with powers that are analogous to the market manipulation aspects of the MALC sought by Ofgem in the CC inquiry. The Energy Policy Act 2005 (EPAct) allows the FERC to issue rules to bar market manipulation in wholesale power and gas markets.

4.72 In conclusion, we note that the US regulatory authorities faced a crisis of market failure and abuse that seems to have gone beyond anything experienced in the UK. It could be argued that the specific circumstances of both the supply/demand balance in California and flawed market rules imply that this experience has little relevance to the UK. However, at the very least the case demonstrates that the problems about which Ofgem expressed concern in 1999, before the California crisis, were not fanciful. We also note that the US regulatory authorities responded with regulatory, not competition, powers and subsequently received additional powers couched in language that is very like the MALC. It is too early to assess the operation of the EPAct, which was given effect by a regulatory notice only at the start of 2006. The USA might, in retrospect, be judged to be overreacting but at this time it would be unreasonable to reach that conclusion. Overall, these developments, unanticipated at the time of the CC report, do provide support in principle for Ofgem's argument that circumstances *can* arise to which something like the MALC may be the appropriate response.

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[50]See discussion in, for example, Meritet: *L'emergence de pouvoir de marche dans les marches electriques: le cas de les Etats-Unis", Problemes Economiques, La documentation francaise* no2.852 (2004). Available in English at: http://www.dauphine.fr/cgemp/Publications/CahiersCGEMP/MeritetMarketPower.pdf.

[51]*Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, FERC, Comment of the Federal Trade Commission (2003). See: http://www.ftc.gov/be/v030014.pdf.

Conclusion

4.73 We have reviewed a wide range of evidence relating to market developments in the UK and elsewhere since publication of the CC's 'MALC' report. The CC provided a number of reasons for its decision. The evidence we have reviewed is more relevant to some of these reasons than others.

4.74 It has been suggested that the CC's decision was merely 'technically correct' given the limited scope that the CC was able to consider: namely the application to just two companies (neither of them likely to be 'principal suspects' in a competition investigation), and the CC's test that the current situation 'may be expected to act against the public interest'. The implication is that a review of the MALC under a different legal framework might have reached a different decision. We assessed this question earlier and concluded that, while the decision relates to only two companies, much of the analysis is broader and that the CC's decision was not based solely on a view that abuse was less likely than not. It seems reasonable, therefore, to review the CC report to assess its analysis of the effects of the MALC quite broadly, while noting that the CC was constrained only to act if it considered that the absence of a MALC may have been expected to act against the public interest.

4.75 On that basis, we conclude that the experience of the UK market in the years following the CC inquiry seems broadly to support the view that the MALC was unnecessary for the foreseeable future in 2001. Market concentration continued to fall, making strategic abuse of market power less likely. NETA resulted in significantly reduced scope for manipulation of market rules (and NETA's governance arrangements allowed for more flexible regulatory responses to any manipulation that did occur). Prices collapsed. The DTI decided not to pursue its proposed licence modifications (which were more limited in scope and time than MALC). Academic commentators, whether employing simple judgement or model-based approaches, seem to agree that an important threshold was crossed some time in the late 1990s, beyond which the likelihood of significant market power arising fell away considerably. The introduction of NETA reinforced this trend and Great Britain is generally believed to have had a reasonably competitive generation sector in recent years. There does not seem to be a compelling case that a MALC in operation during 2001 to 2007, would have prevented any significant abuse of market power in electricity generation.

4.76 On balance, therefore, the market developments over the last seven years do not seem to provide support for the case in favour of the MALC *during that time*, and provide some support against it.

4.77 However, we note again that this only provides very limited evidence on whether a MALC would be in the public interest under conditions of greater market power by generators than has been experienced in Great Britain during that time. In such circumstances, it is relevant to ask whether standard competition law is enough. Recent precedents for the application of competition law to the electricity sector do not seem to advance the debate much beyond the discussion in the CC's report.

4.78 On the one hand, there is widespread recognition that market definition and concentration measures in wholesale electricity markets need to take account of the special characteristics of the industry. Many agencies, including most significantly DG COMP of the European Commission, have noted that generators with small overall market shares might nonetheless possess considerable market power in some circumstances. A more general trend in competition policy away from 'bright line' rules-based approaches to effects-based assessment (again, most significantly at the

European Commission) also provides some support to the view that 'ordinary' competition law can apply to this industry.

4.79 On the other hand, there has not been a clear test case of which we are aware. The question of whether a generator with a small overall market share could be found 'dominant' in an Article 82 case remains open. Furthermore, Ofgem's concern that such a case may take so long that the damage would already have been done remains valid (although we would note that the same applies to many other sectors).

