

Micola, Augusto Rupérez; Banal Estañol, Albert; Bunn, Derek W.

**Working Paper**

## Incentives and coordination in vertically related energy markets

WZB Discussion Paper, No. SP II 2006-02

**Provided in Cooperation with:**

WZB Berlin Social Science Center

*Suggested Citation:* Micola, Augusto Rupérez; Banal Estañol, Albert; Bunn, Derek W. (2006) : Incentives and coordination in vertically related energy markets, WZB Discussion Paper, No. SP II 2006-02, Wissenschaftszentrum Berlin für Sozialforschung (WZB), Berlin

This Version is available at:

<https://hdl.handle.net/10419/51023>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Augusto Rupérez Micola \*  
Albert Banal Estañol \*\*  
Derek W. Bunn \*\*\*

## **Incentives and Coordination in Vertically Related Energy Markets**

- \* IMD-International Institute for Management  
Development  
\*\* City University and University of Cambridge  
\*\*\* London Business School

**SP II 2006 – 02**

January 2006

ISSN Nr. 0722 – 6748

**Research Area**  
Markets and Politics

**Forschungsschwerpunkt**  
Märkte und Politik

**Research Unit**  
Competitiveness and Industrial Change

**Abteilung**  
Wettbewerbsfähigkeit und industrieller Wandel

Zitierweise/Citation:

Augusto Rupérez Micola, Albert Banal Estañol and Derek W. Bunn,  
**Incentives and Coordination in Vertically Related Energy  
Markets**, Discussion Paper SP II 2006 – 02, Wissenschaftszentrum  
Berlin, 2006.

Wissenschaftszentrum Berlin für Sozialforschung gGmbH,  
Reichpietschufer 50, 10785 Berlin, Germany, Tel. (030) 2 54 91 – 0  
Internet: [www.wz-berlin.de](http://www.wz-berlin.de)

## ABSTRACT

### **Incentives and Coordination in Vertically Related Energy Markets\***

by Augusto Rupérez Micola, Albert Banal Estañol and Derek W. Bunn

We present an agent-based model of a multi-tier energy market including gas shippers, electricity generators and retailers. We show how reward interdependence between strategic business units within a vertically integrated firm can increase its profits in oligopolistic energy markets. The effects are shown to be distinct from those of the raising rivals' costs model. In our case, higher prices relate to the nature of energy markets, which facilitate the emergence of financial netback effects.

*Keywords: Agent-based modeling, energy markets, reward interdependence.*

*JEL Classification: C63, L22, L97.*

---

\* We are grateful to Laurent David, Tobias Kretschmer, Olivier Massol, Phanish Puranam and seminar participants at the INFORMS-2004 conference (Denver), European Doctoral Research Conference (London), WEHIA-2005 (Colchester), ACEPOL-2005 (Bielefeld), Gaz de France (Paris), Instituto de Empresa (Madrid), London Business School, Rotterdam School of Management and Unilever's Research Centre (Colworth, UK).

## ZUSAMMENFASSUNG

### **Anreize und Koordination in vertikal integrierten Energiemärkten**

Es wird ein Agenten-basiertes Modell eines Energiemarktes mit mehreren Ebenen der Wertschöpfungskette vorgestellt, das Gaslieferanten, Stromerzeuger und Händler berücksichtigt. Es kann gezeigt werden, wie ein vertikal integriertes Unternehmen, das auf oligopolistischen Energiemärkten agiert, die Honorierungsbeziehungen zwischen strategischen Geschäftsbereichen nutzen kann, um seine Gewinne zu steigern. Üblicherweise versuchen Firmen, die die gesamte Wertschöpfungskette integriert haben, ihren Vorteil dadurch zu nutzen, dass sie die Kosten der Wettbewerber durch Preisdiskriminierung erhöhen und den Markt gegen sie abschotten. Das ist in Energiemärkten nicht möglich. Im vorgestellten Modell wird ein Mechanismus gewählt, der den Charakteristika von Energiemärkten angepasst ist, um über Anreize denselben Endeffekt zu erzielen. Dieser beruht aber nicht auf der Marktabschottung, sondern auf einem finanziellen Valorisierungseffekt, bei dem Unternehmensbereiche am Beginn der Wertschöpfungskette die Preisspannen für die Unternehmensteile am oberen Ende vorgeben.

# 1 Introduction

This paper studies the vertical relationships between gas and electricity markets. Vertical relationships are those that involve an exchange between sequential stages of the value chain. In the energy industry, gas is an important input for electricity generation, and therefore wholesale natural gas and electricity markets are vertically interrelated. The same is true for wholesale and retail electricity markets since retailers buy electricity from wholesalers (Stern, 1998).

Vertical interactions may involve separate firms or different strategic business units (SBUs) within the same firm (Gulati et al., forthcoming). Vertical integration is widespread among European energy firms. Gas producers often own gas-fired power plants and many electricity firms consist of generation and retail SBUs (Midttun and Finon, 2004). Mergers between gas and electricity firms are relatively new in the United States but they are occurring at a rapid pace (Hunger, 2003). Moreover, the pace of merger activity appears to be accelerating as competition opportunities expand, incentive regulation diffuses more widely, and regulators have become less hostile to mergers (Joskow, 2000).<sup>1</sup>

Several streams of literature have studied the advantages as well as the disadvantages of vertical integration. Industrial economists have long argued that vertically related firms could strategically benefit from integrating.<sup>2</sup> Consider an intermediate market in which upstream and downstream firms interact. An integrated firm could gain market share and profits downstream by internalising production and refusing to sell (or selling at higher prices) to non-integrated downstream firms. Indeed, the firm's upstream opponents would then exert more market power at the margin and increase prices, thereby raising the costs of non-integrated downstream firms. Higher costs would become a competitive disadvantage in the downstream market against the vertically integrated firm, resulting in lost market shares. Trading internalisation would then increase both upstream and downstream prices and lead to higher integrated firm profits.

Studies of vertical relationships in energy markets (e.g. Granitz and Klein, 1996; Bushnell et al., 2005) often explain their findings using this foreclosure argument. However, the "raising rivals' costs" or "foreclosure" logic depends crucially on the firm's ability to internalise transactions and / or price discriminate in favour of its downstream SBU. In practice, wholesale energy markets are often compulsory, so trading internalisation is not feasible. Moreover, the standard energy market mechanism is the uniform price auction, which seems to make price differentiation impossible at the outset. Thus, two of the main resting points of the raising rivals' costs logic are often not present in energy markets.

This paper shows that energy firms may benefit from vertical integration by

---

<sup>1</sup>Note that the discussion here is about separation between the buying and selling sides of the wholesale market and quite different from regulatory unbundling of transmission infrastructures which is also widespread in the energy industry.

<sup>2</sup>Management scholars have also identified several motives for firms to integrate vertically (Harrigan, 1984, 1986), including the reduction of transaction costs (Williamson, 1975; Mahoney, 1992) and the reduction of corporate risk (Chatterjee et al., 1992).

using an alternative mechanism to foreclosure. The new mechanism is based on the presence of vertical incentives, which are widely used within energy firms, does not require internalisation or price discrimination and can be a way of circumventing regulatory constraints. One of the main contributions of this paper is to show that, although the new mechanism yields prices that are superficially equivalent to those of foreclosure, it operates in a fundamentally different manner.

