

Guidance on the application of the Competition Act 1998 in the water and sewerage sectors - consultation - comments due by 12 March 2008

Purpose of this guidance

This guidance sets out how Ofwat will apply the CA98 to the water and sewerage sectors in England and Wales. It also provides advice and information about the factors which Ofwat will take into account when considering whether to exercise its powers under the CA98¹. This guidance is not exhaustive. Ofwat will consider the circumstances of each case on an individual basis, with reference to the issues set out in this guidance.

The predecessor to this guidance was originally published in February 2000 as OFT 422. This guidance replaces OFT 422 and reflects the changes in EC competition law, developments in sector-specific legislation, the development of case law and changes to Ofwat's structure.

Ofwat may update this guidance in the future to take account of relevant developments in the water and sewerage sectors. When doing so, Ofwat will take account of any changes to competition law guidance issued by the OFT, other regulators or the European Commission, as well as the development of relevant case law applying the CA98 and the EC Treaty. Consultation with interested parties, including the OFT and other sector regulators, will take place before making any changes to the guidance².

Contents of this guidance

Chapter 2 of this guidance sets out Ofwat's powers and duties under the CA98. It explains Ofwat's jurisdiction, the application of UK and EC competition law, the circumstances in which Articles 81 and 82 of the EC Treaty may be applied, Ofwat's discretion over the use of its CA98 and sectoral powers and its powers under the Enterprise Act 2002 (EA02).

Chapter 3 sets out Ofwat's process of investigation and explains in more detail the interaction between its powers under the CA98 and sector-specific legislation.

¹ This guidance should be read in conjunction with the other guidance in the series – see the OFT's website (www.ofwat.gov.uk).

² The latest version of this guidance can be found in the Ofwat library and is also available on Ofwat's website (www.ofwat.gov.uk) and on the OFT's website (www.ofwat.gov.uk).

Finally, **chapter 4** considers competition issues specific to the water and sewerage sectors with examples, where relevant.

1. Introduction

- 1.1 The Competition Act 1998 (CA98) came into force on 1 March 2000 and is applied and enforced by the Office of Fair Trading (OFT) and the concurrent regulators including the Water Services Regulation Authority (Ofwat).
- 1.2 On 1 May 2004, the EC Modernisation Regulation³ came into force. The Regulation amends the CA98⁴ and gives the OFT and concurrent regulators powers to apply and enforce Articles 81 and 82 of the EC Treaty⁵ as well as Chapter I and Chapter II of the CA98. It also abolishes the system of notifying agreements for exemption under Article 81(3) of the EC Treaty and requires individual companies to assess whether their agreements comply with competition law.
- 1.3 Article 35 of the Modernisation Regulation requires each of the Member States to designate National Competition Authorities (NCAs) for the purpose of applying Articles 81 and 82 of the EC Treaty. Ofwat has been designated as a NCA for this purpose.
- 1.4 Article 81 of the EC Treaty and Chapter I⁶ of the CA98 prohibit agreements between undertakings, decisions by associations of undertakings and concerted practices which have the object or effect of preventing, restricting or distorting competition. Article 81 of the EC Treaty applies to agreements which may appreciably affect trade between Member States in the EU. The Chapter I prohibition applies to agreements implemented or intended to be implemented in the whole or part of the United Kingdom, which may affect trade within the United Kingdom.
- 1.5 Article 82 of the EC Treaty and Chapter II⁷ of the CA98 prohibit conduct by one or more undertakings which amounts to an abuse of a dominant position in a market. Article 82 applies to conduct within the common market or in a substantial part of it in so far as it may affect trade between

³ Council Regulation EC 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (16 December 2002) (OJ L1, 4.1.2003 p.1) (the Modernisation Regulation).

⁴ The Competition Act 1998 and other Enactments (Amendment) Regulations 2004 SI 2004 No. 1261 entered into force on 1 May 2004 and provides for the implementation of the Modernisation Regulation which requires National Competition Authorities (NCAs) and the courts of Member States to apply and enforce Articles 81 and 82 of the EC Treaty.

⁵ The Treaty establishing the European Community.

⁶ Section 2(1) of the CA98.

⁷ Section 18(1) of the CA98.

Member States. The Chapter II prohibition applies if the dominant position is held within the whole or part of the United Kingdom and the conduct in question may affect trade within the whole or part of the United Kingdom.

2. Powers and duties

Ofwat's jurisdiction

- 2.1 Ofwat's jurisdiction to apply Articles 81 and 82 of the EC Treaty and Chapters I and II of the CA98 is set out in section 31 of the Water Industry Act 1991 (WIA91), as amended by the Water Act 2003 (WA03). This jurisdiction extends to all commercial activities connected with the supply of water or securing a supply of water or with the provision or securing of sewerage services in England and Wales⁸, and includes conduct by undertakings that are not appointed under the WIA91, to the extent that the conduct falls within this definition.

The CA98

- 2.2 Ofwat's concurrent powers under the CA98 allow Ofwat to:

- give guidance on the application of the CA98, including general advice and information on how the CA98 applies to the water and sewerage sector;
- consider complaints about possible infringements of any of Article 81, Article 82, the Chapter I and Chapter II prohibitions;
- conduct investigations, both on its own initiative and in response to complaints, including requiring the production of documents and information and searching premises⁹;
- impose interim measures to prevent serious and irreparable damage or to protect the public interest¹⁰:
 - in the form of requiring an undertaking to terminate the unlawful agreement or to cease unlawful conduct; or
 - by requiring an undertaking to modify conduct or agreements to prevent existing (and future) breaches of the prohibitions in the CA98;
- give directions to bring an infringement to an end¹¹;
- accept binding commitments to address competition concerns, where appropriate¹²; and
- impose financial penalties on undertakings of up to 10% of their worldwide turnover in the business year preceding the date of the decision¹³.

⁸ 'Concurrent Application to Regulated Industries' (OFT 405) (December 2004).

⁹ Sections 26, 27, 28 and 28A of the CA98.

¹⁰ Section 35 of the CA98.

¹¹ Section 32 of the CA98.

¹² Section 31A of the CA98.