4.80 Experience in the USA provides some support for the view that a MALC would be in the public interest in circumstances in which the abuse of market power is a pressing concern. The FERC intervened in California using powers that are considerably more flexible (and faster) than 'normal competition law', although less flexible in many respects than the MALC. There seems to be some consensus among US commentators that the Californian market in particular was performing so poorly that 'heavy handed' intervention was necessary and justified. Given the high prices being experienced by consumers, it could be argued that almost any price (in terms of the overall cost of regulatory intervention) was worth paying to control market abuse.

4.81 There seems to be less consensus on whether subsequent US regulatory developments have been justified by the California crisis (and some lesser problems elsewhere). In particular, the provision of MALC-like powers for the FERC in the EPAct of 2005 is controversial. The debate is very similar to that regarding the MALC in 2001. At this time (2007), there is no evidence either of a dampening effect on investment, nor of any positive benefit from intervention against (or deterrence of) market manipulation. It is possible that further experience of the operation of the EPAct will provide better evidence to review the CC's decision than we have been able to consider here.

4.82 The CC investigation and decision concluded before the problems in California (which have affected attitudes to electricity regulation worldwide) came to light. It is interesting to speculate on whether its decision would have been different if the example of California had been before it. That example does seem to provide strong evidence that in extremis, powers similar to those of a MALC are in the public interest (or at least that competition law is not enough). In effect, California exemplified Ofgem's nightmare scenario, made real.

4.83 In summary, the CC's decision not to support the introduction of the MALC in 2001 seems well-justified by subsequent market developments in Great Britain. Equally, however, Ofgem's view that such powers can be necessary in some circumstances also seems to be supported by subsequent developments overseas.

4.84 We cannot conclude on whether there is a case for a MALC 'today' or as a reserve power for Ofgem to retain 'just in case'. For one thing, it is not clear whether such powers are needed in circumstances that are less extreme than the Californian crisis, but more problematic than the British market over the last seven years. Possibly, operation of the US EPAct will provide clues about this in future.

5. Reed Elsevier plc and Harcourt General, Inc: a report on the proposed merger, July 2001

Summary

5.1 This merger inquiry involved the proposed acquisition of Harcourt General, Inc, by Reed Elsevier plc and took place in 2001. The parties overlapped in the supply of Science, Technology and Medical publications—specifically journals in print and electronic form. At the time of the merger, it was estimated that the parties would have a combined share of supply of 32 per cent of the UK market for STM publications (an increment of 7 per cent).

5.2 The majority of the Group concluded that the merger would not act against the public interest, although concerns about future pricing and the supply of electronic journals were highlighted. One member disagreed, highlighting concerns about future prices and bundling. In reaching its decision, the CC faced a number of challenges including technological change and a market which displayed unusual characteristics.

5.3 Prices have increased since the merger, although there is no evidence to suggest that the merger has increased the rate of price rises. Bundling has also increased since the report, but again it is difficult to attribute this to the merger or to find evidence that bundling is adversely affecting customers.

5.4 Overall, the development of the market provides some support for the CC's decision that the merger did not, in itself, act against the public interest. However, some of the analysis could have been sharper and the CC's wider comments might have been pursued more effectively.

Facts of the case

5.5 RE was (and is) jointly owned by Reed International PLC and Elsevier NV. Its principle activities include publishing a variety of academic, legal business, consumer, accountancy and tax titles. Harcourt was a US holding company for a group of publishers that provided a range of titles and other products and services in the fields of education, training and assessment.

5.6 The proposed transaction involved RE acquiring Harcourt and immediately selling on some of the business to the Thompson Corporation. RE was to retain Harcourt's STM and education publications and elements from its professional services group. Thompson was to acquire the rest of the business.

5.7 The parties overlapped in the supply of STM publications, specifically journals, in print and electronic form, and books, and in the supply of journal publishing services to learned societies. STM publications serve specific fields of academic study including pure and applied sciences (biology, chemistry, physics and engineering), technology (computer sciences), medicine and life sciences, and social sciences (eg economics, geography, historical subjects and politics).

5.8 In the period leading up to the merger, the arrival of PCs and then the Internet transformed the process of STM journal delivery. RE and Harcourt offered subscribers access to their journal titles online. At the time of the merger RE's Internet service, known as ScienceDirect, was generally believed to be the most developed of these services, and Harcourt's International Digital Electronic Access Library (IDEAL) was also one of the best available.

5.9 At the time of merger the CC estimated that RE had control of around 25 per cent by value of the UK STM market—both print and electronic—and Harcourt had around 7 per cent. Both companies, however, believed that these were overestimates (due to the inclusion of titles that they published on behalf of others) and that their effective market share was considerably smaller.