The general reward system of an organisation plays a major role in the behavioural choices of its members. Bonuses tied to overall profits create incentives for cooperative behaviour both between individuals (Zander and Wolfe, 1964; Wageman and Baker, 1997) and across departments within a firm (Petersen, 1992; Kretschmer and Puranam, 2004). For individuals, the more interdependent the task, the more interdependent the reward system should be (Wageman and Baker, 1997) because it results in a positive relationship between effectiveness of the integrative devices and organisational performance (Lawrence and Lorsch, 1967). For firms, the importance of cooperation between SBUs grows with their interdependence (Gulati and Singh, 1998) and the higher the inter-unit synergies, the more useful are the collaborative incentives (Kretschmer and Puranam, 2004). Collaborative incentives, however, not only encourage cooperation but may also enhance free riding. Indeed, rewards based on aggregate profits hinder the identification of individual performances. As a consequence, individuals have more incentives to shirk hoping that the others will compensate (Holmstrom, 1982; Petersen, 1992).<sup>3</sup>

Despite the importance of collaborative incentives, the existing literature provides no guidance as to how they should be given to sequential SBUs in vertically integrated energy firms. In order to fill this gap, we consider a setting consisting of three sequential, multiple-unit, compulsory, uniform-price auctions representing a wholesale gas market, a wholesale electricity market and a retail electricity market. Although quite realistic, this complex trading environment presents a manifold of non-Pareto ranked Nash equilibria (von der Fehr and Harbord, 1993). To achieve predictions, we adopt an inductive selection method based on the adaptive theory of reinforcement learning put forward by Roth and Erev (1995).

The agent-based simulations show that coordination overcomes the potential disadvantages of broad collaborative incentives due to the large interdependences between energy markets. More importantly, our results uncover a simple but powerful mechanism to exert vertical market power. Using collaborative incentives that link the reward to the performance of the different SBUs, vertically integrated firms achieve higher prices and higher profit. These observable outcomes are consistent with the foreclosure argument. Closer inspection, however, reveals that the downstream SBU behaves less competitively, increasing downstream prices instead of taking advantage of the rivals' higher costs. Moreover, the upstream SBU behaves more competitively and takes advantage of the

---

<sup>3</sup>Broad incentives could also obstruct learning since it is more difficult to identify the most successful business strategies.

higher downstream prices. Rather than foreclosure, the results are due to a financial netback effect connecting the different markets in which downstream prices set the scope for the level of upstream prices.

The remainder of the paper is organised as follows: Section 2 outlines the agent-based simulation model; Section 3 presents the results, which are extended in Section 4; and a short discussion follows in Section 5.

## 2 The Computational Model

### 2.1 General Setting

The model incorporates key features of electricity and gas markets in the short-run. Consider three sequential, oligopolistic energy markets, a wholesale gas market, a wholesale electricity market and a retail electricity market. Gas sold in the wholesale gas market is an input for the generation of the electricity traded in the wholesale electricity market that, in turn, is sold to end users in the retail market. In the gas market, there are  $A$  upstream natural gas shippers that sell gas to  $B$  electricity generators. These generators buy gas to produce electricity and sell it in the electricity market to  $C$  electricity retailers. These, in turn, re-sell the electricity in the end-user market.<sup>4</sup> Marginal costs are assumed to be constant throughout and normalised to 0 for simplicity. There are no transmission constraints or storage.

Firms are capacity constrained and total capacity is equal across tiers. Moreover, firms in each tier are identical. If one denotes market capacity as  $K^m$ , the individual capacity of a gas shipper is  $K^g = \frac{K^m}{A}$ , that of an electricity generator is  $K^e = \frac{K^m}{B}$  and that of an electricity retailer is  $K^r = \frac{K^m}{C}$ .

### 2.2 Market Rules

Goods are traded repeatedly along the value chain (Figure 1). In a given round  $t$ , three uniform price auctions take place sequentially, at the retail, wholesale electricity and wholesale gas levels. In each market  $i$ ,  $i \in \{r, e, g\}$ , trading occurs as follows. Suppliers simultaneously submit single price bids at which they are willing to sell (up to) their capacity, starting from 0 and up to  $\bar{P}^i(t)$ , a maximum level for each market that will be explained below. An independent auctioneer determines a uniform market price ( $P^i(t)$ ) by intersecting the *ad hoc* supply function with the corresponding inelastic demand curve,  $Q^i(t)$ . The independent auctioneer assigns full capacity,  $q_j^i(t) = K^i$ , to the  $m$  sellers that submitted bids below the market price; the remaining capacity,  $q_j^i(t) = Q^i(t) - mK^i$ , to the seller that submitted a bid equal to the market price;<sup>5</sup> and zero sales,  $q_j^i(t) = 0$ , to the sellers that submitted bids above the market price. The market price and the individual quantities are then communicated independently to each supplier.

<sup>4</sup>Although relevant in the medium term, we do not deal with entry and exit of firms, variation in end-user demand or capacity expansion.

<sup>5</sup>In case of a tie, the selling firm is selected randomly.



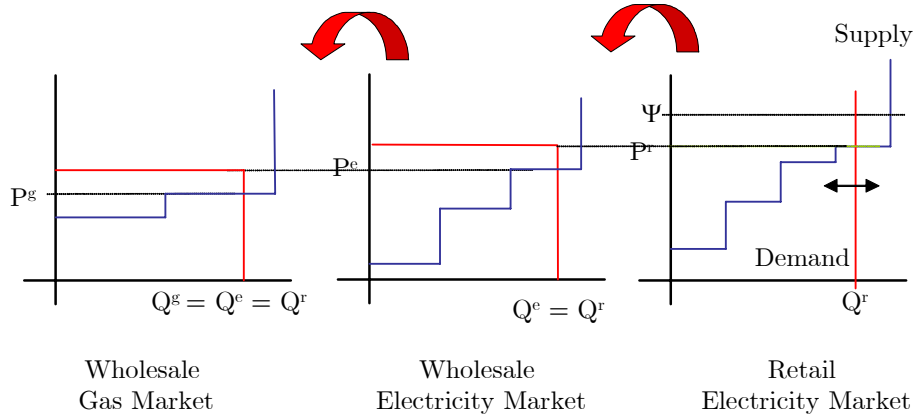


Figure 1: Sequential Clearing of the Market Simulation

At the retail level, the inelastic market demand  $Q^r(t)$  is drawn, independently in each round, from a uniform distribution in  $[\bar{Q}^r - \varepsilon, \bar{Q}^r + \varepsilon]$ , where  $\bar{Q}^r$  is the expected end-user demand and  $\varepsilon$  accounts for the small uncertainty typical in day-ahead electricity forecasting.<sup>6</sup> Possible retail prices are bounded in  $(0, \Psi]$ , with  $\Psi$  being the maximum reasonable end-user price and therefore  $\bar{P}^r(t) = \Psi$ .<sup>7</sup> Retail commitments are honoured with purchases in the wholesale electricity market. The retailers' aggregated demand curve in the wholesale electricity market is therefore equal to the market demand at the retail level if the price is below the retail market price,  $Q^e(t) = Q^r(t)$  if  $P^e(t) \leq P^r(t)$ , and zero otherwise,  $Q^e(t) = 0$  if  $P^e(t) > P^r(t)$ . Accordingly, electricity generators submit bids bounded between  $(0, P^r(t)]$  and therefore  $\bar{P}^e(t) = P^r(t)$ . The generators' aggregated demand curve in the wholesale gas market is equal to the market demand at the retail level if the price is below the wholesale electricity market price,  $Q^g(t) = Q^r(t)$  if  $P^g(t) \leq P^e(t)$ , and zero otherwise,  $Q^g(t) = 0$  if  $P^g(t) > P^e(t)$ . Gas shippers submit bids bounded between  $(0, P^e(t)]$  and therefore  $\bar{P}^g(t) = P^e(t)$ .

