The BritNed Judgment

Annual ACE conference in Bologna

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Presentation represents the views of the speaker

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Overview

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Part I
Overcharge approach

Primary overcharge analyses put forward by the experts
Econometrics vs margin comparison

1 Oxera approach—21.8% overcharge

- econometric overcharge analysis
- cost proxies to avoid relying on ABB's reported costs
    - requires larger dataset, and therefore included underground projects
- aim was to estimate an unbiased overcharge rather than predict prices precisely
- control for factors that change over time between cartel and post-cartel period such as demand
    - included other cartel projects to allow such controls to be included

2 Frontier approach—no overcharge

- simple comparison of BritNed project margin with gross margin of similar post-cartel submarine projects
    - minor adjustments to the reported margins to strip out costs that were not directly related to the project
- no other control for changes between cartel and post-cartel period

Court’s key relevant findings of fact

ABB’s costs are reliable, and no changes between cartel and post-cartel period

ABB put forward a competitively constructed bid for BritNed

- ‘*the direct costs in relation to ABB’s bid for the BritNed Interconnector were honestly and competently compiled with a view to putting forward a **competitive bid***’ (para. 435)
- ‘*margins added to direct costs, including contingencies for risks […] would properly have been added*’ (para. 266)

No change in demand/capacity utilisation

- the Court accepted ABB’s factual witness evidence that capacity utilisation remained broadly similar over time, with ABB expanding capacity as demand increased

Challenges with the Court's findings

ABB's costs unreliable, and demand important factor

Reliance on ABB's costs

- the Court found that ABB's costs for BritNed are competitive and reliable, except for X-inefficiency, but this could be adjusted
- suggests that the Court had an appropriate way to do this?
    - the Court applied a conservative adjustment given the uncertainty regarding the size of the X-inefficiency

Controlling for demand

- ABB considered that capacity most important driver of margin—lots spare for BritNed
- demand increased at the end of the cartel period into the post-cartel
    - dispute was whether capacity increases kept pace—no data on capacity available
    - Oxera used a publicly reported proxy
- Court found that demand/capacity change is difficult to model—prefers no control to proxy
- 'Neither the time trend variable nor the order backlog [demand] variable ought to be fundamental to the operation of the model. If there is an overcharge, then it ought to be capable of being demonstrated in a statistically significant manner without these variables' (para. 418(1))

Underground vs Submarine projects

Additional reason the Court rejected the econometric approach

Motivation

- Oxera included underground projects to increase the size of the dataset from 49 to 92
    - differences could be controlled for, and in any event overcharge was robust to inclusion
- model excluding underground projects produced a similar overcharge
- model with full interaction terms produced a similar overcharge

Finding

- inappropriate and introduced additional unreliability in the model (para. 397)
- similar overcharge result from model excluding underground projects could be a coincidence
- some coefficients changed size, and some controls became insignificant for submarine only