The CC's decision and reasons

5.10 The CC Group comprised three members.[52] Two concluded that while aspects of the proposed merger raised concerns, it would not operate against the public interest. The third, in a minority report, concluded that the merger might be expected to operate against the public interest.

5.11 The CC identified three areas of concern:

(a) arrangements for providing customers with access to electronic versions of STM journals;

(b) arrangements for other access mechanisms to establish links with RE's and Harcourt's electronic platforms; and

(c) the pricing of annual subscriptions to STM journals.

The majority view

5.12 On electronic delivery, it was clear that RE had spent a considerable amount of money in developing ScienceDirect (their Internet delivery platform) and that it had the power to entrench further RE's already powerful position in the STM journal market. More specifically the report noted the following two concerns:

(a) that RE could refuse to link any of the ScienceDirect content to other formats for electronic access to STM material currently in existence or being developed; and

(b) that RE could insist that libraries take the entire ScienceDirect package and not select individual titles or groups of titles within it.

5.13 The Group satisfied itself by assurances given by RE that it was RE's policy to allow publishers' databases and any other STM access formats that were in existence or being developed, to link with ScienceDirect content.

5.14 On dealings with customers, RE submitted that, once their current contracts had come to an end, its policy was to allow customers to subscribe for whatever number of printed journals they wanted and to negotiate whatever level of access to ScienceDirect that they thought appropriate to their needs.

5.15 On pricing, RE acknowledged that during the 1990s, subscriptions to its journals had risen at prices well beyond inflation. It maintained that as a consequence of the continual increase in prices there had been a steady growth in the rate of attrition experienced by a number of its titles to a point where a major re-evaluation of pricing policy had to be made. The result of the review culminated in RE's public announcement that future increases in annual subscription rates would be held below 10 per cent. The CC expected that RE would hold to this announcement.

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[52] Four members had been appointed, but the original chairman fell ill and was replaced from within the Group.

5.16 A final concern was the possibility that RE would seek to raise Harcourt's subscription prices so as to harmonize them with the higher rates charged for its other titles. However, again RE's price pledge provided a certain degree of assurance in this regard,

The minority report

5.17 David Stark, the dissenting member, concluded that the proposed merger could be expected to operate against the public interest. The dissenting view agreed with the underlying analysis of the STM market, but was less persuaded by RE's arguments about the impact of the merger.

5.18 On pricing, Mr Stark believed that, in the medium term, RE would not feel constrained by its 10 per cent pledge and could raise prices by more, if it saw it as being in its financial interests to do so. RE's pricing model for electronic access—with a low incremental cost for extra journals—conveyed greater market power on publishers with a larger corpus, and Mr Stark expected RE to raise prices in the medium term by a greater amount than if it had not been able to acquire Harcourt.

5.19 Mr Stark also believed that RE could insist on libraries taking its entire electronic package and not selecting individual titles or groups of titles within it. It could raise the premium for electronic access and could refuse to link its content to other packages.

Afterword

5.20 The CC report included two final points, for further consideration.

5.21 The first was that the current VAT regime for journals—which accords print versions a zero rating, but subjects contracts to receive journals electronically to a standard rate of 17.5 per cent—threatened to retard further progress in electronic delivery and dissemination of knowledge.

5.22 The second was that the case bought to light a number of features of the market for STM journals that were unusual, which gave rise to wider concerns that had not been resolved and would benefit from further examination. The report recommended that the Director General of Fair Trading should consider whether a wider review was necessary.

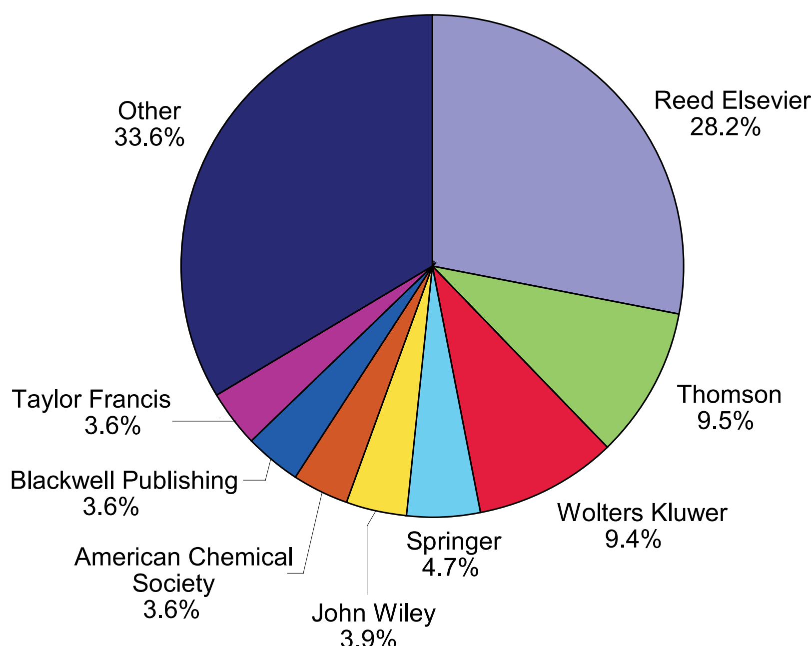
What happened next?