By construction, the end-user market demand in each round  $t$  determines the volumes traded in the wholesale markets,

$$Q^g(t) = Q^e(t) = Q^r(t).$$

Moreover, the three prices are vertically related,

$$P^g(t) \leq P^e(t) \leq P^r(t).$$

<sup>6</sup>Similarly to real electricity markets, the model also includes some excess capacity, i.e.  $\bar{Q}^r + \varepsilon < K^m$ .

<sup>7</sup>This upper price ceiling can be understood as a limit triggering regulatory intervention or the cost of alternative, expensive, peaking load fuels to which the system administrator could switch at short notice if gas prices exceed  $\Psi$ .

Profits for each firm type are

$$\pi_a^g(t) = P^g(t) q_a^g(t) \quad \text{for } a = 1 \dots A \quad (1)$$

$$\pi_b^e(t) = [P^e(t) - P^g(t)] q_b^e(t) \quad \text{for } b = 1 \dots B \quad (2)$$

$$\pi_c^r(t) = [P^r(t) - P^e(t)] q_c^r(t) \quad \text{for } c = 1 \dots C. \quad (3)$$

There are apparently no other multi-tier simulations driven by netback principles in the energy modelling literature. This new method is the paper's main methodological contribution.

### 2.3 Vertical Integration and Reward Interdependence

In the basic model, it is assumed that a shipper (without loss of generality,  $a = 1$ ) and a generator ( $b = 1$ ) are vertically integrated in that they belong to the same organisational structure, i.e. the same firm. Trading is compulsory and firms are not allowed to price discriminate. However, the vertically integrated firm can influence its traders' decisions by giving them incentives that depend on the profits of their own unit but also on the other unit,

$$\Omega_1^g(t) = (1 - \alpha)\pi_1^g(t) + \alpha\pi_1^e(t) \quad \text{and} \quad (4)$$

$$\Omega_1^e(t) = (1 - \alpha)\pi_1^e(t) + \alpha\pi_1^g(t), \quad (5)$$

where  $\alpha = \{0, .01, .02, \dots, .5\}$  parameterises the "reward interdependence" (Wageman and Baker, 1997) between the two vertically related SBUs. A small  $\alpha$  represents narrow incentives, which become broader for growing  $\alpha$ . Note that for  $\alpha = 0$ ,  $\Omega_1^g(t) = \pi_1^g(t)$  and  $\Omega_1^e(t) = \pi_1^e(t)$ , and SBUs trade as if they were independent. For tractability and realism, the model is restricted to the case in which SBUs are rewarded predominantly on the basis of their own performance, i.e.  $\alpha \leq 0.5$ .

Managers in the non-integrated firms do not have reward interdependences so their incentives are correlated to their own unit performance,

$$\Omega_j^i(t) = \pi_j^i(t) \quad \text{for either } i = \{g, e\} \text{ and } j \neq 1 \text{ or } i = r \text{ and any } j. \quad (6)$$

### 2.4 Bidding and Behavioural Learning

The feasible price offer domain for each firm is approximated by a discrete grid consisting of a fixed number of possible actions (independent of  $t$ ). In each trading period, suppliers choose among  $S^i$  possible prices, equally spaced between the minimum and the maximum reasonable price offer,  $(0, \bar{P}^i(t))$ , where  $\bar{P}^r(t) = \Psi$ ,  $\bar{P}^e(t) = P^r(t)$  and  $\bar{P}^g(t) = P^e(t)$ . Hence, the set of possible actions,  $A^i$  at a tier  $i$  in a period  $t$  is given by

$$A^i(t) = s * \left( \frac{\bar{P}^i(t)}{S^i} \right) \quad \text{for } s = 1, \dots, S^i. \quad (7)$$

Notice that in the wholesale markets, the sets of possible prices change over time. In all markets, actions with a lower  $s$  are more competitive or closer to the marginal costs.

Each trader plays each possible action with a given likelihood or “propensity”,  $r_{j,s}^i$ . The probability that an agent  $j$  plays an action  $s$  is given by its propensity divided by the sum of the propensities of all possible actions,

$$p_{j,s}^i(t) = \frac{r_{j,s}^i(t)}{\sum_{s=1}^{S^i} r_{j,s}^i(t)}. \quad (8)$$

Propensities for all actions are initialised to the firms’ maximum profit, i.e.  $r_{j,s}^i(1) = \Psi K^i$  for all  $s$ , so that all actions have the same initial probability,  $p_{j,s}^i(1) = \frac{1}{S^i}$  for all  $s$  and  $i$ .

At the end of each round, traders reinforce the selected action,  $k$ , through an increase in its propensity equivalent to the performance,  $\Omega_j^i(t)$ . Moreover, actions that are similar, i.e.  $k-1$  and  $k+1$ , are also reinforced, by  $\Omega_j^i(t) * (1-\delta)$  where  $0 < \delta < 1$  (“persistent local experimentation” in the terminology of Roth and Erev). All propensities are discounted by  $\gamma$  (“gradual forgetting”) and actions whose probability falls below a certain threshold are removed from the space of choice (“extinction in finite time”). Summarising, the pre-extinction propensities  $r_{j,s}^{i'}$  are

$$r_{j,s}^{i'}(t) = \begin{cases} (1-\gamma)r_{j,s}^i(t-1) + \Omega_j^i(t) & \text{if } s = k \\ (1-\gamma)r_{j,s}^i(t-1) + (1-\delta)\Omega_j^i(t) & \text{if } s = k-1 \text{ or } s = k+1 \\ (1-\gamma)r_{j,s}^i(t-1) & \text{if } s \neq k-1, s \neq k \text{ and } s \neq k+1 \end{cases} \quad (9)$$

and the final propensities, corrected by the extinction feature, are

$$r_{j,s}^i(t) = r_{j,s}^{i'}(t) I_{\left\{ \frac{r_{j,s}^{i'}(t)}{\sum_{s=1}^{S^i} r_{j,s}^{i'}(t)} > \mu \right\}} \quad (10)$$

where  $I$  is an indicator function that takes value 1 if the condition between brackets is satisfied and zero otherwise.

## 2.5 Simulation Parameters

In the first instance, industry structure is simplified to consist of two gas shippers, three generators and four retailers (i.e.  $A = 2$ ;  $B = 3$ ;  $C = 4$ ). Gas shippers will be referred to as  $G_1$  and  $G_2$ , generators as  $E_1$ ,  $E_2$  and  $E_3$  and retailers as  $R_1$ ,  $R_2$ ,  $R_3$  and  $R_4$ . As mentioned above, in the base case, the two vertically integrated entities are  $G_1$  and  $E_1$ . Total capacity is set to  $K^m = 300$ , so that the individual capacity of a gas shipper is  $K^g = 150$ , of an electricity generator is  $K^e = 100$  and of an electricity retailer is  $K^r = 75$ . Expected market demand is  $\bar{Q}^r = 240$  and  $\varepsilon = 5$ , so that there is an expected excess capacity of 20% with about 5% uncertainty in the day-ahead forecasted demand, approximately of the magnitude observed in energy markets. The end-user reasonable price ceiling is set at  $\Psi = 200$ .