Obligation to apply Articles 81 and 82 of the EC Treaty

- 2.3 Article 3(1) of the Modernisation Regulation states that where NCAs (including Ofwat) apply national competition law to agreements or conduct which may affect trade between Member States within the meaning of Articles 81 or 82 of the EC Treaty, they should also apply Articles 81 and 82 of the EC Treaty. Therefore, where the Chapter I and/or Chapter II prohibitions apply, and there is an actual or potential effect on trade between Member States, Ofwat will also apply Article 81 and/or Article 82 in accordance with Article 3 of the Modernisation Regulation. Ofwat will decide whether to apply the Chapter I or Chapter II prohibitions in parallel with the application of Articles 81 or 82 of the EC Treaty¹⁴.
- 2.4 Article 3(2) of the Modernisation Regulation prevents Ofwat and the other NCAs from prohibiting agreements, decisions or concerted practices by undertakings that would be permitted under Article 81¹⁵. However, Ofwat may apply national competition law more strictly and prohibit unilateral conduct under national legislation even if that conduct would be permitted under Article 82.
- 2.5 However, the requirement to apply Article 81 and/or Article 82 does not apply if the national law being applied pursues an objective which is predominantly different from those pursued by Article 81 and Article 82¹⁶.

The objective of Articles 81 and 82 of the EC Treaty

- 2.6 The objective of Article 81 and Article 82 is the protection of competition on the market¹⁷.

Effect on inter-state trade

- 2.7 Where Ofwat is applying national competition law, it will have regard to whether the agreement or conduct under consideration has an actual or

¹³Section 36 of the CA98 and Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 as amended by the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004. For more information, please refer to the 'OFT's guidance as to the appropriate amount of a penalty' (OFT423).

¹⁴ In cases where an undertaking has committed an infringement of both EC competition law (Article 81 or Article 82 of the EC Treaty) and national competition law (Chapter I or Chapter II of the CA98), the undertaking will not be penalised twice for the same anti-competitive effects (paragraph 4.13 of 'Modernisation' (OFT 442) (December 2004)).

¹⁵ The agreement can be permitted if: the agreement does not restrict competition under Article 81(1); the conditions of Article 81(3) are met; or the agreement is covered by an EC block exemption or a continuing individual notification exemption.

¹⁶ Article 3(3) of the Modernisation Regulation.

¹⁷ Recital 9 of the Modernisation Regulation.

potential effect on inter-state trade. Given that water and sewerage services are usually traded over short distances it is unlikely in most cases that there will be an effect on inter-state trade. However, Ofwat will consider each case individually in conjunction with the principles developed by EC case law and will have regard to the European Commission's notice on the effect on trade¹⁸.

Interaction with sectoral powers

- 2.8 When carrying out its duties under the WIA91, Ofwat may, in certain circumstances, be using powers that could be considered to pursue the same objective as Articles 81 and 82 of the EC Treaty, ie the protection of competition on the market. Such instances could be considered to be an application of 'national competition law' for the purposes of Article 3 of the Modernisation Regulation.
- 2.9 Where the exercise of sectoral powers is considered an application of national competition law and has an actual or potential effect on trade between Member States, Ofwat is required to apply Article 81 and/or Article 82 in accordance with Article 3(2) of the Modernisation Regulation. Where Ofwat is exercising powers that predominantly pursue a different objective to that being pursued by Article 81 and Article 82, it would not need to apply these Articles¹⁹.
- 2.10 Ofwat will consider on a case-by-case basis whether the exercise of sectoral powers amounts to an application of national competition law.
- 2.11 Where a particular agreement or practice falls within the scope of the WIA91, as well as one of the prohibitions in the CA98, Ofwat is able to decide whether to use its powers under the WIA91 or the CA98, and will make use of whichever statutory powers it judges to be the most appropriate to address the specific conduct.
- 2.12 In circumstances where Ofwat could use its powers under the CA98 or its sectoral powers, Ofwat will decide at the earliest possible stage which, if either, set of powers it is more appropriate to use and will advise the relevant parties accordingly. Ofwat is not, however, prevented from reviewing its position should further information come to light. The overriding principle is that Ofwat will seek to use the solution (if any) that is, on balance, the most effective, efficient and quick, where a problem is found to exist.

¹⁸ Guidance on the effect on trade concept contained in Articles 81 and 82 of the EC Treaty (OJ C101, 27.4.2004, p.81).

¹⁹ Paragraphs 4.28 to 4.29 of 'Modernisation' (OFT 442) (December 2004).

2.13 Factors that may be relevant to Ofwat's decision (this list is not exhaustive) when deciding whether to use its CA98 or sector specific powers include:

- whether regulation specifically addresses the complaint;
- whether regulation is being developed or implemented which will in the near future address the issues raised by the complainant;
- the complainant's wishes, in cases where a complainant has expressed a preference for our competition or regulatory powers;
- the speed with which enforcement action is likely to progress under either competition or regulatory powers;
- the extent to which a particular enforcement route would resolve the issues raised in the complaint;
- the scope for interim measures or similar should they be appropriate, under competition or regulatory powers;
- the resource implications associated with the different routes;
- the deterrent effect of the different routes; and
- the availability of damages to a complainant.

2.14 Ofwat considers that many potential competition issues in the water industry should be addressed by water companies complying with the requirements of Chapter 2A of the WIA91, as amended by the WA03. Chapter 2A sets out a sector-specific regulatory regime for market competition in public water supply. In particular:

- sections 66A to 66C of the WIA91 set out the duties of water undertakers to supply water to holders of water supply licences (licensees);
- section 66D(2) of the WIA91 provides that the period for which, and the terms and conditions on which a water undertaker is to perform any duty under sections 66A to 66C of the WIA91 are those which are agreed between the water undertaker and the licensee or, where agreement cannot be reached, those which are determined by Ofwat (if the matter is referred to it by the licensee and if those terms are acceptable to the licensee);
- section 66D(3) of the WIA91 provides that the charges payable by a licensee under an agreement or determination shall be fixed in accordance with the Costs Principle as set out in section 66E of the WIA91;
- under section 66D(4) of the WIA91, Ofwat must issue guidance in accordance with which the terms and conditions of any agreement must be made. Under section 66D(6) of the WIA91, Ofwat's guidance must include guidance about the fixing of charges according to the Costs Principle; and
- under sections 66D(7) and (8) of the WIA91, Ofwat has the power to require the parties to an agreement to modify or terminate that

agreement, if it appears that the agreement has not been made in accordance with the Costs Principle or other relevant guidance issued.