Market shares

5.23 Figure 9 shows the global market shares of STM publishers in 2003. The top three commercial publishers controlled approximately 50 per cent of total industry sales and the next ten added a further 29 per cent of sales. There are also a considerable number of smaller publishers who include learned societies and not-for-profit organizations.

FIGURE 9

Global market shares of STM publishers, 2003



Source: EPS Ltd 2004.

5.24 The main change in market structure since the RE/Harcourt merger was the merger between Springer and Wolters Kluwer, which were both acquired by the two private equity firms Cinven and Candover. The combined Springer/Kluwer produced 1,150 STM journals compared with 1,800 offered by Reed Elsevier.

Technological change

5.25 The market for STM journals has undergone considerable change as a result of technological progress and the advancement of the Internet as a means of the dissemination of research publications.

5.26 The change is most apparent in the number of journals that are now available digitally. At present, most journals are published electronically in addition to the traditional paper version. There is also a trend towards the publication of electronic-only versions. The added search features and ease of accessibility have increased the usage of journals.[53] Printed versions of journals provide relatively little additional value to libraries and their users. However, the advantageous tax treatment of paper journals provides an ongoing incentive for libraries to purchase hard copies (even if they are not used).

5.27 There is a variety of ways in which content may be accessed electronically. Publishers have their own platforms—such as ScienceDirect—through which users may access their journals. RE has developed its own search and retrieve software—SCOPUS—and there are also collaborative industry initiatives, such as Cross-Ref, which enable users to search across journals from multiple publishers. In addition, non-specialist search engines—such as Google—are frequently used by students to locate relevant articles.

[53]One publisher told us that usage of electronic publications had increased by 40 per cent a year.

5.28 The development of electronic publishing has also raised the possibility of new business models. These include 'open access', in which academic institutions make their research findings available to all in data repositories and 'author pays' models, in which authors pay for their article to be peer reviewed and published and no subscription charge is levied. However, the traditional approach, with publication of research being financed by subscription to journals, remains the primary form of research dissemination. Academics and the departments that employ them still place considerable weight on publications and citations in leading journals: hence these remain the source of much of the best new research.

Bundling and the 'big deal'

5.29 Bundling is a common feature of STM publishing and appears to have increased with greater use of electronic distribution. This appears to have been driven by both supply- and demand-side factors. With electronic publishing, the incremental costs of supplying an extra journal to an individual library are low. In addition, libraries continue to face financial constraints and are unlikely to increase overall expenditure to take new journals.

5.30 One of the most common forms of bundling is referred to in the industry as the 'big deal'. This provides for access to all the online titles of a publisher, for a small fee, on top of the expenditure on those journals to which a customer has previously subscribed. As the number of large publishers who offer big deals grows, an increasing share of total library budgets are devoted to funding these agreements.[54] This may ultimately result in a reduced capacity for libraries to purchase titles from smaller publishers. Smaller publishers have responded, to an extent, by also offering this type of bundled deal, individually and collectively.

5.31 Big deals are a controversial issue within the STM market.[55] Although they provide libraries with additional content at a low marginal cost, concerns have been expressed about a reduction in flexibility and—with fixed budgets—the possibility of excluding smaller publishers.

Bargaining and consortia

5.32 Negotiations with publishers have increasingly been conducted by consortia, both in the UK and abroad.

5.33 In 2004, an agreement was reached between UK publishers and the NESLi consortium (National Electronic Site License Initiative). This agreement covers a substantial proportion of the market. For example, in the case of RE of 152 UK Higher Education institutions with research programmes, 114 subscribe to ScienceDirect under the NESLi agreement, 22 subscribe to ScienceDirect, but not under NESLi and 16 subscribe to RE journals but not to ScienceDirect.[56] The NESLi agreement lasts for two years and involves a cap on annual price increases with substantial discounts for 'peripheral' content and large customers. The NESLi agreement appears to have been somewhat unusual, in that NESLi had negotiated its deal before getting all users onside and had then 'sold' the deal to libraries.