Fifty-one reward interdependence cases  $\alpha = \{0, .01, .02, .03, \dots, .50\}$  are studied and 50 simulation runs consisting of 500 periods were carried out for each of them. The data presented consists of averages for the last 200 periods, for each run and each case. These represent long term stationary values<sup>8</sup> to which the three markets converge, based on the R&E reinforcement parameters.<sup>9</sup>

### 3 Results

#### 3.1 Market Prices and Profits

Figures 2, 3 and 4 report the 95% mean confidence intervals of simulated prices in the three sequential markets when  $G_1$  and  $E_1$  are vertically integrated. They present the relationship between reward interdependence  $\alpha$  (on the horizontal axis) and  $P^g$ ,  $P^e$  and  $P^r$  (on the vertical axis), respectively. As shown by Figure 2, shippers coordinate on higher prices as  $\alpha$  grows. The lack of reward interdependences ( $\alpha = 0$ ) results in an average gas price of approximately 59 monetary units, which increases to about 63 units for  $\alpha = .50$ . Figure 3 shows that wholesale electricity prices are also clearly influenced by  $\alpha$ . When  $\alpha = 0$ , the simulation produces an average price of about 83 units, for  $\alpha = .50$  it is about 93. Finally, Figure 4 presents retail price levels not varying systematically as a function of  $\alpha$ . The structure of incentives in the vertically integrated firm does not influence  $P^r$ .

By construction, the expected absolute size of the resource rent shared by the three market tiers is constant ( $= \Psi \bar{Q}^r$ ). What changes is the proportion accruing to each of them. Increasing  $P^g$  with constant production costs results in a higher proportion of the rent staying with the gas duopoly. Taking Figures 2, 3 and 4 together,  $P^e$  increases compensate to some extent the higher  $P^g$ , but that is not the case for  $P^r$ . Market prices seem to indicate that generators and, particularly, retailers are subject to shippers foreclosure emerging from reward interdependences between  $G_1$  and  $E_1$ .

Moreover,  $\alpha$  influences both the profits of the vertically integrated firm and its two SBUs (Figure 5). Broader vertical incentives increase the  $G_1$ 's profit but decrease those of  $E_1$ . The resulting overall corporate profit ( $\pi_1^g + \pi_1^e$ ) is clearly increasing from about 9,000 monetary units to over 10,000. Thus, there is a positive relationship between vertical reward interdependence across the two strategic business units, the firm's overall profit and the concentration of profit upstream.

#### 3.2 Price-setting Behaviour

In a uniform price auction, prices are determined by the last bid on the merit order, and therefore being a marginal seller is a necessary condition to influence prices. Hence, the frequency with which each firm takes the marginal

<sup>8</sup>Augmented Dickey-Fuller (ADF) reject the null unit root hypotheses with  $p < .01$ .

<sup>9</sup>The R&E parameters used throughout are  $\gamma = 0.01$ ,  $\delta = 0.5$  and  $\mu = 0.0005$ .

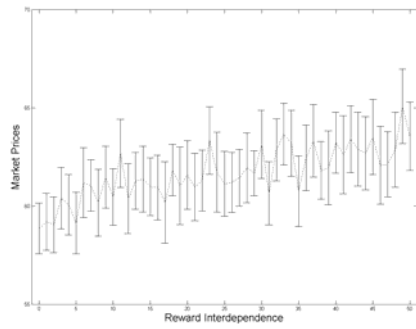


Figure 2: Natural Gas Prices

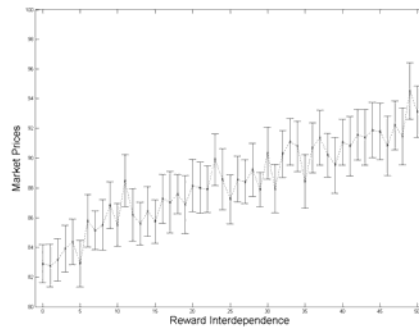


Figure 3: Wholesale Electricity Prices

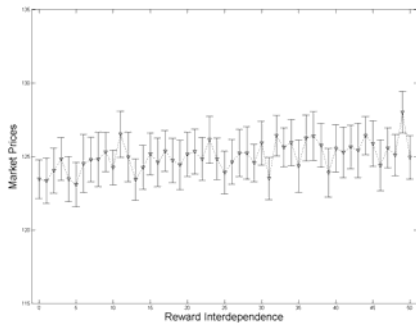


Figure 4: Retail Electricity Prices

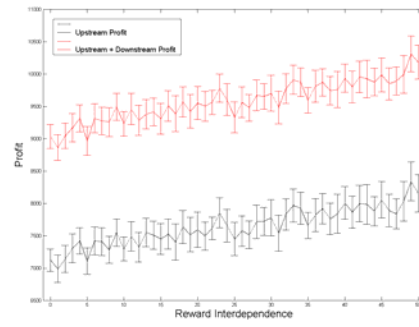


Figure 5: Profit, Vertically Integrated Firm

Figure 2: Natural Gas Prices; Figure 3: Wholesale Electricity Prices;  
 Figure 4: Retail Electricity Prices, Figure 5: Profit, Vertically Integrated Firm.

price-setting position on the supply merit order represents one dimension of its predisposition to exert market power (at the expense of market share). The raising rivals' cost logic would require  $G_1$  to concede market power upstream and  $E_1$  to undercut their rivals downstream. Following that argument,  $G_1$  and  $E_1$  should be setting prices less often for a higher  $\alpha$ .

The vertical axes in Figures 6 and 7, provide averages over the frequencies with which each market player sets the price in the 200 end-of-simulation periods averaged across the 50 simulation runs. An increase in the reward interdependence between  $G_1$  and  $E_1$  creates two simultaneous effects. On the one hand, the proportion of trading periods in which  $G_1$  sets prices goes down from about 50% when  $\alpha = 0$  to around 41%, when  $\alpha = 0.5$  (Figure 6). Consistent with the foreclosure predictions, reward interdependence provides incentives for the  $G_1$  to influence  $P^g$  less often at the benefit of  $G_2$ .

On the other hand, the proportion of trading periods in which  $E_1$  is price-setting increases from 33% when  $\alpha = 0$  to about 50% for  $\alpha = 0.5$  (Figure 7). Hence there is a positive relationship between  $\alpha$  and  $E_1$ 's predisposition to exert market power, which is *at odds* with the foreclosure prediction. Since  $E_1$  bidding behaviour results in lower profits downstream but higher overall profits, there is an alternative mechanism to foreclosure that, operating via  $\alpha$ , links  $E_1$ 's behaviour to the overall firm profit.

### 3.3 Latent Intensity of Competition

Figures 8 and 9 characterise the  $S^i$  end-of-simulation individual latent probability distributions from which agents choose. The concentration of probabilities is largely invariant across a large number of periods once the market reaches convergence, so the distributions at  $t = 500$  are an indication of the firms' long-term mixed strategies.

On the horizontal axes, strategies are identified with numbers ranging from 1 for the more competitive to 100 for the highest possible bid. Cumulative probabilities for the three tiers are calculated on the vertical axes for each element of the strategy space. The curves summarise the cumulative bidding probabilities for  $\alpha = 0$  and  $\alpha = 0.5$ , averaged across the 50 simulation runs. In all cases, probabilities concentrated on lower (higher) strategies result on the agents behaving more (less) competitively. That is, curve movements to the "Northwest - NW" and "Southeast - SE" are indications of more and less competition, respectively. The figures offer a number of insights linking individual probability distributions to market outcomes:

(a) The shippers' distribution are very similar under  $\alpha = 0$  but become different under  $\alpha = 0.5$  (Figure 8). Reward interdependence incentives in the vertically integrated firm have the effect of making  $G_1$  bids more competitive (NW movement). Moreover,  $G_2$ 's prior is slightly less competitive (movement to SE). Gas firms behave as predicted by the foreclosure argument and concentrate market power on  $G_2$ .