- 2.15 There are other sections of the WIA91 which set out sector-specific rules for competition and other relevant issues such as sections 6-9 of the WIA91 on inset appointments and sections 40 and 40A of the WIA91 on bulk supply determinations.

Conforming with Community law

- 2.16 Article 16(2) of the Modernisation Regulation prevents Ofwat from taking decisions under Article 81 or Article 82 which would run counter to decisions by the European Commission on the same agreement or conduct.
- 2.17 Section 60 of the CA98 places an obligation on Ofwat to answer questions arising under Part I of the CA98 (which includes the Chapter I and Chapter II prohibitions) in such a way as to ensure consistency with Community law. The competition law guidance 'Modernisation' (OFT442)²⁰ contains further detail on conforming to EC law.

The application of national and EC competition law

- 2.18 The CA98 sets out the procedures that Ofwat must follow when using its competition powers. These procedures are the same for the application and enforcement of Article 81 and Article 82 of the EC Treaty, as for the Chapter I and Chapter II prohibitions. The process and case assessment in this guidance apply equally to the investigation of potential infringements of Article 81 or Article 82, as to the investigation of potential infringements of the Chapter I or Chapter II prohibitions.

Interaction with the EA02

Market investigation references

- 2.19 The EA02 empowers the OFT and certain regulators (including Ofwat) to make references to the Competition Commission (CC) for the investigation of particular markets²¹. Section 131(1) of the EA02 provides that the OFT and the concurrent regulators have powers to make a market investigation reference to the CC where there are reasonable grounds for suspecting

²⁰ Paragraphs 4.7 to 4.12 of 'Modernisation' (OFT 442) (December 2004).

²¹ Part 4 of the EA02.

that any feature, or combination of features, of a market in the UK prevents, restricts or distorts competition. The obligation to apply Articles 81 and 82 may arise to the extent that the objective of a market reference is predominantly similar to that of Articles 81 and/or Article 82 and the conduct in question affects trade between Member States²². Further details of Ofwat's powers under Part 4 of the EA02 are set out in the OFT guidance 'Market investigation references' (OFT511)²³.

Criminal cartel offences

2.20 The EA02 gives the OFT powers to investigate individuals suspected of having committed the criminal cartel offence²⁴. Ofwat and the regulators with concurrent powers under the CA98 do not have any power to investigate the criminal cartel offence. The competition law guidance 'Modernisation' (OFT 442) sets out the OFT's approach to the interaction of EC competition law with this power²⁵.

²² Paragraph 2.12 of 'Market Investigation References – Guidance about the Making of References Under Part 4 of the Enterprise Act' (OFT511) (March 2006).

²³ 'Market Investigation References – Guidance about the Making of References Under Part 4 of the Enterprise Act' (OFT511) (March 2006).

²⁴ Section 188 of the EA02.

²⁵ Paragraphs 4.21 to 4.27 of 'Modernisation' (OFT 442) (December 2004).

3. Process for investigation

Whether to start a CA98 investigation

- 3.1 Ofwat may conduct an investigation if it has reasonable grounds for suspecting that Article 81, Article 82, the Chapter I and/or the Chapter II prohibition has been infringed.
- 3.2 Under section 25 of the CA98 the OFT or a concurrent regulator may conduct an investigation if there are reasonable grounds for suspecting an infringement of the Chapter I prohibition, Chapter II prohibition, Article 81 or Article 82 of the EC Treaty. We will consider starting an investigation under the CA98 in response to a complaint when the evidence is sufficient to fulfil the section 25 criterion, and when we deem it to be the most appropriate legislation to address the issues raised by the complaint. We may also start an investigation on our own initiative when we consider the section 25 criterion has been met.
- 3.3 When we receive a complaint we consider carefully, amongst other things:
- the scale of the potential harm to consumers that might arise from the conduct under scrutiny;
 - which of our powers would be the most appropriate to address the complaint;
 - the complainant's views;
 - the benefits of setting a precedent for the market;
 - the size of the market(s) potentially affected by the conduct under scrutiny; and
 - our resource constraints.
- 3.4 Where a complaint raises issues that fall within the scope of the WIA91 as well as the CA98, Ofwat has discretion to use its powers under the WIA91 or the CA98. In such cases, Ofwat will make use of whichever statutory powers it judges to be the more appropriate (if any) to address the specific conduct. Ofwat will decide at the earliest possible stage which powers it is more appropriate to use and will inform the relevant parties accordingly.
- 3.5 CA98 investigations are often lengthy and resource intensive. They can impose significant costs on Ofwat and all the parties involved throughout the investigation. To ensure that Ofwat deploys its resources effectively, Ofwat will require evidence from complainants to support any allegations of anti-competitive behaviour. A general allegation that the CA98 (and/or Articles 81 and 82 of the EC Treaty) has been breached is unlikely to be adequate. Ofwat will endeavour to assist complainants, where appropriate, to submit the necessary information.

- 3.6 Cases are allocated by agreement between the OFT and the relevant concurrent regulator, to the UK competition authority 'best' placed to act²⁶. Cases regarding water and/or sewerage services in England and Wales are normally allocated to Ofwat. Where an agreement or conduct has an effect upon competition in the markets regulated by Ofwat and on competition in another EC Member State, the case will be allocated to the NCA in the Member State 'well' placed to act²⁷.
- 3.7 Once there is agreement that Ofwat is responsible for a case, Ofwat will attempt as quickly as possible to determine whether the case meets the requirements of section 25 of the CA98. Ofwat will also consider the potential economic effect of the agreement or conduct in the particular case. Ofwat will also use its existing knowledge of the issues to determine the nature of the complaint, where it is relevant. Ofwat may seek additional information informally from undertakings before deciding whether it should commence an investigation.
- 3.8 Where there are insufficient grounds for suspecting an agreement or conduct infringes Article 81, Article 82, the Chapter I and/or the Chapter II prohibition, Ofwat will not commence a formal CA98 investigation. In such circumstances, Ofwat will inform the relevant parties of this decision in writing. The OFT's guidance 'Involving Third Parties in Competition Act Investigations' (OFT451) provides details of the circumstances in which the OFT (and Ofwat) will provide complainants and other third parties with an opportunity to comment on its provisional findings before the conclusion of an investigation²⁸.

