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Competition in Energy Markets – Note by BIAC

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1. Introduction

1. *Business at OECD* (BIAC) appreciates the opportunity to comment on the assessment of competition in energy markets, particularly with respect to natural gas and electricity. Natural gas and electricity are critical to the world economy. Because of the high degree of dependence on natural gas and electricity by whole economies, even the slightest market disruptions, which may go largely unnoticed in other industries, can attract significant scrutiny from consumers and regulators.

2. Perfect market equilibrium is not practically obtainable, and short-term supply shocks are to be expected in any market. That natural gas and electricity markets are currently undergoing short-term supply shocks, whether caused or exacerbated by events related to, for example COVID-19 or the Russo-Ukrainian War, is not indicative of irrationally functioning markets. Previously, the supply/demand imbalance was just the opposite. Natural gas demand plummeted during the COVID-19 lockdowns, causing 2020 Henry Hub natural gas spot prices to drop to their lowest annual price since 1997.¹ But as COVID-19 restrictions fell away, demand for natural gas increased by 3.2% in 2021.² These supply/demand fluctuations will eventually be subject to market corrections but short-term intervention in the relevant markets can cause longer-term market distortions that need to be weighed against the benefits of short-term intervention.

3. If short-term intervention, such as price caps or subsidies, are being considered to address short-term supply shocks and corresponding price increases during exceptional circumstances (e.g., wartime), the long-term effects of this intervention on competition should be carefully weighed. While short-term intervention may provide immediate relief to certain market participants, it risks causing longer-term market distortions. For example, supply shocks may incentivize long-term renewable energy investment or regional energy infrastructure investment. Short-term intervention may disincentive these long-term investments.

4. Finally, higher prices and profits resulting from short-term supply shocks can also incentivize companies to more fiercely compete and incur costs that would otherwise be avoided to address supply/demand imbalances. For example, natural gas suppliers may consider higher cost mechanisms that would not otherwise be practicable in a low margin environment, such as shipping LNG via vessel instead of pipelines. Such an investment would broaden supply range and help alleviate infrastructure-related supply shortages.

¹ U.S. Consumption and Production of Natural Gas Decreased While Exports Grew in 2020, U.S. Energy Info. Admin. (Nov. 2, 2021), <https://www.eia.gov/todayinenergy/detail.php?id=50196>.

² Noah Browning & Bozorgmehr Sharafedin, Fossil Fuel Demand Shakes Off Pandemic in Blow to Climate Fight, Reuters (Oct. 4, 2021), <https://www.reuters.com/business/energy/fossil-fuel-demand-shakes-off-pandemic-blow-climate-fight-2021-10-04/>.

2. Natural Gas and Electricity Markets Are Integral to the World Economy and Generally Function Rationally

5. Because energy is a necessary input across all types of markets, natural gas and electricity markets have a profound effect on the world economy outside of their respective product markets. Thus, when natural gas and electricity markets move in harmony with rational interactions between supply and demand, the resulting effects are broadly amplified throughout the world, unlike most other markets. Similarly, energy supply and demand are deeply connected to the global economy, where even the slightest global macroeconomic disruption can have a significant impact on supply and demand.

6. The profound and immediate effect of world events on gas and electricity prices is arguably evidence of highly competitive relevant markets, as market participants are quick to react to changing market dynamics. A United States Federal Trade Commission report put it simply and concisely: “Rising prices signal consumers to purchase less and producers to supply more. Falling prices signal consumers to purchase more and producers to supply less.”³ The familiar back-and-forth should not be viewed as indicative of persistent market problems but quite the opposite. Empirical evidence demonstrates that energy markets are closely aligned with supply and demand conditions, such that downturns or upturns associated with this cyclical pattern should not be surprising.⁴ Inelastic demand linked to the essential nature of energy products can further intensify the effect of supply shocks, leading to more intense scrutiny, at no fault of the producers or suppliers.⁵

3. Excess Intervention May Cause Natural Gas and Electricity Market Distortions

7. Although supply and demand imbalances can result in higher prices, the higher prices themselves reflect appropriately functioning markets.⁶ As the United States Federal Trade Commission has observed, “Market prices are a mechanism that equalizes the quantity demanded and the quantity supplied. . . . Prices will stop rising or falling when

³ See U.S. Fed. Trade Comm’n, Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition 8 (2005), <https://www.ftc.gov/sites/default/files/documents/reports/gasoline-price-changes-dynamic-supply-demand-and-competition-federal-trade-commission-report-2005/050705gaspricesrpt.pdf> [hereinafter FTC Gasoline Report] (“Market prices reflect myriad individual decisions about prices at which to sell or buy. Market prices are a mechanism that equalizes the quantity demanded and the quantity supplied. Rising prices signal consumers to purchase less and producers to supply more. Falling prices signal consumers to purchase more and producers to supply less. Prices will stop rising or falling when they reach the new equilibrium price: the price at which the quantity consumers’ demand matches the quantity that producers supply.”).