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[54]For example, around 45 per cent of Imperial College's budget for library resource material of £3 million went towards the cost of journal subscriptions. Of this, 80 per cent was spent on big deals.
[55]For a discussion, see Chapter 4 of the House of Commons Science and Technology Committee, *Scientific publications: free for all?*, Tenth Report of Session 2003-04.
[56]The CC's interview with RE.

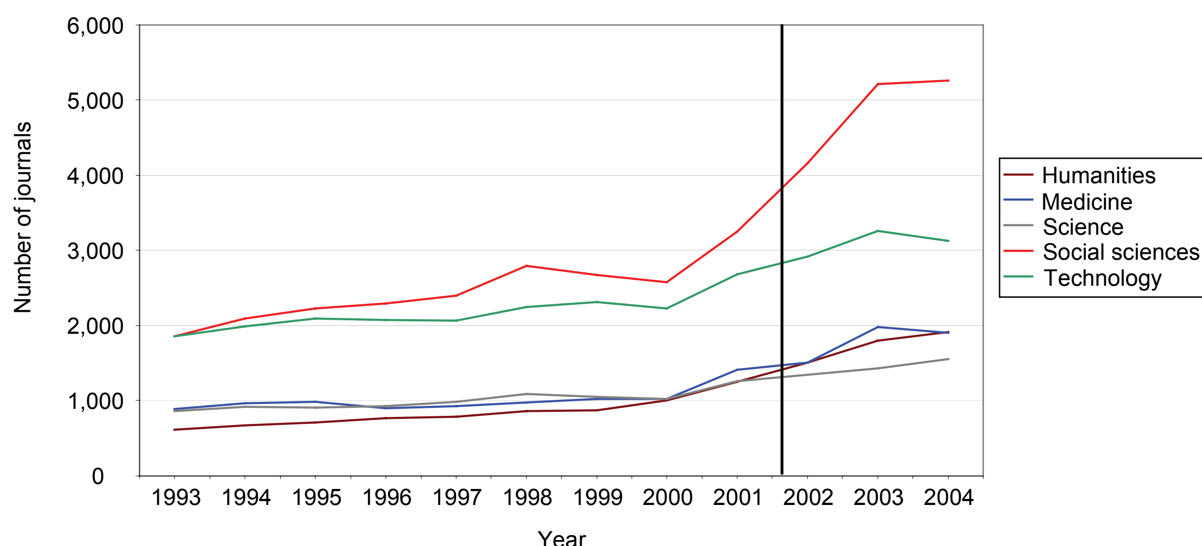
5.34 The nature and extent of the bargaining power of consortia and libraries is unclear. While a consortium may be able to 'deliver' a large number of libraries and a high value of sales to publishers, it may be limited in its ability to walk away from a negotiation with a large publisher. Many journals are considered to be 'must haves' by academics and it may not be a credible threat to refuse to take one of these journals. However, the failure of negotiation with a consortium could be costly to publishers—in terms of the additional time that would be spent negotiating with libraries individually and potentially through reduced sales overall.

Number of journals available

5.35 Figure 10 shows how the total number of periodicals available in the UK has evolved since the merger, which is shown by the vertical line. The number of journals available in every discipline is on a continual upward trend, which does not appear to have been affected by the merger

FIGURE 10

Number of journals available in the UK by discipline



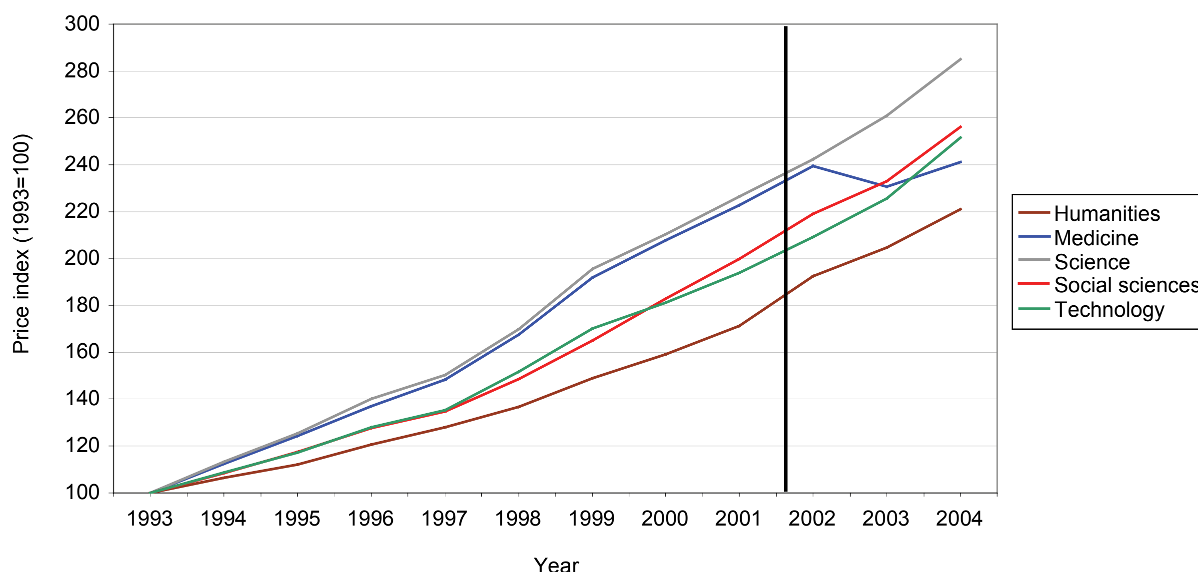
Source: Swets/Blackwells periodical price index 2004.