Information gathering

- 3.9 The CA98 provides Ofwat with various powers to investigate suspected anti-competitive behaviour. It may:
- require the production of specified documents or specified information²⁹;
 - enter business premises without a warrant³⁰; and
 - enter and search business³¹ and/or domestic³² premises with a warrant.

²⁶ The Competition Act 1998 (Concurrency) Regulations (SI 2004 No. 1077) and *Concurrent application to regulated industries* (OFT405) (December 2004).

²⁷ European Commission Notice on cooperation within the network of competition authorities (OJ C101, 27.04.2004, p.43).

²⁸ 'Involving Third Parties in Competition Act Investigations' (OFT451) (April 2006).

²⁹ Section 26 of the CA98.

³⁰ Section 27 of the CA98.

³¹ Section 28 of the CA98.

³² Section 28A of the CA98.

- 3.10 These powers are set out in detail in the OFT guidance 'Powers of Investigation' (OFT 404)³³.
- 3.11 When investigating potential infringements under the CA98, the WIA91 or issues under Part 4 of the EA02, Ofwat may need to seek information from various undertakings and other relevant persons. Ofwat has a range of information gathering powers under competition and sector-specific legislation.
- 3.12 When requesting information, Ofwat will specify the potential infringement that it is investigating and the legislation it is using. Where more than one of Ofwat's powers are considered to be potentially appropriate, Ofwat may make separate information requests under each of these powers. This will enable Ofwat to decide which specific power(s) are likely to be the most appropriate to address the conduct or agreement concerned.
- 3.13 If it becomes clear to Ofwat when conducting an investigation that a particular power is no longer appropriate, it will cease to request information under that power and will inform the undertaking concerned. Ofwat will also inform an undertaking if a new infringement is suspected after an investigation has commenced. This may affect Ofwat's choice of which power it considers appropriate to address the suspected infringement(s).
- 3.14 Where information has been gathered using powers under the CA98, Ofwat may use that information to investigate other matters under the CA98, the WIA91, or Part 4 of the EA02, subject to, and in accordance with, the provisions of these Acts, relevant EC legislation and case law.
- 3.15 Where information has been received from the European Commission or another NCA, Ofwat may only use this information for the following purposes³⁴:
- the application of Article 81 or 82 in relation to the subject matter for which it was collected; or
 - the parallel application of national competition law to a case which is being considered under Article 81 or 82 and which will lead to the same outcome.
- 3.16 The CA98 also provides the OFT with powers to assist, or act on behalf of, the European Commission in connection with European Commission investigations regarding Articles 81 and 82. The OFT can also carry out an

³³ 'Powers of Investigation' (OFT 404)(December 2004).

³⁴ Article 12 of the Modernisation Regulation.

inspection on behalf of a NCA of another Member State, if requested³⁵. Ofwat does not have direct powers under the CA98 to assist the European Commission or NCAs by carrying out an inspection of premises on their behalf. However, Ofwat may assist the OFT fully in investigations which relate to Ofwat's areas of jurisdiction and where it has expertise.

Making representations

- 3.17 Section 31 of the CA98 states that, following an investigation, Ofwat may make a decision in relation to an alleged infringement of Article 81 or Article 82 of the EC Treaty or the Chapter I or Chapter II prohibitions. Before doing so, Ofwat must provide written notice to the likely affected person or persons and provide them with an opportunity to make representations.
- 3.18 Ofwat will consult the relevant parties prior to all case closures, where a CA98 investigation has been commenced³⁶.

Enforcement action

- 3.19 Ofwat's enforcement powers under the CA98 allow Ofwat to, amongst other things:
- give directions to bring an infringement to an end³⁷;
 - give interim measures directions during an investigation³⁸;
 - accept binding commitments offered to it³⁹; and
 - impose financial penalties on undertakings for infringing Article 81, Article 82, the Chapter I and/or Chapter II prohibitions⁴⁰.
- 3.20 The OFT's guidance, 'Enforcement' (OFT 407)⁴¹, sets out more details of how the OFT and concurrent regulators, including Ofwat, will apply their powers of enforcement.

Directions

- 3.21 The CA98 provides that Ofwat may give such directions as it considers appropriate to bring an infringement to an end where Ofwat has made a

³⁵ Part 2 and 2A of the CA98.

³⁶ 'Involving Third Parties in Competition Act Investigations' (OFT451) (April 2006).

³⁷ Sections 32 to 34 of the CA98.

³⁸ Section 35 of the CA98.

³⁹ Section 31A to 31C of the CA98.

⁴⁰ Section 36 of the CA98.

⁴¹ 'Enforcement' (OFT 407) (December 2004).

decision that Article 81, Article 82, the Chapter I and/or Chapter II prohibitions has, or have been, infringed. Ofwat must prove the infringement if it is to give directions to bring it to an end.

- 3.22 The directions may be given to such person(s) as Ofwat considers appropriate, which includes individuals and undertakings. Ofwat is not limited to giving directions to the infringing parties.

Interim measures

- 3.23 The CA98 states that Ofwat may give interim measures directions pending its final decision as to whether or not there has been an infringement of Article 81, Article 82, the Chapter I and/or Chapter II prohibitions. Interim measures directions will not affect the final decision.

- 3.24 Ofwat may give interim measures directions before it has completed its investigation of the suspected infringement if:

- Ofwat has begun an investigation under section 25 of the CA98 and not completed it; and
- Ofwat considers that it is necessary to act urgently either to prevent serious, irreparable damage to a particular person or category of persons, or to protect the public interest⁴².

Accepting commitments

- 3.25 Ofwat may accept binding commitments from undertakings suspected of infringing Article 81, Article 82, the Chapter I and/or Chapter II prohibitions. Ofwat is required to have regard to the OFT's guidance when considering whether to accept commitments offered⁴³. Ofwat is only likely to accept commitments in cases where the competition concerns are readily identifiable, where the concerns are fully addressed by the commitments offered and the proposed commitments are capable of being implemented effectively, and, if necessary, within a short period of time⁴⁴. Ofwat may accept commitments in respect of some of its competition concerns and continue its investigation in respect of other concerns arising from the same agreement or conduct⁴⁵.

