



PRODUCTIVITY AND ENTERPRISE – A WORLD CLASS COMPETITION REGIME

OCTOBER 2001

1. This paper is the Office of Water Services' response to the Department of Trade and Industry's White Paper setting out proposals for inclusion in an Enterprise Bill. We welcome the opportunity to respond to the proposals to improve the operation of competition in the interest of customers and we endorse the ambition to make markets work well for consumers.
2. Our main points on the proposals are set out below. We have a number of secondary points, which are set out at the back of this response.

Promotion of competition

3. We are committed to playing our part, as a competition authority, to develop competition in the provision of water and sewerage services to customers and to take action against anti-competitive behaviour.
4. We welcome the Government's commitment to give competition authorities an advocacy role to advise on the impact on competition of existing and proposed legislation. We also welcome the Government's commitment to consider such advice and to publish a response within 90 days.
5. The other sectoral regulators already have duties to promote competition. For water and sewerage it is only to "facilitate", Water Industry Act 1991 (WIA), but the Government has announced its intention to change this to "promote" in the proposed Water Bill. We need to work with the Office of Fair Trading (OFT) to ensure there is no confusion about our future respective roles in respect of competition in the water and sewerage industry. This is especially the case as an Enterprise Bill giving the OFT powers is likely to be enacted before a Water Bill.

Competition authorities

6. Ofwat is a national competition authority with concurrent powers to those of the OFT for the water and sewerage industry in England and Wales. We welcome the proposals to strengthen the powers of the UK competition authorities, including the powers of the sectoral regulators. Our existing concurrent powers in respect of monopolies under the Fair Trading Act 1973 (FTA73) are valuable. The sectoral regulators should also have the proposed new powers to investigate markets. Although we have not used the complex monopoly powers under the FTA73, we have used the formal information gathering powers for a scale

monopoly investigation. We consider it is helpful to have these powers in the regulator's toolbox for use as necessary.

7. We are committed to working productively with OFT to clarify the exercise of concurrent powers. We agree that the powers for prosecuting for criminal offences in relation to hard-core cartels should rest with the OFT. But the sectoral regulators should also have clear authority to identify such cases and refer them for prosecution. The existing concurrency arrangements under the Competition Act 1998 will ensure that cases that might involve criminal prosecution are referred to OFT.
8. We note that UK competition authorities will have a greater role in enforcing community competition law. As a national competition authority, we welcome these additional powers, which we expect to operate concurrently with OFT.

Market investigations

9. The Director should be subject to his general duties under section 2 of the WIA 1991 when deciding whether or not to make a market investigation reference to the Competition Commission. This reflects the current position where the Director is subject to these duties when making a monopoly reference to the Competition Commission under the FTA73. In order to ensure consistency, the Competition Commission should also have regard to those duties when dealing with a market investigation reference.
10. However the market investigation test is worded, it must catch behavioural abuses by monopolists on markets where there may be very little, or no, prospect of competition. In the past, the Director considered using his monopoly reference powers under FTA73 in respect of excessive pricing in such a market, and may need to use such powers again.
11. We recognise the value of setting timetables for market investigations to further transparency. We expect that the Enterprise Bill will make it clear that regulators will have the responsibility for referring regulated industries for investigation. However timetables should not become a straitjacket that prevents the Competition Commission coming to a fully reasoned decision on cases it pursues.

Water/water mergers

12. We are working with you to understand the relationship between the new merger controls and sections 32 to 36 of the WIA which governs mergers involving two (or more) water companies. The DTi, in 'Mergers: The response to the consultation on proposals for reform' (October 2000), stated at section 4.13 that the Government has no proposals to amend the existing special merger regime for the water and sewerage industry.
13. Ofwat considers that the existing special provisions for dealing with mergers between water companies as set out in sections 32 to 36 of the WIA should be preserved in the new merger regime. The "public interest" test in these provisions expressly refers to the Director's need to be able to make comparisons in order to carry out his duties under the WIA. Due to the monopoly nature of the industry there is a need to retain comparative competition until such time as there is effective market competition even if ultimately it means that certain mergers have

to be blocked. The current powers have been effective. The findings of the Monopolies and Mergers Commission (MMC) cases in 1996 and 1997 support the current approach. For example the MMC concluded in the case of Severn Trent's bid for South West Water that:

"A reduction in the number of independent companies that are able to take part in this process is therefore likely to impede effective comparative competition".

14. The new mergers regime must preserve the Competition Commission's ability to take account of comparators in its decision making process in relation to water/water mergers. The proposed test involving the 'lessening of competition' would not address this.
15. The proposed qualifying threshold, in the White Paper, for automatic reference to the Competition Commission, is a significant change and we have concerns about its implications for water/water mergers. At present the gross assets test of £30 million for water/water mergers means all but one very small company are above the threshold and all such mergers would be automatically referred to the Competition Commission. If the proposed turnover test of £45 million applied to the water industry, mergers involving a number of small independent water-only companies would not then be automatically referred to the Competition Commission. This could be a threat to comparative competition.
16. If a threshold based on turnover was introduced for water/water mergers, it would need to be set lower than £45 million to maintain the current position. However, Ofwat recognises that the asset based threshold in the WIA of £30 million has not been changed since privatisation.
17. We have initiated discussions with you to make sure the essence of the WIA is preserved.