⁴ See Dirk Janvan de Vena Roger Fouquet, Historical Energy Price Shocks and Their Changing Effects on the Economy, 62 Energy Econ. 204, 205 (2017) (“changes in impacts depended greatly on the circumstances related to the demand for and supply of energy sources”).

⁵ See Lutz Kilian, The Economic Effects of Energy Price Shocks, 46 J. Econ. Literature 871 (2008).

⁶ See FTC Gasoline Report, *supra* note 3, at 7 (“In general, the price of a commodity, such as gasoline, reflects producers’ costs and consumers’ willingness to pay. . . . Price changes generally reflect changes in producer costs or consumer demand. Simply put, prices rise if it costs more to produce and supply a good, or if people desire to buy more of that good at the current price. Prices fall if it costs less to produce and supply a good, or if people desire to buy less of that good at the current price.”).

they reach the new equilibrium price.”⁷ Thus, short-term intervention, usually to address rising prices, risks artificially distorting market realities and further exacerbating underlying supply-demand imbalances. Notably, it is critical to “maintain price signals to allow for endogenous demand adjustment” but “many current [short-term] policy initiatives in [EU] member countries go against this principle.”⁸

8. Price caps are a common form of short-term intervention used to address high prices in energy markets. Recently, in response to increasing electricity and natural gas prices, many countries around the world have implemented price-caps. For example, the United Kingdom recently capped wholesale electricity and gas prices for businesses at less than half the market rate, at a cost of up to £42 billion, according to some estimates.⁹ Similarly, the Netherlands recently announced that it would impose a price cap on natural gas and electricity from January 1, 2023, capping prices at their January 2022 levels.¹⁰ Germany, too, announced plans to implement a natural gas price cap through 2024 for consumers and small and medium-sized businesses at a cost of €200 billion to Germany.¹¹

9. BIAC recognizes the well-intentioned motivations for enacting electricity or natural gas price caps but cautions against hasty implementation that does not appropriately contemplate potential long-term consequences. There are many considerations that, even in the face of short-term price increases, may counsel against drastic short-short term intervention, such as price caps.

10. Price caps are often very costly, as evidenced by Germany’s planned €200 billion intervention, and may require diversion of funds already allocated for other spending, only to interfere with an appropriately functioning market.¹² Such massive spending may mute demand adjustments to price increases, such as energy conservation and energy efficiency investments, that could have a long-term positive impact.¹³ Although demand for natural gas and electricity tends to be inelastic relative to the consumption of other products or

⁷ Id. at 8.

⁸ See Gabriel Di Bella et al., Natural Gas in Europe: The Potential Impact of Disruptions to Supply 30 (Int’l Monetary Fund, Working Paper No. 2022/145, 2022), <https://www.imf.org/en/Publications/WP/Issues/2022/07/18/Natural-Gas-in-Europe-The-Potential-Impact-of-Disruptions-to-Supply-520934>.

⁹ Paul Sandle, UK Eases Pressure on Business by Halving Energy Bills This Winter, Reuters (Sept. 21, 2022), <https://www.reuters.com/business/energy/britain-caps-electricity-gas-prices-businesses-2022-09-21/>.

¹⁰ Dutch Government to Impose Price Cap on Energy – NOS, Reuters (Sept. 19, 2022), <https://www.reuters.com/business/energy/dutch-government-impose-price-cap-energy-nos-2022-09-19/>.

¹¹ Holger Hansen & Kirsti Knolle Germany Agrees 200 bln Euro Package to Shield Against Surging Energy Prices, Reuters (Sept. 29, 2022), <https://www.reuters.com/business/energy/german-govt-agrees-relief-package-response-soaring-energy-prices-sources-2022-09-29/>.