- 3.26 Ofwat will not, other than in exceptional circumstances, accept binding commitments in cases involving a serious abuse of a dominant position or secret cartels between competitors which include:

⁴² Section 35(2) of the CA98.

⁴³ Part 4 of *Enforcement* (OFT407) (December 2004).

⁴⁴ Paragraph 4.3 of *Enforcement* (OFT407) (December 2004).

⁴⁵ Paragraph 4.10 of *Enforcement* (OFT407) (December 2004).

- price-fixing;
- bid-rigging (collusive tendering);
- establishing output restrictions or quotas;
- sharing markets; and/or
- dividing markets⁴⁶.

Imposing penalties

- 3.27 Ofwat is required to have regard to the OFT's guidance when determining the appropriate level of a penalty⁴⁷ it will impose for an infringement of Article 81, Article 82, the Chapter I prohibition and/or the Chapter II prohibition.
- 3.28 In cases where an undertaking has infringed both Articles 81 or 82 and the Chapter I or the Chapter II prohibition, the undertaking will not be penalised twice for the same anti-competitive effects⁴⁸. If a penalty or fine has been imposed by the European Commission, or by a Court or a body in another Member State in relation to the same anti-competitive agreement or conduct, Ofwat will take this penalty or fine into account when determining the amount of penalty for that agreement or conduct⁴⁹.

Publishing decisions

- 3.29 Where Ofwat makes a decision that an infringement of Article 81, Article 82, the Chapter I and/or Chapter II prohibitions has occurred it will publish its decision on its website and on the OFT's public register⁵⁰. Ofwat also publishes, when appropriate, formal "no grounds for action" decisions on its website and the OFT's public register.

Compliance

- 3.30 The main aim of the CA98 is to promote healthy competition in line with the OFT's (and Ofwat's) aim to make markets work well for, and protect, consumers.

⁴⁶ Paragraph 4.4 of *Enforcement* (OFT407) (December 2004).

⁴⁷ Section 38(8) of the CA98.

⁴⁸ Paragraph 1.15 of 'OFT's guidance as to the appropriate amount of a penalty' (OFT423) (December 2004).

⁴⁹ Paragraph 2.20 of 'OFT's guidance as to the appropriate amount of a penalty' (OFT423) (December 2004).

⁵⁰ Competition Act 1998 decisions are published on Ofwat's website (<http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/navigation-ca98decisions>) and the OFT's public register (http://www.ofwat.gov.uk/advice_and_resources/resource_base/ca98/decisions/)

- 3.31 It is not for Ofwat (or the OFT or any other NCA) to specify how an undertaking is to comply with EC or UK competition law. The OFT's guidance on compliance⁵¹ sets out how undertakings can comply with the CA98 by implementing a company compliance programme. A compliance programme provides a formal framework for ensuring that the undertaking as a whole, as well as individual employees and directors, comply with the CA98.
- 3.32 All undertakings have a duty to act lawfully, and compliance with the CA98 is particularly important. An undertaking that has committed an infringement may receive a reduction in the amount of any penalty imposed by Ofwat where it has subsequently taken adequate steps to introduce a compliance policy following an investigation. However, where an undertaking's compliance policy has been ignored and an infringement committed, this may be considered an aggravating factor and may lead to a greater penalty being imposed on that undertaking.
- 3.33 A compliance programme should be tailored to the particular requirements of the undertaking concerned. There is no standard programme that can apply in all cases; however the general features that should be included as a minimum in any programme are as follows:
- the support of senior management;
 - appropriate policy and procedures; and
 - training and evaluation.
- 3.34 A compliance policy will raise the awareness of competition law throughout the company, reduce the possibility of the competition rules being infringed and help prepare the company to deal with a potential investigation.

Requests for formal and informal guidance and advice

- 3.35 Ofwat considers that it will rarely be necessary or appropriate for a water supplier to seek advice (formal or informal) from Ofwat about the application of the CA98. Undertakings (and their legal advisers) will generally be well placed to analyse the effect of their own conduct under Article 81 and Article 82 and under the Chapter I and Chapter II prohibitions in the light of relevant Community case law and Community

⁵¹ 'How your business can achieve compliance' (OFT 424) (March 2005) is available on the OFT's website (<http://www.ofwat.gov.uk/NR/rdonlyres/78AD1280-4EB8-46D4-A52B-207F9AFEAAE1/0/oft424.pdf>).

instruments including EC block exemption regulations and European Commission notices⁵².

- 3.36 The OFT has set out details of the changes to EC and UK competition law, resulting from the Modernisation Regulation, in its guidance. 'Modernisation' (OFT 442). The OFT's position with regard to the provision of formal and informal advice is set out in Part 7. Undertakings may request confidential informal advice on the application of Article 81, Article 82, the Chapter I and/or Chapter II prohibitions from the OFT on general questions and in specific cases that raise novel or unresolved questions of law. It may be possible to obtain written guidance from the European Commission in the form of a Guidance Letter or from the OFT in the form of an Opinion⁵³.
- 3.37 Ofwat may provide, where appropriate, confidential informal advice on competition law issues relating to the water and sewerage industries on a case-by-case basis. Views given by way of informal advice are not binding⁵⁴.
- 3.38 Where a case raises novel or unresolved questions about the application of Article 81, Article 82, the Chapter I and/or Chapter II prohibitions in the United Kingdom, and where the OFT considers there is an interest in issuing clarification for the benefit of a wider audience, it may publish written guidance in the form of an Opinion⁵⁵. Ofwat agrees with the OFT's position. Any undertaking considering making a request to Ofwat for formal or informal advice should first read Part 7 of the guidance, 'Modernisation' (OFT 442).
- 3.39 The European Commission has published a notice setting out the circumstances in which it will consider issuing a Guidance Letter⁵⁶.

Appeals

- 3.40 Under Sections 46 and 47 of the CA98, certain decisions taken by Ofwat may be appealed to the Competition Appeal Tribunal (CAT). In particular, decisions by Ofwat as to whether Article 81, Article 82, the Chapter I and/or the Chapter II prohibition have been infringed may be appealed.