(b) Probability distributions on the generator side are similar for all firms under  $\alpha = 0$  (Figure 9). However, when  $\alpha = 0.5$ ,  $E_1$  tends to exert more

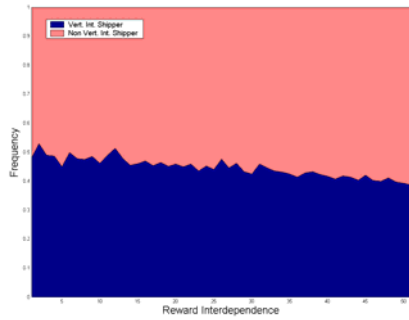


Figure 6: Shippers' Price-setting Frequencies

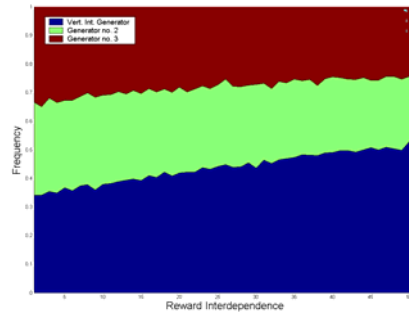


Figure 7: Generators' Price-setting Frequencies

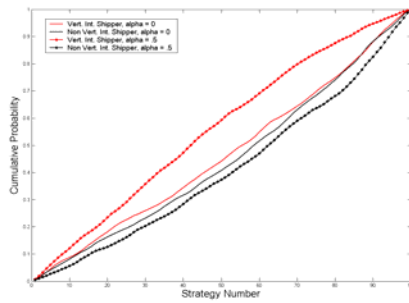


Figure 8: End of Simulation Distribution of Strategies of Shippers

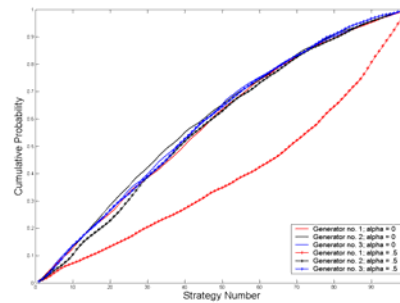


Figure 9: End of Simulation Distribution of Strategies of Generators

Figure 3: Shippers' Price-setting Frequencies, Figure 7: Generators' Price-setting Frequencies; Figure 8: End of Simulation Distribution of Strategies of Shippers; Figure 9: End of Simulation Distribution of Strategies of Generators.

market power than that of its competitors,  $E_2$  and  $E_3$  (movement to the SE). This does not fit into the raising rivals' costs logic and suggests that the coordination mechanism is driven by reward interdependences and the ability of the generating SBU to benefit from higher natural gas prices.

### 3.4 Firm Learning, Behaviour and Market Outcomes

Through their dynamic trading interaction, firms learn to prioritise those bidding strategies that achieve higher payoffs and choose them more often. Each firm's price setting frequency is related to that prioritisation of the strategies and, once marginal supply and demand patterns are established, price regularities follow. The results suggest a link between  $\alpha$ , firm learning, trading behaviour and market outcomes.

As  $\alpha$  increases,  $E_1$  sets  $P^e$  more often and manages to increase it markedly. Being at the margin more often is clearly at the expense of market share, reducing  $\pi_1^e$ . However, due to the netback market clearing procedure, a higher  $P^e$  provides more scope for higher  $P^g$ 's.  $G_1$  then lets  $G_2$  exert more market power and increase  $P^g$ .  $G_1$ , on the other hand, trades on the base-load more often, increasing its market share and profitability. The rise in upstream profits compensates the losses downstream and therefore  $\pi_1^g + \pi_1^e$  increase.

The simulations' logic is therefore quite different from foreclosure. The vertically integrated firm learns to gain market share in the upstream market and gives up market share downstream in exchange for higher  $P^e$ . The identification of this mechanism relating the market clearing sequence to vertical coordination via broad reward interdependences is this paper's main economic policy contribution.

## 4 Extensions

This section checks whether the results depend on the position of the vertically integrated SBUs in the value chain and on the market concentration levels.

### 4.1 Alternative Positions of the Vertically Integrated Firm

New simulations analyse reward interdependences between  $G_1$  and  $R_1$  plus those between  $E_1$  and  $R_1$ , keeping all other parameters constant. Table 1 and Figures 10 and 11 summarise results for  $\alpha = 0$  and  $\alpha = .5$  in these new simulations.

Two interesting findings emerge from the simulated consequences of a merger between a natural gas shipper and a retailer, complementing and extending the previous results. First, retail prices,  $P^r$ , increase from an average of 124 for  $\alpha = 0$  to 144 when  $\alpha = .5$  (+16.12%), compared to a negligible change when there is a merger between a shipper and a generator (+0.88%). Reward interdependence with  $G_1$  induces  $R_1$  to implement a less competitive-mixed strategy through which the firm becomes price setting more often with  $P^r$  increasing steadily.



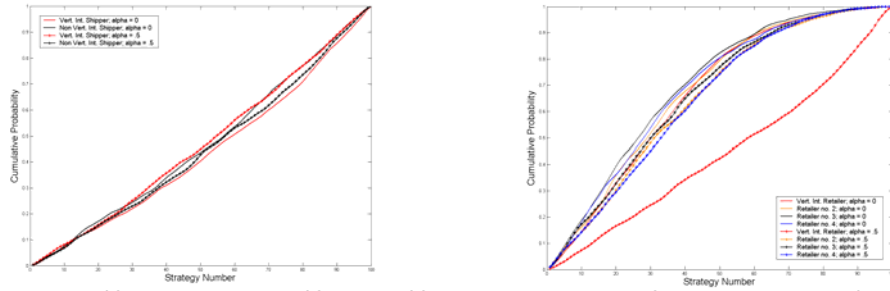


Figure 10: End of Simulation Distribution of Strategies of Shippers and Retailers in the Shipper-Retailer Merging Case

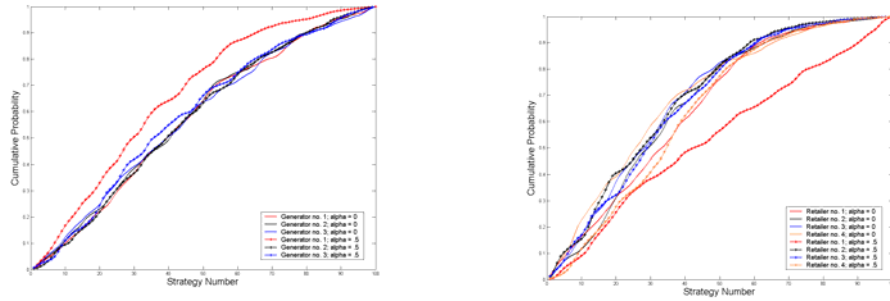


Figure 11: End of Simulation Distribution of Strategies of Generators and Retailers in the Generator-Retailer Merging case