¹² See Anil Ari et al., Surging Energy Prices in Europe in the Aftermath of the War: How to Support the Vulnerable and Speed up the Transition Away from Fossil Fuels 18 (Int’l Monetary Fund, Working Paper No. 2022/152, 2022), <https://www.imf.org/en/Publications/WP/Issues/2022/07/28/Surging-Energy-Prices-in-Europe-in-the-Aftermath-of-the-War-How-to-Support-the-Vulnerable-521457>.

¹³ See id. at 18 (short-term investments such as tax reductions or price controls “are an inefficient tool to protect the economically vulnerable, are fiscally costly, and they mute the demand adjustment to the price shock (including energy-conserving behavior and energy efficiency investments)”).

inputs, short-term interventions like price caps further incentivize those most likely to adjust demand behavior not to, only ratcheting up the supply pressure causing high prices.¹⁴

11. Given the impact of energy markets on the global economy, preventing natural demand adjustments that could help rebalance supply can also have adverse spillover effects outside of national energy markets, especially for lower-income countries that rely heavily on energy imports. These lower-income, import reliant countries can be disadvantaged by the artificially maintained high global energy prices being propped up by national short-term intervention that prevents national demand-side correction.¹⁵

12. Relatedly, because high natural gas and electricity prices tend to be political flashpoints, short-term intervention that reduces prices is difficult to walk back. And other countries that have not yet enacted price-reduction measures often face mounting pressure to take similar actions. Therefore, once short-term intervention is undertaken, it risks a global domino effect on a much larger scale, further intensifying potential long-term global consequences.¹⁶

13. Finally, short-term intervention that disincentivizes demand correction runs the risk of further driving up the price of natural gas and electricity in the long run where there are structural supply constraints.¹⁷ Specifically, natural gas and electricity supply heavily depend on stationary transportation infrastructure with set capacities (e.g., pipelines and grids). In Europe, for example, some of these limitations, including natural gas import capacities, are already becoming apparent following the supply reducing actions in response to the Russo-Ukrainian war.¹⁸ There are north-south bottlenecks in France, Germany, and Italy that constrain natural gas imports into Central and Eastern Europe, and pipeline capacities to transport natural gas into Europe from the United Kingdom are already at 100% capacity, driving European natural gas prices above United Kingdom natural gas prices.¹⁹ Short-term price interventions would not alleviate these supply capacity problems and may further increase prices in the long-term by not allowing demand to appropriately calibrate itself.

4. Intervention May Disincentive Development Investment in Natural Gas, Electricity, and Renewable Energy

14. BIAC would also like to reiterate that profits play a necessary and important role in well-functioning natural gas and electricity markets. They compensate owners for capital invested in businesses and compensate those businesses for taking risks, including the risks

¹⁴ Justin-Damien Guénette, Price Controls Good Intentions, Bad Outcomes 3 (World Bank Pol’y Rsch. Working Paper No. 9212, 2020), <https://openknowledge.worldbank.org/bitstream/handle/10986/33606/Price-Controls-Good-Intentions-Bad-Outcomes.pdf?sequence=5&isAllowed=y> (“At least in part, this is because price controls cause a shift in consumption towards the subsidized good, and away from other non-subsidized goods.”).

¹⁵ See Ari et al., *supra* note 12.

¹⁶ See *id.*

¹⁷ See Di Bella et al., *supra* note 8, at 30 (noting that “important [natural gas] bottlenecks likely to remain even after extra measures, and thus shortages likely in some countries”).

¹⁸ See *id.*

¹⁹ See *id.*, at 10.

of war or terrorism that may destroy supply assets. Higher prices are likely to lead to higher profits. And higher profits are likely to draw increased investments and lead to competing businesses finding mechanisms to address imbalances, even at higher costs in the short term that are possible because of the increased margins—to the benefit of both consumers and society at large. With increased profits, natural gas and electricity companies will be incentivized to further compete and expand, leading to increased supply and decreased prices in the long-term.