⁵² European Commission Notice on informal guidance relating to novel questions concerning Article 81 and 82 of the EC Treaty that arise in individual cases (Guidance letters) (OJ C101, 27.4.2004, p.78) and paragraph 7.1 of 'Modernisation' (OFT 442) (December 2004).

⁵³ Paragraph 7.2 of 'Modernisation' (OFT 442) (December 2004).

⁵⁴ Paragraph 7.20 of 'Modernisation' (OFT 442) (December 2004).

⁵⁵ Paragraphs 7.4 to 7.19 of 'Modernisation' (OFT 442) (December 2004).

⁵⁶ Part II of European Commission Notice on informal guidance relating to novel questions concerning Article 81 and 82 of the EC Treaty that arise in individual cases (Guidance letters) (OJ C101, 27.4.2004, p.78). The Notice is available from the Commission's website at http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_101/c_10120040427en00780080.pdf.

The CAT may confirm or set aside Ofwat's decision, impose, revoke or vary the amount of any penalty imposed by Ofwat, remit the matter to Ofwat or make any other decision, give any such directions or take such other steps that Ofwat itself could have made⁵⁷.

- 3.41 Sections 46(3) and 47(1) of the CA98 contain lists of the type of decisions which may be taken by Ofwat, the OFT (or other sectoral regulators) and which may be subject to an appeal to the CAT.
- 3.42 The CAT's website www.catribunal.org.uk provides more information about the role of the CAT.

⁵⁷ Schedule 8, Part I, paragraph(3)(2) of the CA98.

4. Assessing cases in the water sector

4.1 This chapter describes some of the characteristics of the water and sewerage sectors in England and Wales that are likely to affect Ofwat's assessment of complaints it receives. These include characteristics arising from the physical nature of water as well as the current regulatory framework.

Market definition

4.2 Defining the relevant market is an important step in identifying the competitive constraints on an undertaking. Market definition is a useful part of the framework for assessing market power and analysing the effects of agreements or conduct. Market definition is not an end in itself but a key step in identifying the competitive constraints acting on a supplier of a given product or service. Market definition provides a framework for competition analysis⁵⁸.

4.3 Ofwat will define the market for each individual case as conditions of competition may change over time and will depend upon the particular case. A market definition normally contains a product, a geographic area and a temporal dimension, where appropriate.

4.4 In defining the relevant market, Ofwat will follow the framework set out in the guidance 'Market definition' (OFT403)⁵⁹. This will include a consideration of the following:

- the extent to which customers would switch to other products following a hypothetical price increase above the competitive price level;
- the ability of suppliers to enter the market analysed over an appropriate time period and act as a competitive constraint on prices; and
- the effect of the timing of production and purchasing on a customer's ability to switch products.

4.5 When considering the product definition of a market, Ofwat will analyse the specific nature of the product or service in question. For example, a distinction between services for household and non-household customers may be appropriate. In some cases, we might define markets for products or services that are inputs to, or components of, the provision of water or sewerage services.

⁵⁸ Paragraph 2.1 of 'Market Definition' (OFT403) (December 2004).

⁵⁹ 'Market Definition' (OFT403) (December 2004).

- 4.6 While geographical factors are likely to be of critical importance in market definition in the water sector, Ofwat will not be bound by geographical patterns inherited at privatisation. The development of inset appointments, customer self-supply, private supplies and on-site services might be important influences on geographic market definitions. In relation to water or sewerage services for domestic customers, for example, Ofwat might find that the appointed area of a water or sewerage undertaker constitutes the relevant geographic market. However, this same geographic market definition may not apply in the case of water supply or trade effluent disposal for large customers.

Assessment of market power

- 4.7 Market power can be thought of as the ability to sustain prices above profitably competitive levels or restrict output or quality below competitive levels. An undertaking with market power might also have the ability and incentive to harm the process of competition in other ways; for example, by weakening existing competition, raising entry barriers or slowing innovation⁶⁰.
- 4.8 The assessment of market power can be useful under Article 81 and the Chapter I prohibition in considering the concept of ‘appreciability’ and is central under Article 82 and the Chapter II prohibition in the identification of ‘dominance’ (see the guidance, ‘Assessment of Market Power’ (OFT415))⁶¹.
- 4.9 An agreement will infringe Article 81 and/or the Chapter I prohibition only if it has as its object or effect an ‘appreciable’ prevention, restriction or distortion of competition within the common market in the case of Article 81 or the United Kingdom in the case of the Chapter I prohibition. Paragraphs 2.15 to 2.21 of the guidance ‘Agreements and Concerted Practices’ (OFT401)⁶² set out the factors Ofwat will take into account when assessing the ‘appreciable effect on competition’ test.
- 4.10 In respect of Article 82 and the Chapter II prohibition, Ofwat will assess whether the undertaking or undertakings in question occupy a dominant position in the relevant market. The European Court has defined a dominant position as “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to

⁶⁰ Paragraph 1.4 of ‘Assessment of Market Power’ (OFT 415) (December 2004).

⁶¹ ‘Assessment of Market Power’ (OFT415) (December 2004).

⁶² ‘Agreements and Concerted Practices’ (OFT401) (December 2004).

an appreciable extent independently of its competitors, customers and ultimately of consumers”⁶³.

- 4.11 An undertaking will not be dominant unless it has substantial market power⁶⁴. Market power is not an absolute term but a matter of degree, and the degree of market power will depend on the circumstances of each case. In assessing whether an undertaking has substantial market power, it is helpful to consider whether, and the extent to which, an undertaking faces competitive constraints. Those constraints might be existing competitors, potential competitors and other factors such as strong buyer power from the undertaking’s customers. These constraints are discussed further in the guidance ‘Assessment of Market Power’ (OFT415)⁶⁵.
- 4.12 Market shares can also be a useful indicator of market power, although market share does not, on its own, determine whether an undertaking is dominant. However, in developing the case law on dominance, the European Court has stated that dominance can be presumed, in the absence of evidence to the contrary, where an undertaking has a market share persistently above 50%⁶⁶. It is unlikely that an undertaking will be individually dominant if its market share of the relevant market is below 40% but dominance could be established below this figure if there are other relevant factors, such as the weak position of competitors and high entry barriers, which provide strong evidence of dominance⁶⁷.
- 4.13 In many parts of the water and sewerage sectors there is extensive regulation of prices, quality and other product characteristics. This might be relevant when assessing the ability of an undertaking to behave independently, or when assessing an undertaking’s ability and incentive to raise prices. On the other hand, in many parts of the water and sewerage sectors the existence of large sunk costs, absolute advantages arising from the regulation of water abstractions and discharges to the environment might act as barriers to entry which Ofwat might need to take into account in its assessment of market power.