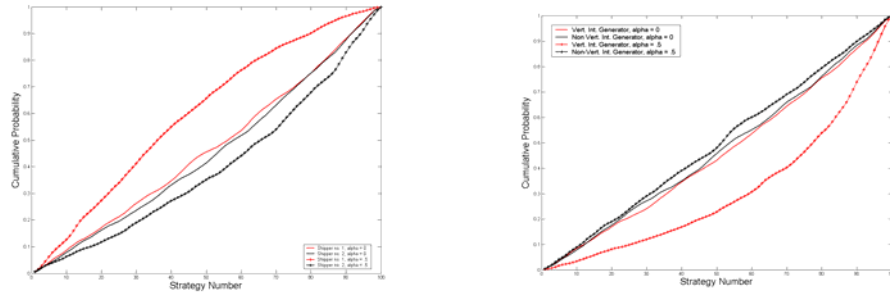


Figure 12: End of Simulation Distribution of Strategies Shippers and of Generators for a Symmetric Market Structure

Figure 4: End of Simulation Distribution of Strategies of Shippers and Retailers in the Shipper-Retailer Merging Case; Figure 11: End of Simulation Distribution of Strategies of Generators and Retailers in the Shipper-Retailer Merging Case; Figure 12: End of Simulation Distribution of Strategies of Shippers and Generators for a Symmetric Market Structure.

	$\mathbf{P}^g$	$\mathbf{P}^e$	$\mathbf{P}^r$
Separation ( $\alpha = \mathbf{0}$ )	59	83	124
Shipper-Generator ( $\alpha = .5$ )	63 +6.77%	93 +12.04%	125 +0.88%
Shipper-Retailer ( $\alpha = .5$ )	67 +15%	95 +14.45%	144 +16.12%
Generator-Retailer ( $\alpha = .5$ )	63 +6.77%	88 +6.02%	136 +9.67%

Table 1: Average Prices, A=2; B =3; C=4

	$\mathbf{P}^g$	$\mathbf{P}^e$	$\mathbf{P}^r$
Separation ( $\alpha = \mathbf{0}$ )	71	100	143
Shipper-Generator ( $\alpha = .5$ )	73 +2.81%	108 +8%	143 0%

Table 2: Average Prices, A=B=C=2.

The second result is that wholesale prices also increase. The  $P^r$  effect moves up in the value chain. It translates into higher  $P^e$  and  $P^g$  from about 83 to 95 (+14.45%) and 59 to 67 (+15%), respectively. Reward interdependences hurt end users in this case. Although the  $E_1, E_2, E_3$  probability priors and trading behaviour change little,  $G_1$  becomes more competitive and facilitates the exertion of  $G_2$  market power (Figure 10). That effect results in a  $P^e - P^g$  difference similar to the initial case. Moreover, by construction, higher  $P^r$  widens the  $[0, P^r]$  range within which  $P^e$  is determined. With a constant number of bidding strategies,  $S^i$ , similar generators' probability distributions result in higher  $P^e$  as  $P^r$  increases.

The simulations assuming integration between  $E_1$  and  $R_1$  show increases in  $P^e$  (+6.02%) and  $P^r$  (+9.67%).  $R_1$  manages to leverage its overall revenue and implement a more collusive mixed strategy that expands the base for higher  $P^e$ .  $E_1$ , on the other hand, bids more often on the base part of the load curve – more competitively. That results in  $E_2$  and  $E_3$  setting (higher)  $P^e$  (Figure 11). It is interesting to note how the non-integrated  $G_1$  and  $G_2$  capture a large proportion of that rent through a  $P^g$  increase of 6.77%.

## 4.2 Symmetric Market Structure Across Tiers

In the analysis above, market structure remained invariable and progressively less concentrated ( $A = 2$ ;  $B = 3$ ;  $C = 4$ ). The vertical foreclosure literature suggests that higher upstream concentration is an important element of the firms' ability to exert vertical market power. This conclusion is checked by simulating a market structure symmetric across tiers.

Table 2 summarises market prices for  $A = B = C = 2$ . Vertical inte-

gration between a shipper and a generator leads, as in the asymmetric case, to higher wholesale electricity and natural gas prices but not higher end user prices. Higher prices with increasing  $\alpha$ , therefore, hinge on the market clearing sequence rather than on market structure asymmetries.

The panels in Figure 12 present the strategy cumulative probability distributions in this setting. The left hand side panel shows the probability distribution for the vertically integrated firm’s upstream SBUs moving to the NW when  $\alpha$  changes from  $\alpha = 0$  to  $\alpha = .5$ , complemented again by the independent firm’s SE movement. The right hand side panel offers evidence of the downstream firm positioning itself so as to set higher prices when  $\alpha = .5$ . While there is no variation in the independent firm’s bidding strategies, the vertically integrated firm’s cumulative probability distribution moves to the SE.

These results strengthen the chapter’s main insight of higher prices emerging through market sequence coordination, rather than via the foreclosure logic. They also suggest that market structure asymmetries are not a necessary condition for the mechanism to operate.<sup>10</sup>

## 5 Discussion

The existence of interdependences between vertically related SBUs has become a bedrock in the business strategy literature, yet we know relatively little about the underlying forces that create these interdependences and their effects. A set of agent-based simulations identifies one such effect in the de-regulated energy industry. Reward interdependences between SBUs lead to trading coordination and higher prices. Under tight reward interdependence structures, vertically integrated firms give up profits downstream in order to increase the scope for upstream profits. This leads to strategic behaviour that superficially has the appearance of foreclosure but that is based on a quite different principle. This paper adds to the preceding literature in at least three ways.

On the methodological side, there are apparently no other multi-tier energy simulations driven by netback principles in the literature. Industry wisdom suggests that this type of market clearing characterises better the reciprocal relationships between electricity and gas prices than conventional supply chain models.

The second contribution relates to the literature on the sources of vertical market power in the energy industry (e.g. Bushnell et al., 2005; Granitz and Klein, 1996; Kühn and Machado, 2004). The financial dependence between electricity and natural gas markets is not captured in the foreclosure argument, where causal pricing relationships are sequential from the upstream to the downstream segment. The simulations unveil a new mechanism that suggests a solution to the puzzle of how vertical market power is observed in some energy markets where it should not really appear. Netback, i.e. “spark spread”, pricing means that wholesale gas and electricity prices are determined

---

<sup>10</sup>Results under symmetrical  $A = B = C = 3$  and  $A = B = C = 4$  assumptions were qualitatively equivalent to those of  $A = B = C = 2$ .

in a down-to-upstream sequence. Hence, vertical market power can occur in compulsory, uniform price auction, without trading internalisation and price discrimination.

Thirdly, the research identifies a link between internal incentive structures, SBU behaviour and firm performance. Reward interdependence has been shown to be an instrument leading to market power, via higher vertical SBU coordination. Ways in which reward interdependences can be articulated include direct bonuses and stock options, and casual evidence indicates that these are widespread in the energy industry. It is interesting to note that such reward interdependence contracts are internal to the firm and, hence, normally fall outside the scope for regulatory intervention. Whether firms use them explicitly as a way of aligning their interests to those of their SBU employees is an interesting question for future empirical work.

