CMA
Competition & Markets Authority

The Rt Hon Amber Rudd MP
Secretary of State
Department of Energy and Climate Change
3 Whitehall Place
London
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From: Alex Chisholm
Chief Executive - CMA

3 December 2015

Dear Minister,

Energy Bill – Competition Issues

I am writing on behalf of the Competition and Markets Authority (CMA) regarding the Energy Bill ('the Bill') currently before Parliament.

The Enterprise Act 2002[1] now includes provision for the CMA, at its discretion, to 'make recommendations to ministers on the impact of proposals for legislation on competition within any UK market(s) for goods and services'. The attached paper contains the CMA's recommendations in relation to the provisions of the Energy Bill relating to the oil and gas industry.

The CMA understands the Government's objectives in using the Energy Bill to establish the Oil and Gas Authority (OGA) and to seek to maximise economic recovery of oil and gas from the UK Continental Shelf. As you may know, the CMA has been working with your Department's officials on the implementation of the recommendations of the Wood Review. We have advised on the boundaries competition law places on collaboration among industry participants and on the continued potential for competition as well as collaboration in achieving your objectives. Most recently we have worked with the OGA on a successful event in Aberdeen designed to raise awareness of competition law in the industry and prevent ill-founded fears of competition law enforcement deterring industry participants from playing their part in beneficial collaboration in the interests of maximising economic recovery.

[1] Section 7, as amended by the Small Business, Enterprise and Employment Act 2015.

The provisions in the Bill give rise to some risks to competition and to the effective functioning of markets. We have raised these in discussions with your officials and with the OGA, and have appreciated the constructive approach they have taken to our interventions. Nevertheless, as some of these risks are inherent in the proposals, we consider it appropriate to draw attention to them by making the attached recommendations. Our recommendations are primarily concerned with ensuring that in discharging its responsibilities the OGA takes due account of risks to competition and of the impact of its actions on competition in markets. We trust that you and your Department will want to consider the recommendations carefully and, where necessary, to act.

In order to meet the requirements of the Enterprise Act, these recommendations will be published on the CMA's website.

The CMA has worked with your Department and the OGA to identify competition issues and clarify the boundaries of competition law for the OGA and for the industry. However, as the authority with responsibility for enforcement of competition law, it is not for the CMA to provide detailed advice to the Government or the OGA on whether particular actions they might take or encourage others to take are compliant with competition law. The UK competition regime is founded on the principle of self –assessment. Accordingly, it is for those concerned to take their own legal advice on these issues, as they have to date. Having identified the risks, drawn them to attention of your officials and now made these recommendations, the CMA considers it unlikely that it will need to remain involved with the further development of the OGA. Nevertheless, the CMA stands ready to advise on competition issues as they arise in this and other areas of your Department's work.

Alex Chisholm
Chief Executive

Energy Bill – Recommendations to Government

1. The Competition and Markets Authority (CMA) is the UK's primary competition and consumer protection authority. Its mission is to make markets work well for consumers, business and the economy. The CMA has a power to make and publish written recommendations to ministers on the impact of proposals for Westminster legislation on competition within any UK market(s) for goods or services.[2] Such recommendations must be published by the CMA.

2. The CMA recognises and endorses the Government's decision to establish the Oil and Gas Authority (OGA) as an independent regulator. Regulators' independence of Government can promote regulatory certainty and therefore investor confidence. Nevertheless, it is still for the Government to ensure, in its establishment and oversight of the OGA, that competition between the firms it regulates is not harmed. Effective competition can be expected to stimulate increased efficiency as well as encourage entry and innovation, and can therefore contribute to the Government's objective of maximising economic recovery of oil and gas from the UK Continental Shelf.

3. Neither the Infrastructure Act 2015 that established the OGA, nor the Energy Bill (the Bill), gives the OGA a statutory duty to have regard to competition or the effects of its actions on competition in markets. But the actions of regulators can have far reaching effects on the markets they regulate and oversee. So even if it is not obliged by law to do so, the OGA should be empowered and motivated to ensure that the impact of its actions on competition in markets is carefully considered. Where possible that impact should be positive. But where there is a risk of harm to competition, that harm needs to be outweighed by the public policy benefits the OGA is seeking to secure, and no greater than is necessary to achieve those benefits.

4. In summary, the CMA considers it important that the OGA:
   - acts at all times in accordance with competition law (as it is bound to do);
   - does not act in ways that might, even inadvertently, encourage or facilitate breaches of competition law by others (and therefore does not put itself at risk of being found to breach the UK's EU law obligations, in particular the duty of sincere co-operation under Article 4(3) of the Treaty on European union)
   - promotes and supports competition in industries it regulates; and
   - where possible, uses pro-competitive mechanisms to advance its aims.