Prices

5.36 Figure 11 indicates how published prices of periodicals by discipline category available in the UK have evolved since the merger (indicated on the graph by the vertical line).

FIGURE 11

Price evolution of journals available in the UK by discipline



Source: Swets/Blackwells periodical price index 2004.

5.37 Table 3 draws further on this information and shows how average annual price increases pre- and-post merger have changed for each discipline category relative to the inflation rate.

TABLE 3 **Average annual price increases in the UK journal sector**

	Average annual price increase %	
Subject area	*1993–2001*	*2002–2004*
Humanities	7.6	6.9
Medicine	10.2	3.3
Science	10.4	9.2
Social sciences	9.1	7.7
Technology	8.6	9.1
Inflation rate	2.6	2.2

Source: Swets/Blackwells periodical price index 2004.

5.38 In line with the commitment made to the CC, Reed's prices have risen by less than 10 per cent and Harcourt's European price increases have been in line with RE's. In the UK, NESLi secured a deal with RE of a price increase of not more than 5.5 per cent a year. This includes price rises associated with increases in content.

Public policy developments since the case

5.39 In light of the CC's comments, the OFT conducted an informal consultation under section 125(4) of the Fair Trading Act, 1973 on the market for STM journals. The OFT issued a statement in September 2002, concluding that the market might not be working well, but that it remained to be seen whether market forces and new technology would remedy the problems that might exist. The OFT concluded that it would not be appropriate to intervene for now, but that the position would be kept under review.

5.40 The House of Commons Science and Technology Committee published a case into Scientific Publications on 7 July 2004.[57] This noted that academic libraries are struggling to purchase subscriptions to all the journal titles needed by their users, as a result of high and increasing journal prices and the inadequacy of library budgets to meet the demand placed on them. The committee recommended that all UK higher education institutions establish institutional repositories on which their published output can be stored and from which it can be read, free of charge, online.

5.41 The committee also strongly criticized government departments for a continued lack of action on the differential VAT treatment of digital publications, compared with printed copies.

Evaluation of report

5.42 Since the merger, prices have continued to rise, but there is no evidence that the merger has increased the rate of price rises. Figure 11 suggests that published price increases have followed the pre-merger trend. RE has kept to its 'pledge' of keeping price increases below 10 per cent and many UK libraries have experienced increases of considerably less than this, under the NESLi agreement. It is possible that prices would have increased by less, absent the merger, but overall it does not appear that permitting the merger led to a significant increase in prices.

5.43 Bundling has increased since the CC's report—this possibility did not feature heavily in the main report, although concerns were expressed in the minority view. However, it is difficult to attribute this development to the merger or to conclude that it is necessarily having an adverse effect on customers. There is no evidence that RE has attempted to use the ScienceDirect platform to exclude other publishers or that other suppliers have been unable to compete against a larger market leader.

5.44 Overall, the development of the market provides some support for the CC's decision that the merger, in itself, did not act against the public interest.

Quality of analysis

5.45 In analysing the competitive effects of this merger, the CC faced a number of challenges. The merger took place against a backdrop of technological change and the CC had to compare the likely outcome of the merger against a counterfactual which was itself uncertain. The CC also had some difficulties in collecting evidence relating to sales and market shares, due in part to the fragmented nature of the market (both in terms of the 'tail' of smaller providers and the wide range of journals sold).[58]

5.46 In addition, the market for STM journals displays some unusual characteristics, which make it difficult to apply standard antitrust models.[59] Publishers act as an intermediary between authors (who provide their articles for free) and libraries (who pay for subscriptions on behalf of end-users). Individual journals are highly differentiated from one another—for example, *The Lancet* is not remotely substitutable for *Econometrica*. Even where journals cover a similar subject matter,

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[57] House of Commons Science and Technology Committee, *Scientific publications: free for all?*, Tenth Report of Session 2003-04.
[58] There was also a low response rate to the information request to libraries, despite an apparently high level of interest in the merger.
[59] See, for example, the discussion at p10 of House of Commons Science and Technology Committee, *Scientific publications: free for all?*, Tenth Report of Session 2003-04.

end users can regard them as complements rather than substitutes (for example articles in one journal may cross refer to articles in another).