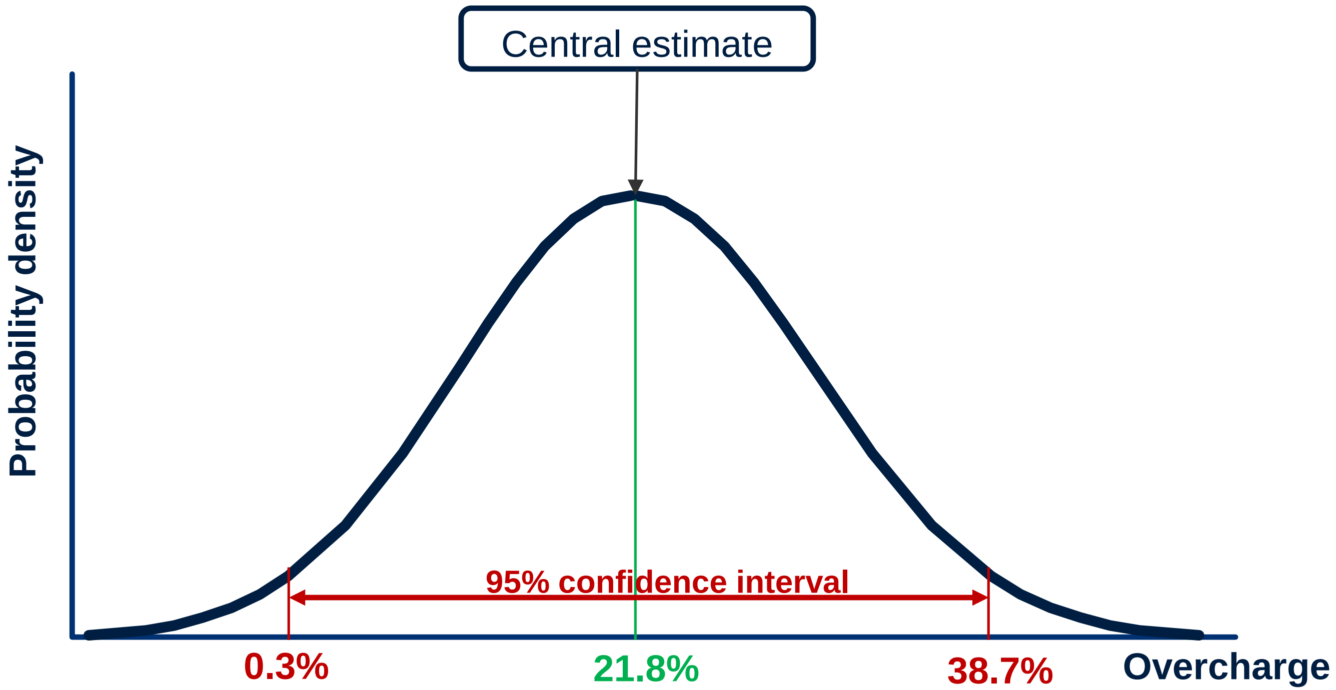
Challenge

- Court logic suggests overcharge is unreliable whether or not underground projects are included due to limited data available—is this consistent with the practical guide on quantifying harm?
- was it understood that halving the sample size is expected to affect standard errors?
- if there were differences, would a full interaction model not control for these?

Part II
Court's approach to statistical significance

Confidence interval around overcharge estimate

Econometric analysis



‘size of the interval […] an indicator that the model is not producing useful outcomes such that I can rely upon’ (para. 418(3))

Court’s approach to statistical significance

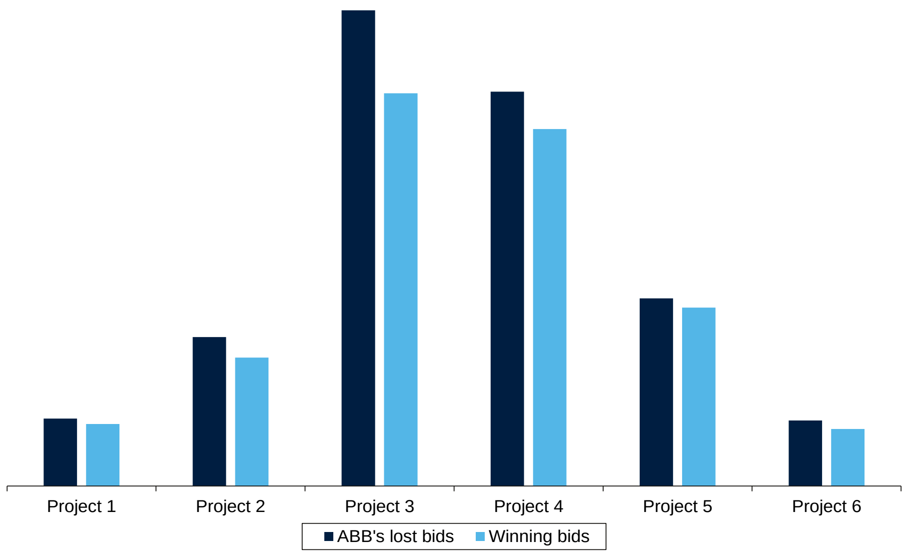
5% statistical significance insufficient?