⁶³ Case 27/76 United Brands v Commission [1978] ECR 207. This definition has been used in other cases.

⁶⁴ Paragraph 2.9 of ‘Assessment of Market Power’ (OFT 415) (December 2004).

⁶⁵ ‘Assessment of Market Power’ (OFT415) (December 2004).

⁶⁶ Case C62/86, AKZO Chemie BV v Commission [1993] 5 CMLR 215.

⁶⁷ Paragraph 4.18 of ‘Abuse of a Dominant Position’ (OFT 402)(December 2004).

Assessment of agreements

- 4.14 The approach to assessing whether agreements and concerted practices are anti-competitive is described in the guidance 'Agreements and Concerted Practices' (OFT401)⁶⁸.
- 4.15 In the water and sewerage sectors, examples of agreements which might prevent, restrict or distort competition to the detriment of consumers include agreements:
- between undertakers not to compete in each other's areas of appointment, for example in relation to cross-border supplies or inset appointments;
 - between undertakings to collude on pricing conduct;
 - leading to collusion in bidding for contracts (including agreements not to bid);
 - leading to preference for related, or each other's related, suppliers in procurement or the outsourcing of contestable services; and
 - leading to collusion with the intention of preventing, restricting or distorting comparative competition⁶⁹.
- 4.16 Ofwat will use its powers under the CA98 to investigate suspected cases of anti-competitive agreements or concerted practices, and apply remedies where an agreement breaches Article 81 and/or the Chapter I prohibition.

Assessment of abuse

- 4.17 It is the abuse of, not the existence of, a dominant position that is prohibited by Article 82 and the Chapter II prohibition. Therefore, where an abuse of a dominant position is alleged or suspected and it is found that an undertaking or group of undertakings has the ability to act, to an appreciable extent, independently of its customers and competitors, Ofwat will investigate further, to determine whether or not any infringement has occurred.
- 4.18 In general, the likely effect of a dominant undertaking's conduct on customers and on the process of competition is more important to the determination of an abuse than the specific form of the conduct in question. Conduct may be abusive when, through the effects of conduct

⁶⁸ 'Agreements and Concerted Practices' (OFT401) (December 2004).

⁶⁹ The broad approach to regulation of the water and sewerage industries in England and Wales used by Ofwat to deliver improvements in prices and services for customers, whereby price limits and service standards are set with reference to comparisons based on the past performance of companies.

on the competitive process, it adversely affects consumers directly (for example, through the prices charged) or indirectly (for example, conduct which reduces the intensity of existing competition or potential competition). A dominant undertaking is under a special responsibility not to allow its conduct to impair undistorted competition. More information is provided in the guidance 'Abuse of a Dominant Position' (OFT402)⁷⁰ and DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses⁷¹.

Specific issues in the water and sewerage sectors

4.19 This section identifies a number of issues specific to the water and sewerage sectors where Ofwat may apply its competition law powers. The issues identified here are not exhaustive but are intended to provide some indication of how Ofwat might approach applying its CA98 powers in relation to the identified issues.

Pricing conduct

4.20 For most services connected with the water and sewerage sectors there is some form of regulation which affects prices and, in many instances, the setting of price limits. In relation to the public water and sewerage networks, competition on price has been limited to large non-household users, although this form of competition may be extended further in future. The WIA91 (as amended) allows customers who are supplied (or likely to be supplied) with a quantity of water at or above a specified volumetric threshold two options for choosing a provider other than the appointed water or sewerage company for where the customer is situated. The two options are choice through the Water Supply Licensing (WSL) regime or an inset appointment (both of these are described in more detail below).

4.21 Tariffs for users whose supply of water is above the large user threshold were removed from the tariff basket on 1 April 2000. This prevents appointed water companies from rebalancing tariffs between price reviews to recover lost revenues from other groups of customers. However, prices for large users are still subject to regulation through the appointment conditions of water and sewerage companies. Appointment Condition E, for example, prohibits appointed water and sewerage companies from exercising undue preference or undue discrimination in the charging of customers (and categories of customers). Ofwat's view is that large user tariffs should normally be set with reference to a robust cost justification.

⁷⁰ 'Abuse of a Dominant Position' (OFT 402)(December 2004).

⁷¹ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (December 2005) at <http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf>.

- 4.22 Furthermore, under the WIA91, appointed water and sewerage companies' charges schemes are subject to annual approval by Ofwat. When approving charges schemes, Ofwat takes into account a number of criteria, including undue preference and undue discrimination. Once Ofwat has approved a charges scheme it would not normally expect to reconsider the scheme before the appointed company submitted its proposals for the following year.
- 4.23 Regulatory powers and the CA98 can both apply to the pricing conduct of appointed water and sewerage companies. Some aspects of pricing conduct may be effectively dealt with in terms of compliance with the appointment conditions, while other types of pricing conduct may be addressed through the use of Ofwat's powers under the CA98. Ofwat will consider the detailed circumstances of each case in deciding how to address pricing conduct.
- 4.24 Pricing for customers below the large user threshold is regulated under the WIA91. In most cases, it is likely that any allegations of anti-competitive behaviour for those customers would be addressed through sector-specific powers rather than the CA98.
- 4.25 There are some areas of the water and sewerage sector where price regulation does not apply at present, such as tankered waste. In those sectors, Ofwat would still need to take into account sector-specific regulation which affects price if it decided to investigate pricing conduct under the CA98.
- 4.26 In the water and sewerage industry, many prices are calculated on the basis of average costs across each water and sewerage company's area of appointment (regional average charging). Regional average charging supports or aligns with, and/or is required by several legal and government policy objectives. When assessing pricing conduct under competition law, Ofwat will take into account the legal and policy requirements for regional average charging and relevant rulings of the CAT and other courts.