15. First, supply/demand imbalances that cause higher prices incentivize natural gas and electricity companies to increase supply-related investment. For example, tight supply conditions would incentivize companies to address possible infrastructure deficiencies identified above, thereby improving the supply and security of natural gas and electricity to Europe in the long-term.²⁰

16. Second, short-term intervention may disincentivize private investment in renewable energy and more environmentally consumer behavior. It has been observed that transition to renewable energy is the best way to soften supply/demand spikes in the energy markets and improve energy security.²¹ In particular, the Russian invasion was viewed as an “impetus for some nations to accelerate their clean energy transitions based on renewable energy.”²² But where short-term intervention reduces the incentives for energy companies to make significant investments in renewable energy, consumers are likely to be worse off in the long-term, as increased energy supply from renewable energy sources would be less. Also, when natural gas and electricity consumers are faced with high prices, they are more likely to adopt energy conserving behavior that may benefit the environment and energy demand conditions in the long-term.²³

5. Short-Term Interventions Should Not Threaten Long-Term Competition

17. The impact of short-term intervention on long-term competition policy must also be carefully considered. A supply/demand imbalance does not necessitate competition law enforcement, and short-term intervention should not be used to address competition concerns. Recently, there have been calls for increased scrutiny of the energy sector from a competition law perspective, seemingly driven by issues not within the ambit of competition law policy. For example, in November 2021, United States President Joe Biden called on the United States Federal Trade Commission to investigate potentially anticompetitive conduct in the oil and gas industry in response to increasing industry profits

²⁰ See *id.*, at 30 (“Some larger investments in infrastructure will be needed, but there are also some more technical solutions that could be targeted to improve security of supply in the near-term. These would include the ability to reverse flows from West to East and solving the difficulty in sending French gas to Germany due to different standards on gas additives (which would also open the possibility of improving pipeline connections to the Iberian Peninsula where there is excess LNG import capacity).”).

²¹ See Ari et al., *supra* note 12, at 22.

²² Behnam Zakeri et al., *Pandemic, War, and Global Energy Transition*, *Energies* 15:6114, at 5 (2022), <https://doi.org/10.3390/en15176114>.

²³ See Ari et al., *supra* note 12, at 17 (“[R]elief policies should preserve strong incentives for conserving energy and transitioning away from fossil fuels.”).

amidst rising prices and decreasing costs.²⁴ Competition laws, if appropriately applied, are sufficient to ensure competitive natural gas and electricity markets but should not be improperly used to interfere with appropriately functioning markets.

18. Competition authorities are extremely familiar with energy markets and have a long history of taking action to stop anticompetitive behavior, when necessary. One of the most prominent price-fixing cases in the United States, *United States v. Socony-Vacuum Oil Co.*, concerned an enforcement action regarding gasoline price-fixing in the spot market.²⁵ More recently, in October 2021, the European Commission started investigating whether gas suppliers were manipulating the market, appropriately observing that “a breach of competition rules can only be found if there is evidence showing an agreement or practice that restricts competition, or else abusive conduct by a company with a dominant position on the market.”²⁶ Although it is unclear whether evidence of potentially anticompetitive behavior or public sentiment spurred the investigation, BIAC underscores the appropriate scope of the investigation.

19. BIAC also notes the key role of economic analysis in assessing competition law issues in energy markets. Competition authorities should continue to look to the standard tools and concepts of antitrust policy, such as defining relevant markets, assessing market power concepts, and considering procompetitive rationale, when assessing potentially anticompetitive conduct in energy markets. If the competition analysis considers non-economic variables or public sentiment, the economic accuracy of enforcement decisions becomes uncertain, which may further complicate subsequent judicial review.

6. Conclusion

20. BIAC appreciates the natural gas and electricity supply/demand imbalances may pose challenges to many businesses and consumers. Even so, any short-term intervention should be narrowly tailored to not impact long-term competition policy and efficiently functioning markets. The natural gas and electricity markets are critical to the world economy, and it should be assumed that all contemplated short-term intervention will have a ripple effect into the broader global economy. It should also be appreciated that supply/demand imbalances can incentivize desirable responses by market participants that could lead to long-term energy market improvements, such as by increasing renewable energy generation or alleviating supply infrastructure bottlenecks.

21. Furthermore, competition law promotes innovation, fairness, and economic efficiency in both the short-term and long-term and should not be used to disrupt otherwise appropriately functioning markets. Because natural gas and electricity markets function rationally, short-term supply and price shocks are generally to be expected and should not be the driving force behind increased competition law enforcement.

²⁴ Letter from President Joe Biden to the Honorable Lina Khan, Chair, U.S. Fed. Trade Comm’n (Nov. 17, 2021), <https://int.nyt.com/data/documenttools/ftc-gas-prices/92d93dca9793b8b4/full.pdf>.

²⁵ *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

²⁶ America Hernandez, EU Gathers Evidence for Competition Probe of Gas Suppliers, Politico (Oct. 26, 2021), <https://www.politico.eu/article/eu-competition-probe-gas-suppliers-price-soar/>.