- null hypothesis = zero overcharge
- p-value gives the likelihood of estimated overcharge assuming that the true overcharge was zero
- p-value just under 5%—i.e. statistically significant at the 5% level
    - corresponding confidence level is 95%
    - lower end of 95% confidence interval will be close to zero
- Court found this is too uncertain—implies a tighter 95% confidence interval is required
    - 5% statistical significance threshold (two-sided) insufficient?
    - 1% threshold required? 0.1%?
    - presumption of harm? balance of probabilities?
- all else equal, statistical significance increases with sample size
    - more difficult to bring claims against cartels where a smaller dataset is available?

Part III
Cartel inefficiency

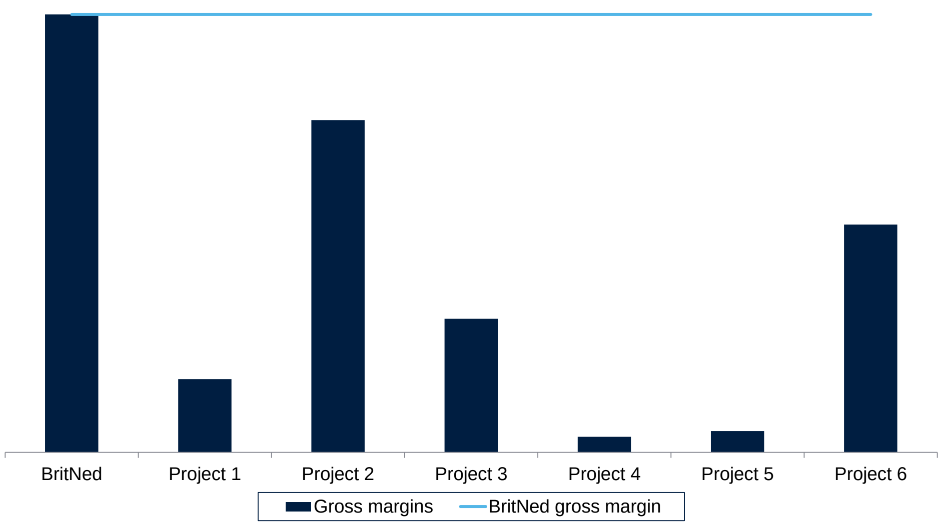
Baked-in inefficiency adjusted margins analysis (I)

- Oxera identified the baked-in inefficiency based on ABB's losing bids
- ABB's post-cartel lost bids were on average more than 10% higher than winning bids for the most similar projects, for which the price was available in the public domain (and project scopes were the same)



Baked-in inefficiency adjusted margins analysis (II)

- quantified the overcharge based on an adjusted margin analysis
  - adjusted margin calculated using ABB’s costs, and the winning bid price—i.e. the margin that ABB would have earned if its price was the same as the winning bid
  - difference between BritNed margin and post-cartel margins informative of the level of X-inefficiency/overcharge on BritNed



Part IV
Regulatory exemption (‘pass-on’)

Regulatory exemption (‘Pass-on’)

BritNed is entitled to recover all of, actually, 90% of the overcharge

Defence was originally rejected (assuming that any damages awarded would be subject to the IRR Cap)**:**

- excess profits do not benefit BritNed—must expand capacity or fund networks
- reasons of justice, fairness and public policy why cap argument should not enable a cartelist to retain the overcharge
    - the Court considered that networks could not easily claim for an overcharge that they may incur in 2036—claim could vanish in ‘some legal black hole’
- ‘a court does not inquire into the use to which a successful claimant will put damages he, she or it has been awarded’ (para. 537)
- BritNed should undertake to give the money back to ABB if damages not subject to IRR cap

Revised judgment

- BritNed refused to provide the undertakings
    - refusal suggests to the Court that there is a risk of overcompensation that must be reflected in the award of damages
    - the Court reduced the damages by 10% to reflect the risk of over-compensation

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