5.47 Stakeholders interviewed as part of this exercise considered that the CC had developed a good understanding of the STM market and how it was evolving. They considered that the CC had explained clearly how the market worked and had taken into account its particular characteristics.

5.48 Nonetheless, there are some areas in which the analysis might have been taken further—or where an analysis under the Enterprise Act, using our current duties and procedures might have produced a clearer decision.

5.49 It is not entirely clear from the report's conclusions how, and on what dimensions, STM publishers actually competed with each other before the merger. This made it difficult, in turn, to evaluate the degree to which the parties acted as a competitive constraint on each other pre-merger and whether they would be constrained by smaller competitors post-merger. The CC could perhaps have developed and tested more explicit theories about what harm the merger could have caused, based on the nature of pre-merger competition and reflecting recent developments in theories of bundling, two-sided markets and network effects. It should be noted that each of these topics is the subject of ongoing academic research.

5.50 As it was, some of the analysis contained in the supporting chapters of the report was not fully reflected in the conclusions. The Group appears to have placed a lot of weight on RE's stated policies (most notably with respect to RE's pledge on prices) and relatively little on economic analysis, such as that conducted by Professor McCabe[60] and submitted to the case. Further, the financial analysis of the parties in Chapter 3 does not appear to have been integrated into the competitive assessment.

5.51 In particular, with regard to RE's price pledge, the report could have been more sceptical as to the extent of competition in a market where price increases were 'capped' at 10 per cent. The parties justified these increases on the grounds that the number of articles in journals was also increasing and therefore the price per article was increasing at a slower rate. However, the marginal cost of increasing the number of articles is likely to be low, and there was little evidence presented that price increases were justified by increases in costs. Having said that, neither was it clear whether (and if so, how) the merger would tend to exacerbate any competition problems in the market.

5.52 It is likely that an Enterprise Act case would have seen a more focused and explicit analysis of the counterfactual.[61] This was an important issue in this case—Harcourt was 'in play' and appears likely to have been acquired by another competitor if RE had not bought it. A clearer analysis of the counterfactual might have helped the Group articulate its view of how the market would have developed absent the merger, although we did not identify any specific problems arising from an absence of such analysis.

5.53 It is also interesting to note that in reaching its conclusion on the public interest, the Group considered customer benefits which RE expected would arise from the merger. These benefits were not analysed in detail, nor were they quantified. As a result, the Group may have placed too much weight on the role of some fairly

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[60] *Academic Journal Pricing and Market Power: A Portfolio Approach*, Mark J McCabe, American Economic Review, March 2002, pp259–269.

[61] The impact on prices had Harcourt been acquired by another publisher is discussed in paragraph 2.110, at an important stage of the decision, but there is little supporting evidence or analysis.

nebulous customer benefits at the expense of analysing competition. Such a process would be unlikely to occur under the Enterprise Act, as the SLC test would have been considered before evaluating customer benefits.

5.54 As this was a merger clearance, the decision itself did not have a direct impact on the market. The CC's comments about the market did result in an OFT report, though the perception among those we contacted was that this report came too soon after the CC's case. We saw no evidence that the CC's comments about VAT were followed up either by the CC or Government, though they may have raised the profile of the issue.

Conclusion

5.55 This was a challenging case for the CC, both in substance and process. The problems identified in the market appear to have gone beyond the merger itself, and it seems unlikely that a sufficiently strong case could have been built for blocking the merger. In view of this, the decision to clear the merger was probably the correct one.

5.56 The clarity of the reasoning behind the Group's decision could perhaps have been improved with a greater regard to some of the relevant economic concepts. In particular, much of the discussion centred on the degree of competition in the market. Given the rate of price increases, the Group perhaps tended to overestimate the degree of competition. A stronger case might have been to accept that competition problems existed and to focus on the question of whether the merger would exacerbate these problems (the Group referred to 'unusual features' of the market in recommending an OFT investigation). Finally, a discussion of the counterfactual may have helped to clarify the analysis.