Cost assessment

- 4.27 Costs will often be a key consideration in the assessment of pricing conduct in relation to the CA98 prohibitions. Where Ofwat has grounds to suspect that pricing conduct breaches competition law, it will investigate the costs of providing the product in question. We will make use of cost information already available to us through regulatory activities and check the consistency of the approach used by the undertaking.

- 4.28 It might be appropriate to look at more than one costing methodology when analysing an undertaking's conduct as different costing methodologies can produce different results. In the water and sewerage sectors where common costs⁷² are often significant there may be no single correct methodology for allocating costs. For example, when assessing an access price, Ofwat might look at methods such as average accounting costs, avoidable costs, marginal/incremental costs or standalone costs, depending on the nature of the case.
- 4.29 The appropriate cost methodology will also depend on the type of anti-competitive conduct being alleged. For excessive pricing, Ofwat has in the past referred to suitable measures of average accounting cost, "stand alone" cost, long-run incremental cost and the local cost to the appointed water company of an activity. For assessing whether a price is predatory Ofwat might have regard to the avoidable cost, variable cost or incremental cost of an activity over the appropriate time period.
- 4.30 In some cases, appointed water and sewerage companies may be judged to serve a number of markets, which are subject to varying levels of competition. It may then be necessary for the assessment of costs to involve consideration of appointed water and sewerage companies as multi-product companies, with examination of methods of cost allocation to different products or services. This reflects the risk that an appointed water and sewerage company might, for example, exploit a dominant position in one market to subsidise predatory behaviour in another market.

Combined supply and retail competition

4.31 The WA03 introduced a specific framework for combined supply and retail competition known as the WSL regime. From 1 December 2005, non-household customers who are likely to be supplied with at least 50 megalitres⁷³ of water a year at each premises have been able to choose their water supplier from a range of new licensees. Water supply licensees are able to supply water to eligible customers in one of two ways:

- **a retail licence** – a water supply licence that authorises the holder to purchase a wholesale supply of water from an appointed water company and use its supply system for the purpose of supplying water to the premises of customers; or
- **a combined licence** – allows the holder to introduce water into an appointed water company's supply system and to supply the water to customers at eligible premises.

⁷² Common costs are costs which are common to the whole of a company and which cannot be allocated to specific activities.

⁷³ A megalitre (MI) is one million litres.

- 4.32 The access pricing rule for the WSL regime is set out in the Costs Principle contained in section 66E of the WA03. Under the Costs Principle, access prices are calculated as the retail price minus the appointed water and sewerage company's expenses which "can be reduced or avoided" or which are "recoverable in some other way" as a result of the licensee taking over responsibility for the customer.
- 4.33 The WSL regime contains a dispute handling process. As a result, most complaints about anti-competitive behaviour relating to combined supply and retail competition will be dealt with under this specifically designed regime rather than the CA98. However, there are some issues not covered specifically in the WA03 and the relevant regulations and guidance. In those circumstances, Ofwat would apply the CA98 if it was appropriate to do so.

Inset appointments

- 4.34 An inset appointment occurs when one company replaces the incumbent as the appointed water and/or sewerage company for a specified area. There are three circumstances in which an inset appointment can be granted:
- for large users whose water use is likely to exceed the statutory criterion (250 MI in Wales and 50 MI in England);
 - for an area which is not served by an incumbent appointed company; and
 - for an area if the incumbent appointed company consents to transfer that area to the inset appointee.
- 4.35 Insets are provided for in the WIA91. Ofwat publishes guidance on how to apply for an inset appointment application. As a result, Ofwat will usually seek to resolve disputes about insets using its specific powers under the WIA91 and the information in its guidance. Nevertheless, there might be occasions when Ofwat will find it appropriate to apply the CA98 to such complaints about inset-related issues.

The abstraction licensing regime

- 4.36 Access to, and the use of, water resources is currently governed by a licensing regime operated by the Environment Agency, the Secretary of State for the Environment, Food and Rural Affairs and the Welsh Assembly. Those who wish to abstract and use water from rivers or the ground must be licensed by the Environment Agency. This confers protected rights on the licensee, preventing the grant of further licences in derogation of the earlier right without that licence holder's consent.

- 4.37 Changes introduced by the WA03 were intended to facilitate water rights trading. To trade water rights, undertakings must make an application to the Environment Agency for a full or varied licence. The Environment Agency assesses the impact of the proposed abstraction to protect the environment and the rights of other water users.
- 4.38 Whilst abstraction licences remain regulated, there can be circumstances in which Ofwat would consider that an abstraction licensee's conduct in exploiting (or seeking to protect) its licensed entitlements could be a breach of competition law. The fact that an abstraction licensee is entitled under the abstraction licence to use a resource in a particular way does not remove its actions from consideration under the CA98.

The exclusion from the CA98 prohibitions for services of general economic interest, under paragraph 4 of Schedule 3 to the CA98

- 4.39 Neither Article 81, the Chapter I prohibition, Article 82 nor the Chapter II prohibition apply to an undertaking entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly in so far as the prohibition would obstruct the performance, in law or in fact, of the particular tasks assigned to that undertaking. Ofwat will therefore be required to assess whether or not, in a particular case, this exclusion is applicable.
- 4.40 It is Ofwat's view that there are no revenue producing monopolies in the water and sewerage sector of England and Wales. Therefore the remainder of this Part will focus on the exclusion for services of general economic interest (SGEI).
- 4.41 As explained in the guidance 'Services of General Economic Interest Exclusion' (OFT421)⁷⁴, the exclusion is interpreted strictly, with undertakings seeking to benefit from the exclusion having to prove that they meet all the requirements of it.⁷⁵ Where an undertaking is able to satisfy all the requirements, the SGEI exclusion will only apply to particular obligations entrusted to the undertaking and will not apply to the undertaking itself or its activities generally.
- 4.42 Ofwat will only consider an SGEI exemption where undertakings are able to show that:
- they have been 'entrusted' with the operation of a SGEI; and

⁷⁴ 'Services of General Economic Interest Exclusion' (OFT421) (December 2004).

⁷⁵ Paragraph 1.9 of 'Services of General Economic Interest Exclusion' (OFT421) (December 2004).

- the application of Article 81, the Chapter I prohibition, Article 82 nor the Chapter II prohibition would obstruct the performance, in law or in fact, of the particular task entrusted to it.