## References

- [1] Bushnell, J., Celeste Saravia and Erin Mansur: “Vertical Arrangements, Market Structure, and Competition: An Analysis of Restructured U.S. Electricity Markets”. UC Energy Institute CSEM Working Paper-126.
- [2] Chatterjee, S. (1991): “Gains in Vertical Acquisitions and Market Power: Theory and Evidence”. *The Academy of Management Journal*, vol. 34, issue 2, pp. 436-448.
- [3] Chatterjee, S. Michael Lubatkin and Timothy Schoenecker (1992): “Vertical Strategies and Market Structure: A Systematic Risk Analysis”. *Organization Science*, vol. 3, no. 1, pp. 138-156.
- [4] Finon, D. and Atle Midttun (2005): *Reshaping European Gas and Electricity Industries*. Elsevier Science, ISBN 0-08-044550-0.
- [5] Granitz, E. and Benjamin Klein (1996): “Monopolization by “Raising Rivals’ Costs”: The Standard Oil Case”. *Journal of Law & Economics*, vol. 39, issue 1, pp. 1-47.
- [6] Grossman S. J., and O. D. Hart (1986): “The Cost and Benefit of Ownership: A Theory of Lateral and Vertical Integration” *Journal of Political Economy*, vol. 94, pp. 691-719.
- [7] Gulati, R., Paul R. Lawrence and Phanish Puranam (forthcoming): “Adaptation in Vertical Relationships: Beyond Incentive Conflict”. *Strategic Management Journal*.
- [8] Gulati, R. and Harbir Singh (1998): “The Architecture of Cooperation: Managing Coordination Costs and Appropriation Concerns in Strategic Alliances”. *Administrative Science Quarterly*, vol. 43, pp. 781-794.
- [9] Gupta, A. K. and Govindarajan, V. (1986): “Resource Sharing among SBU’s: Strategic Antecedents and Administrative Implications”. *Academy of Management Journal*, vol. 29, no. 4, pp. 695-714.

- [10] Harrigan, K. R. (1984): “Formulating Vertical Integration Strategies”. *The Academy of Management Review*, vol. 9, issue 4, pp. 638-652.
- [11] Harrigan, K. R. (1986): “Matching Vertical Integration Strategies to Competitive Conditions”. *Strategic Management Journal*, vol. 7, issue 6, pp. 535-555.
- [12] Holmstrom, B. (1982): “Moral Hazard in Teams” *Bell Journal of Economics*, vol. 13, no. 2, pp. 324-340.
- [13] Hunger, D. (2003): “Analyzing Gas and Electric Convergence Mergers: A Supply Curve is Worth a Thousand Words” *Journal of Regulatory Economics*, vol. 24, no. 2, pp. 161-173.
- [14] Joskow, P. (2000): “Deregulation and Regulatory Reform in the U.S. Electric Power Sector” in *Deregulation of Network Industries: The Next Steps* (S. Peltzman and C. Winston eds.), Brookings Press.
- [15] Judd, K. L. and Leigh Tesfatsion, eds. (forthcoming): *Handbook of Computational Economics, Volume II: Agent-Based Computational Economics*. Handbooks in Economics Series, North-Holland, the Netherlands.
- [16] Knez, M. and Colin Camerer (1994): “Creating Expectational Assets in the Laboratory: Coordination in ‘Weakest Link’ Games”. *Strategic Management Journal*, vol. 15, special issue: ‘Competitive Organizational Behavior’, pp. 101-119.
- [17] Kühn, K.-U. and Matilde Machado (2004): “Bilateral Market Power and Vertical Integration in the Spanish Electricity Spot Market”. *CEPR Working Paper*, DP4590.
- [18] Kretschmer, T. and Phanish Puranam (2004): “Interdependence between Organizational Units: When Do Broad Incentives Create Value”. Working Paper, London Business School.
- [19] Lawrence, P. R. and Jay W. Lorsch (1967): “Differentiation and Integration in Complex Organisations”. *Administrative Science Quarterly*, vol. 12, issue 1, pp. 1-48.
- [20] Mahoney, J. T. (1992): “The Choice of Organizational Form: Vertical Financial Ownership versus Other Methods of Vertical Integration”. *Strategic Management Journal*, vol. 13, issue 8, pp. 559-584.
- [21] Midgley, D.F., Robert Marks and Lee G. Cooper (1997): “Breeding Competitive Strategies”. *Management Science*, no. 43, issue 3, pp. 257-275.
- [22] Midttun, A. and Dominique Finon (2004): *Reshaping European Gas and Electricity Industries*. Elsevier Science, ISBN: 0080445500.
- [23] Newbery, D. (1999): *Privatization, Restructuring and Regulation of Network Utilities*. MIT Press, ISBN 0-262-14068-3.
- [24] Nicolaisen, J., Petrov, V. and Tesfatsion, L. (2001): “Market Power and Efficiency in a Computational Electricity Market with Discriminatory

Double-Auction Pricing”. *IEEE Transactions on Evolutionary Computation*, vol. 5, pp. 504-523.

- [25] Ordoover, J. A. Garth Saloner and Steven Salop (1990): “Equilibrium Vertical Foreclosure”. *The American Economic Review*, vol. 80, no. 1, pp. 127-142.
- [26] Petersen, T. (1992): “Individual, Collective and Systems Rationality in Work Groups: Dilemmas and Market-Type Solutions”. *American Journal of Sociology*, vol. 98, no. 3.
- [27] Rey, P. and Jean Tirole (2004): “A Primer on Foreclosure”. *Handbook of Industrial Organization*, edited by Mark Armstrong and Rob Porter.
- [28] Riordan, M. H. (1995): “Anticompetitive Vertical Integration by a Dominant Firm”. *The American Economic Review*, vol. 88, no. 5.
- [29] Roth, A. and Erev, I. (1995): “Learning in Extensive Form Games: Experimental Data and Simple Dynamic Models in the Intermediate Term”. *Games and Economic Behaviour*, 8, pp. 164-212.
- [30] Smith, V. (1982): “Competitive Market Institutions: Double Auctions vs. Sealed Bid-Offer Auctions”. *The American Economic Review*, vol. 72, issue 1, pp. 58-77.
- [31] Stern, J. P. (1998): *Competition and Liberalization in European Gas Markets: A Diversity of Models*. Royal Institute of International Affairs, London. ISBN 1 86203 017 0.
- [32] von der Fehr, N. and D. Harbord (1993): “Spot Market Competition in the UK Electricity Industry”, *The Economic Journal*, vol. 103, pp. 531-546.
- [33] Wageman, R. and Baker, G. (1997): “Incentives and Cooperation: The Joint Effects of Task and Reward Interdependence on Group Performance”. *Journal of Organizational Behaviour*, vol. 18, no. 2, pp. 139-158.
- [34] Williamson, O. (1975): *Market and Hierarchies*. Free Press, New York.
- [35] Zander, A. and Donald Wolfe (1964): “Administrative Rewards and Coordination among Committee Members”. *Administrative Science Quarterly*, pp. 50-69.