[2] The existing powers of the CMA under section 7 of the Enterprise Act 2002 have been revised by section 37 of the Small Business, Enterprise and Employment Act 2015.

Information exchange and agreements between firms

5. The Energy Bill sets out a range of provisions which will potentially create circumstances in which the OGA could facilitate anti-competitive exchange of information among undertakings active in the sectors it regulates. The CMA recognises that it is not the Government's intention to encourage this. Nevertheless, the combination of a number of the powers and obligations of the OGA gives rise to the risk that circumstances conducive to undesirable exchange of sensitive information among them could arise. Relevant powers and obligations include:
   - the OGA's obligation (which derives originally from the recommendations of the Wood review) to have regard "for the need to work collaboratively with the Government of the United Kingdom and persons who carry on, or wish to carry on, relevant activities";
   - the OGA's power to attend relevant meetings discussing relevant issues (i.e. issues that are relevant to the fulfilment of the principal objective or relate to activities carried out under an offshore licence) granted by Clause 31 of the Bill; and
   - the OGA's range of information gathering powers.

6. The CMA would normally view the combination of encouragement to collaborate, facilitation of industry meetings and gathering of information from competitors with some concern. There is a risk that opportunities to share information become more frequent and the temptation to do so stronger than would normally be the case among competitors. In this instance, however, it is clear that it is not the Government's intention to encourage or allow anticompetitive information sharing. The Bill contains provisions designed to ensure that the OGA treats commercially sensitive information with great care. The OGA is neither obliged nor empowered to share sensitive information nor able to disclose it save in defined circumstances.

7. Nevertheless it is important to bear in mind that, should competitively sensitive information or insight about competitors' actions be shared among competitors, competition may be dampened and suppliers may be encouraged to breach competition law. For example, exchange of future pricing intentions or capacity utilisation information may give firms insight into the competitive constraints faced by their rivals and give an indication of their plans, reducing competitive uncertainty. Table 1 provides an overview of the types of information that would be more or less concerning, from a competition perspective, if it were to be shared between competitors (via the OGA or otherwise).

Table 1: Risks of collusion presented by information sharing

Higher risk from information being shared	Lower risk from information being shared
Specific information	Aggregated information
Individualised information	Anonymised information
Non-public information	Genuinely public information
Future information/plans	Historic information
Information will need to be disclosed frequently	Disclosure of information is a one off
Information is sent directly by competitor	Information is sent by an independent source
Quantitative information	Qualitative information

8. The OGA will itself be bound by competition law and so will not have the power deliberately to facilitate anti-competitive information exchange. Rather, the risk is that circumstances conducive to anti-competitive information sharing by others may arise in the course of its work. It is therefore advisable for OGA officials to have regard to this risk when working with industry parties. The Government should consider the best way to ensure this takes place. Where the powers or the intentions of the OGA are to be clarified through secondary legislation or the issuing of guidance, these risks should be borne in mind as these provisions are developed.

9. The same set of provisions in the Bill, particularly the OGA's obligation to have regard "for the need to work collaboratively with the Government of the United Kingdom and persons who carry on, or wish to carry on, relevant activities", could also give rise to the risk that anti-competitive agreements which breach competition law develop. The OGA has no powers to act contrary to competition law, but it should guard against the risk that agreements that have as their object or effect the prevention, restriction or distortion of competition arise out of, or alongside, the collaboration the OGA seeks to encourage. Such agreements are likely to harm competition and consumers. The fact that an agreement is sanctioned by the OGA does not necessarily prevent it from falling foul of national or European competition law. Whilst it is ultimately the responsibility of the parties to any agreement to assure themselves that such agreements are compliant with competition law, it is also advisable for the OGA to limit the extent to which it might appear to encourage parties to enter into agreements that may be anti-competitive.

10. Not all agreements that incentivise suppliers to coordinate their behaviour will harm competition or result in suppliers breaching competition law.

Agreements between competitors on technical and operational matters which have no material commercial implications and agreements that give rise to significant efficiencies are unlikely to raise concerns under competition law. From what the CMA understands of its intentions, the OGA's work with industry players to encourage improvements in efficiency of recovery could be expected to fall into this category.

11. It is therefore also important to guard against the risk that unwarranted caution about the potential application of competition law to beneficial collaboration chills legitimate activity. The CMA has, together with the OGA, taken steps to clarify for the industry how the law applies in this area.