Other mergers

18. There have been a number of mergers involving a single water company, for example RWE's bid for Thames Water, investigated under the provisions of the FTA73. At present if a target water company's assets are worth more than £70m (or the market share test is exceeded), after initial investigation, the Secretary of State can either advise that the merger be referred to the Competition Commission or seek legally binding undertakings to address any concerns arising from the proposal.
19. Under the merger regime envisaged in the Enterprise Bill if the OFT recommended that a merger be referred to the Competition Commission, including one involving a water company, then a competition based test would appear to apply.
20. Where a non-water company has sought to merge with a water company, Ofwat has generally been concerned that under new ownership the water company can continue to properly carry out and finance its regulated activities and that the merger does not affect Ofwat's ability to protect the interests of customers. Without these assurances the merger could be against the public interest. These are not necessarily the same concerns that might be considered in a competition

based test. The new merger regime should allow Ofwat's regulatory concerns to continue to be addressed.

Licence modifications

21. The proposals in the White Paper will affect the licence modification mechanisms in the WIA. We consider the current licence modification mechanism should remain unchanged. An Enterprise Bill will therefore need to make consequential changes to the WIA, however we expect these changes to be straightforward.

Funding Competition Commission inquiries

22. We welcome most of the proposals to strengthen the Competition Commission. But we remain concerned about the funding arrangements for the Commission and the implications of the decisions taken during the two water company price determination references last year. We believe the Commission's costs for such an inquiry should be met by general taxation as for all other industries. Ofwat should meet its own costs and company shareholders should meet the costs incurred by the company. Decisions taken by the Commission last summer allowed the companies to recoup all the reference costs from their customers i.e. (their own plus those of the Commission and Ofwat). This had a significant impact on the bills of customers of those small companies. We believe this matter requires further consideration.

Super complaints

23. As part of its concurrent powers with OFT, Ofwat should be responsible for dealing with any super complaints that are brought on behalf of water and sewerage customers.
24. The White Paper does not explicitly set out whether or not super complaints can be brought on behalf of water and sewerage customers. We consider that the Ofwat National Customer Council (ONCC) which brings together the Chairs of the statutory Customer Service Committees (CSCs) is the appropriate body rather than Consumers' Association or National Consumer Council to submit super complaints on behalf of water and sewerage customers. The CSCs represent the interests of customers of the water and sewerage companies in England and Wales. Although the ONCC is not a statutory body at present, it is a more appropriate organisation than the CSCs to pursue super complaints. This is because super complaints will 'concern situations where markets fail to work for customers rather than the activities of particular companies'. ONCC is in the best position to judge where such situations exist. The Government's proposal to set up a Consumer Council for Water, in the draft Water Bill, will set up a statutory national representative body and it should have the power to bring super complaints on behalf of customers.

Secondary points

Cross utility group

25. The White Paper proposes that members of the Competition Commission should be those with expertise relevant to competition. We presume the Commission will also continue to include members with utility expertise. The draft Water Bill (Clause 40) provides for the abolition of the sector specific panel for water and in its place the single cross-utility group (set up under Utilities Act 2000 to deal with electricity and gas references) dealing with water references and we consider this is appropriate.

Expert consultants

26. We welcome the opportunity to use expert consultants during the course of investigations under the Competition Act 1998 (Section 4.47).

Remedies

27. We welcome the proposal to update remedies and give the appropriate Secretary of State the ability to amend and add further remedies by statutory instruments (Section 5.18 and 5.19). We also welcome the proposal to publish provisional findings ahead of remedies (Section 5.24).

Timetables

Merger investigations

28. Although we recognise the benefit of shortening timetables (section 5.22), merger investigations are already tight for sectoral regulators. This is because we need to consult the public on proposed mergers ahead of offering advice to the OFT on the issues raised. Ofwat has previously drawn its concerns about statutory timetables (and OFT's self-imposed deadlines) to OFT's attention. Timetables for the regulated sectors should take account of this.

Damages

29. In determining how damages (section 8.21 – 8.22) are awarded to a consumer body and distributed we suggest for regulated industries this is left to the Competition Commission Appeals Tribunal (CCAT). We suggest the CCAT seek help from the relevant sectoral regulator to make its decisions. The regulator effectively operating as an 'amicus' to the court.
30. Such actions for damages should not be permitted until the Director has completed any investigation he has begun or indicated that he will not be making such an investigation. Otherwise a court may be asked to rule on an alleged infringement at the same time as the Director.