APPENDIX 1

Current account rates in 2001 and 2005

	As of May							
	2001	*2001*	*2001*	*2001*	*2005*	*2005*	*2005*	*2005*
Account name	*Monthly account fee £*	*Minimum monthly funding requirement £*	*Credit interest on £1 balance %*	*Annual authorized overdraft rate %*	*Monthly account fee £*	*Minimum monthly funding requirement £*	*Credit interest on £1 balance %*	*Annual authorized overdraft rate %*
Abbey National (Abbey)								
Bank Account	0	None	0.1	9.9				
Preferred in-credit					0	1,000	2.53	14.7
Preferred overdraft					0	1,000	0.1	8.7
Alliance & Leicester								
Current Account	0	None	0.25	12.00	0	None	0	17.08
Premier Current Account	0	None	0.25	9.9	0	500	2.12	7.9
Premier Plus Current Account					0	1,000	3.75	7.9
Bank of Ireland								
(London) Freeway Account					0	None	0	14.88
(NI) Clear Account (Level 1)					0	1,500	0	9.11
(NI) Clear Account (Level 2)					0	500	0	13.52
(NI) Clear Account (Level 3)					0	None	0.1	21.34
Bank of Scotland								
Current Account					0	None	0.5	18.9
Current Account					0	1,000	3.04	8.9
Moneyback					0	1,000	0.5	13.9
Barclays								
Additions	6	None	0.10	18.8	9.5	None	0.1	9.9
Additions Plus					12	None	0.1	9.9
Bank Account	0	None	0.10	18.8	0	None	0.1	15.6
Platinum Banking					0	None	0.1	12
Cahoot								
Current Account	0	None	4.90	6.4–8.0	0	None	4.25	10
Citibank								
International Sterling Current Account					0	None	0.5	9.9

Clydesdale Bank								
Current Account Plus					0	None	0.1	8.29
First Direct								
Cheque Account	0	None	0.10	15.9	0	None	0.1	15.9
Bank Account	0	None	1.49	12.9	0	1,000	2	9.9
Bank Account	0	>2,500	2.96	12.9				
First Trust								
Bonus Account					2	None	0.1	varies
Current Account					0	None	0	varies
Packaged Account					8	None	1	13.75
Halifax								
Current Account					0	None	0.5	18.9
Current Account	0	>500	4	10	0	1,000	3.04	8.9
Moneyback					0	1,000	0.5	13.9
HSBC								
Bank Account	0	None	0.10	18.3	0	None	0.1	14.8
IF								
Current Account	0	None	4.65	10.5	0	None	2.75	9.8
LloydsTSB								
Classic Account	0	None	0.10	18.6	0	500	0.1	18.2
Classic Plus					0	1,000	3.75	15.5
Gold Service	8	1,000	0.10	16.5	10	None	0.1	16.2
Gold Service +					10	1,000	3.75	14.8
Platinum	12	None	0.10	13.25	15	None	0.1	11.2
Platinum Plus					15	1,000	3.75	10
Select	4	None	0.10	18.60	5	None	0.1	17.7
Select Plus					5	1,000	3.75	14.8
Nationwide BS								
FlexAccount	0	None	1.00	9.9	0	1,000	3	7.75
Natwest								
Current Plus	0	None	0.10	18.38	0	None	0.1	17.69
Advantage Gold	6	None	0.25	16.06	9	None	0.25	15.98
Advantage Premier	12.5	None	0.50	9.37	12.5	None	0.5	9.92
Northern Bank								
Current Account Plus					0	None	0.1	10.37
Principal Account					0	None	0.1	varies
Northern Rock								
Current Account					0	None	0.1	11.9

Norwich & Peterborough BS								
Gold					0	1–499	0.25	16.9
Gold					0	500	3	8.8
Smile								
Current Account	0	None	4.25	9.9	0	None	3.3	9.9
Smilemore					6	None	3.3	9.9
The Co-operative Bank								
Current Account.	0	None	0	19.56	0	None	0	19.56
Privilege Account					6	None	0	12.9
The Royal Bank of Scotland								
Interest Paying	0	None	0.10	19.5	0	None	0.1	13.9
Royalties	5	None	0.40	13.2	5	None	0.2	13.2
Royalties Gold	9	None	0.70	10.6	10	None	0.5	10.6
Royalties Premier					15	None	0.5	10.1
Ulster Bank								
Current Account					0	None	0	varies
First Current Account					7	None	1	varies
Woolwich								
Current Account	0	None	0.10	11	0	None	0.1	15.6
Open Plan Current Account	0	None	1.50	11	0	None	0.1	15.6
Yorkshire Bank								
Current Account Plus					0	None	0.1	8.29

Source: May 2005, Which? Extra, May 2001, Moneyfacts (reported in CC report Table 4.12).