**Bücher des Forschungsschwerpunkts Markt und politische Ökonomie**  
**Books of the Research Area Markets and Political Economy**

- Pablo Beramendi  
**Decentralization and Income Inequality**  
2003, Madrid: Juan March Institute
- Thomas Cusack  
**A National Challenge at the Local Level: Citizens, Elites and Institutions in Reunified Germany**  
2003, Ashgate
- Sebastian Kessing  
**Essays on Employment Protection**  
2003, Freie Universität Berlin  
<http://www.diss.fu-berlin.de/2003/202>
- Daniel Krähmer  
**On Learning and Information in Markets and Organizations**  
2003, Shaker Verlag
- Bob Hancké  
**Large Firms and Institutional Change. Industrial Renewal and Economic Restructuring in France**  
2002, Oxford University Press
- Andreas Stephan  
**Essays on the Contribution of Public Infrastructure to Private: Production and its Political Economy**  
2002, dissertation.de
- Peter A. Hall, David Soskice (Eds.)  
**Varieties of Capitalism**  
2001, Oxford University Press
- Hans Mewis  
**Essays on Herd Behavior and Strategic Delegation**  
2001, Shaker Verlag
- Andreas Moerke  
**Organisationslernen über Netzwerke – Die personellen Verflechtungen von Führungsgremien japanischer Aktiengesellschaften**  
2001, Deutscher Universitäts-Verlag
- Silke Neubauer  
**Multimarket Contact and Organizational Design**  
2001, Deutscher Universitäts-Verlag
- Lars-Hendrik Röller, Christian Wey (Eds.)  
**Die Soziale Marktwirtschaft in der neuen Weltwirtschaft, WZB Jahrbuch 2001**  
2001, edition sigma
- Michael Tröge  
**Competition in Credit Markets: A Theoretic Analysis**  
2001, Deutscher Universitäts-Verlag
- Torben Iversen, Jonas Pontusson, David Soskice (Eds.)  
**Unions, Employers, and Central Banks**  
2000, Cambridge University Press
- Tobias Miarka  
**Financial Intermediation and Deregulation: A Critical Analysis of Japanese Bank-Firm-Relationships**  
2000, Physica-Verlag
- Rita Zobel  
**Beschäftigungsveränderungen und organisationales Lernen in japanischen Industriegesellschaften**  
2000, Humboldt-Universität zu Berlin  
<http://dochohost.rz.hu-berlin.de/dissertationen/zobel-rita-2000-06-19>
- Jos Jansen  
**Essays on Incentives in Regulation and Innovation**  
2000, Tilburg University
- Ralph Siebert  
**Innovation, Research Joint Ventures, and Multiproduct Competition**  
2000, Humboldt-Universität zu Berlin  
<http://dochohost.rz.hu-berlin.de/dissertationen/siebert-ralph-2000-03-23/>
- Damien J. Neven, Lars-Hendrik Röller (Eds.)  
**The Political Economy of Industrial Policy in Europe and the Member States**  
2000, edition sigma
- Jianping Yang  
**Bankbeziehungen deutscher Unternehmen: Investitionsverhalten und Risikoanalyse**  
2000, Deutscher Universitäts-Verlag
- Christoph Schenk  
**Cooperation between Competitors – Subcontracting and the Influence of Information, Production and Capacity on Market Structure and Competition**  
1999, Humboldt-Universität zu Berlin  
<http://dochohost.rz.hu-berlin.de/dissertationen/schenk-christoph-1999-11-16>
- Horst Albach, Ulrike Görtzen, Rita Zobel (Eds.)  
**Information Processing as a Competitive Advantage of Japanese Firms**  
1999, edition sigma
- Dieter Köster  
**Wettbewerb in Netzproduktmärkten**  
1999, Deutscher Universitäts-Verlag
- Christian Wey  
**Marktorganisation durch Standardisierung: Ein Beitrag zur Neuen Institutionenökonomik des Marktes**  
1999, edition sigma

## DISCUSSION PAPERS 2005

Lutz Engelhardt	<b>Geschäftsmodelle und nationale Institutionen: Ein Vergleich britischer und deutscher Neuemissionen aus der IT-Service – und Softwareindustrie 1996 – 2002</b>	SP II 2005 – 01
Philipp Rehm	<b>Citizen Support for the Welfare State: Determinants of Preferences for Income Redistribution</b>	SP II 2005 – 02
Sigurt Vitols Lutz Engelhardt	<b>National Institutions and High Tech Industries: A Varieties of Capitalism Perspective on the Failure of Germany's "Neuer Markt"</b>	SP II 2005 – 03
Sebastian G. Kessing Kai A. Konrad	<b>Union Strategy and Optimal Income Taxation</b>	SP II 2005 – 04
Kai A. Konrad Amedeo Spadaro	<b>Education, Redistributive Taxation, and Confidence</b>	SP II 2005 – 05
Joseph A. Clougherty	<b>The International Drivers of Domestic Airline Mergers in Twenty Nations: Integrating Industrial Organization and International Business</b>	SP II 2005 – 06
Talat Mahmood Sara Geerdes Klaus Schömann	<b>Unmet Labour Demand In Europe – Chances for Immigrants?</b>	SP II 2005 – 07
Johannes Münster	<b>Simultaneous Inter- and Intra-Group Conflicts</b>	SP II 2005 – 08
Albert Banal-Estañol Jo Seldeslachts	<b>Merger Failures</b>	SP II 2005 – 09
Kai A. Konrad	<b>Silent Interests and All-Pay Auctions</b>	SP II 2005 – 10
Johannes Münster	<b>Lobbying Contests with Endogenous Policy Proposals</b>	SP II 2005 – 11
Oz Shy	<b>Dynamic Models of Religious Conformity and Conversion: Theory and Calibration</b>	SP II 2005 – 12
Kai A. Konrad Sergios Skaperdas	<b>Succession Rules and Leadership Rents</b>	SP II 2005 – 13
Kai A. Konrad Dan Kovenock	<b>Equilibrium and Efficiency in the Tug-of-War</b>	SP II 2005 – 14
Thomas Cusack Torben Iversen Philipp Rehm	<b>Risks at Work: The Demand and Supply Sides of Government Redistribution</b>	SP II 2005 – 15
Tomaso Duso Klaus Gugler Burcin Yurtoglu	<b>EU Merger Remedies: A Preliminary Empirical Assessment</b>	SP II 2005 – 16
Dan Kovenock Brian Roberson	<b>Electoral Poaching and Party Identification</b>	SP II 2005 – 17
Sebastian G. Kessing Kai A. Konrad Christos Kotsogiannis	<b>Federal Tax Autonomy and the Limits of Cooperation</b>	SP II 2005 – 18



Jonathan Beck Michał Grajek Christian Wey	<b>Hypermarket Competition and the Diffusion of Retail Checkout Barcode Scanning</b>	SP II 2005 – 19
Ela Glowicka	<b>Bailouts in a Common Market: A Strategic Approach</b>	SP II 2005 – 20
Richard Deeg	<b>Complementarity and Institutional Change: How Useful a Concept?</b>	SP II 2005 – 21

## DISCUSSION PAPERS 2006

Klaus Gugler Dennis C. Müller B. Burçin Yurtoglu	<b>The Determinants of Merger Waves</b>	SP II 2006 – 01
Augusto R. Micola Albert Banal Estañol Derek W. Bunn	<b>Incentives and Cooperation in Vertically Related Energy Markets</b>	SP II 2006 – 02

Bei Ihren Bestellungen von WZB-Papers schicken Sie bitte unbedingt einen an Sie adressierten Aufkleber mit sowie je paper eine Briefmarke im Wert von 0,51 Euro oder einen "Coupon Reponse International" (für Besteller aus dem Ausland)

Please send a self addressed label and postage stamps in the amount of 0.51 Euro or a "Coupon-Reponse International" (if you are ordering from outside Germany) for each WZB-paper requested

**Bestellschein**

**Order Form**

**Absender / Return Address:**

Wissenschaftszentrum Berlin  
für Sozialforschung  
Presse- und informationsreferat  
Reichpietschufer 50

D-10785 Berlin-Tiergarten

---

---

---

---

**Hiermit bestelle ich folgende(s)  
Discussion paper(s):**

**Please send me the following  
Discussion paper(s):**

Bestell-Nr. / Order no.	Autor/in, Kurztitel /Author(s) / Title(s) in brief