12. Agreements overseen by the OGA may raise novel competition issues. The CMA has the power to issue short form opinions in cases where clarity is required on the application of competition law in specific circumstances. The circumstances in which the CMA will consider issuing a short form opinion are described in the CMA's published guidance.[3]

Recommendation 1: The Government should consider how to ensure that the OGA does not inadvertently facilitate the exchange of sensitive information or the formation of anti-competitive agreements between competitor firms or among industry parties.

13. Agreements between regulated firms may still distort competition even if they do not breach competition law. For example, agreements that limit distribution channels or organisational form or set industry standards may or may not breach the law, but even if they do not, could restrict competition to the detriment of consumers. We think it is advisable therefore for the OGA to assess, on a case by case basis, whether the benefits both of the agreements it designs (and of any agreements among industry participants that it becomes aware of) outweigh the potential harm from any restrictions on competition they create and that a fair share of them should accrue to customers. Relevant benefits of collaborative agreements could include improvements in the speed or efficiency of production and distribution.

Recommendation 2: Even when agreements do not create legal risk, the benefits arising from agreements should outweigh any restrictions on competition. The Government should consider how to ensure that the OGA conducts such an assessment of agreements of which it becomes aware wherever necessary.

[3] Available on the CMA website at Guidance on the CMA's approach to short form opinions

The OGAs powers and activities

14. The actions of regulators, including how they exercise their powers and fulfil their statutory duties, can make a difference to the prospects for competition in the industries they regulate. At worst, ill-judged regulation can deter entry and stifle innovation. At best, regulation can harness competitive forces that exist in the market to the benefit of consumers. The OGA is in a good position to use pro-competitive regulation to achieve its aims and to exploit the appetite for competition within the oil and gas sector.

15. When considering how to exercise its powers, the OGA will need to consider:
    - whether technical standards or other regulatory rules that are applied favour particular players in the market to the detriment of others who would find it more difficult to attain such standards;
    - whether any proposed levies and fees may in combination significantly raise costs for certain market players, raising barriers to entry; and
    - whether licencing award processes (which have the potential to create barriers to entry and give advantages to incumbent firms) are optimal given the particular circumstances of the industry, but drawing on experience and insights from other regulated industries

16. License award processes have to be suited to the circumstances of the industry, the relevant legal framework, and the priorities of the Government in awarding licences. Nevertheless, UK and overseas regulators have developed and used a range of license award processes, many of them based around auctions, designed to capture the benefits of competition for licenses and ensure they are granted to those best equipped to create value from them. More generally, t is advisable for the OGA to consider whether its licencing conditions and processes support competition.

17. Several of the OGA's objectives and obligations may be seen as encouraging it to pursue pro-competitive approaches, notably:
    - the principal objective of maximising economic recovery, which is arguably best served by encouraging competition in markets;
    - the need to have regard to stable and predictable regulation that encourages investment; and
    - the need to have regard to innovation.

18. OGA officials should consider the potential that exists across the full range of its activities for encouraging competition and the Government should consider the best way to ensure, without compromising the independence of the regulator, that they do so.

Recommendation 3: The Government should ensure that the ways in which the OGA exercises its powers, including for example its licencing conditions and processes, have a pro-competitive impact in relevant markets.

19. In pursuit of its primary objective to maximise economic recovery, the OGA will have opportunities to use market or competitive mechanisms to encourage firms to act in ways consistent with that aim. Using competitive forces to create incentives that might not be present under normal market conditions can be a better way to achieve public policy objectives than regulatory rules, or could be a useful complement to them.

20. The OGA could act in this way by:
    - assessing the potential effects on competition of all its activities (the CMA's newly revised *Competition Impact Assessment Guidance*[4] provides advice on how to do so);
    - encouraging the companies it regulates to comply with competition law, to foster a culture of compliance within their organisations, and to report any evidence of anticompetitive activity they become aware of to the CMA;
    - engaging in activity that sets a tone for the industry and encourages the view that the competitive spirits which thrive in many industry players are a benign force (alongside the collaboration it is also obliged to foster). The awards and competitions already initiated by the OGA are good examples of this; and
    - using competition-friendly language in its public documents and pronouncements.

Recommendation 4: The Government should ensure that the OGA considers whether and how market incentives and mechanisms can be used in pursuit of its objective to maximise economic recovery.

21. It is for the Government to consider whether to accept the recommendations made to it by the CMA and if so how to give effect to them. The CMA has not recommended any changes to the Energy Bill itself; it is for the Government to determine how, without compromising the OGA's independence, to encourage it to take due account of these issues.

Competition and Markets Authority
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[4] Available on the CMA website at Competition impact assessment guidelines for policymakers