



**Notice of intention to accept binding  
commitments from Bristol Water plc  
in relation to the market for services  
for new water connections**

**22 May 2014**

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## 1. Executive summary

- 1.1. In March 2013, the Water Services Regulation Authority (**Ofwat**) opened an investigation into Bristol Water plc (**Bristol Water**) for alleged abuse of a dominant position in relation to discrimination against self-lay organisations<sup>1</sup> (**SLOs**) in the provision of contestable services to provide new water connections.
- 1.2. The abuse of a dominant position is prohibited by Chapter II of the Competition Act 1998 (**the Act**) and Article 102 of the Treaty on the Functioning of the European Union (**the TFEU**).
- 1.3. Ofwat considered that the investigation raises issues of strategic significance for the industry, given that services for new water connections is one of only a few areas of competition in the market in the water and sewerage industry. The alleged conduct is also connected to issues around ensuring a level playing field for appointed water companies and new entrants alike, in so much as it deals with potential discriminatory behaviour by a vertically integrated company that could have an adverse effect on competition in a prospectively competitive market. These issues will grow in importance as more competition occurs as a result of the market reforms introduced by the new Water Act 2014.
- 1.4. During the investigation, Ofwat gathered evidence from the parties and came to a preliminary view that Bristol Water holds a dominant position in the (upstream) market for the non-contestable supply and maintenance of water infrastructure in its area of appointment under the Water Industry Act 1991 (WIA91), and that conduct in this market potentially affected the (downstream) market for the provision of contestable services to provide new connections. Ofwat identified four specific competition concerns related to Bristol Water's conduct (including pricing and other behaviours) that could potentially restrict entry and expansion of competitors in the provision of new water connections. These concerns are:

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<sup>1</sup> A self-lay organisation is a contractor or multi-utility infrastructure provider that provides water supply infrastructure for developers.

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- potential leveraging of a dominant position in upstream services to harm effective competition for downstream services;
  - differences in the calculation of self-lay and requisition quotations, which can result in the amount presented to the customer as being recovered by Bristol Water being less for the requisition;
  - the additional charges Bristol Water requires of SLOs without a clear objective justification for and transparency around the reasons for the charges, the level of the charges and differences in their application between SLOs; and
  - Bristol Water's interactions with SLOs in terms of communicating information to SLOs and developers on the processes and the prerequisite requirements they need to satisfy in order to access the upstream services provided by Bristol Water.
- 1.5. Bristol Water notified Ofwat that it was interested in offering commitments to address the concerns. Between July 2013 and January 2014, Ofwat discussed with Bristol Water the form and content of the commitments that would be likely to be considered appropriate in light of its concerns. Ofwat paused its investigation during this period such that discussions could focus on the commitments. As a result, Ofwat had not gathered complete evidence from the parties, nor completed its market definition exercise, but is satisfied that it has gathered sufficient information to enable it to effectively assess whether accepting commitments is appropriate for this case and whether commitments proposed by Bristol Water fully meet the competition concerns identified for this case.
- 1.6. In January 2014, Bristol Water offered a comprehensive set of commitments. Ofwat provisionally considers that the package of commitments offered fully address the competition concerns identified for this case; are capable of being implemented effectively and within a short period of time; and that accepting them would not undermine deterrence.
- 1.7. The main commitments offered by Bristol Water are structural and process commitments designed to recognise that Bristol Water's own downstream developer services function competes with SLOs and that both are customers of Bristol Water's non-contestable upstream services. The resulting functional separation of Bristol Water's downstream developer services arm from its upstream services together with commitments to ensure equivalence in price and non-price terms for equivalent transactions, reduce the potential ability

(albeit not the potential incentive) for Bristol Water to discriminate between its own business and its competitors in the relevant downstream market.

- 1.8. As required by paragraph 2 of Schedule 6A of the Act, Ofwat hereby gives notice that it proposes to accept the commitments now offered by Bristol Water (as detailed in appendix 1) and invites representations on this proposed course of action. Details of how to submit representations are set out in chapter 7 of this document. Given the strategic importance of this case for the wider industry, Ofwat will accept representations for eight weeks following publication of this document. The closing date for submitting representations is Friday 18 July 2014.
- 1.9. In particular, Ofwat would welcome views on:
- a. whether the commitments fully address the competition concerns identified by Ofwat for this case;
  - b. the efficacy of the commitments in the context of the day-to-day operations of water companies, SLOs and developer customers;
  - c. the visibility and effectiveness of those elements of the commitments that Bristol Water is implementing with immediate effect;
  - d. the type(s) of information that Bristol Water should provide to Ofwat to evidence its implementation of and compliance with the commitments; and
  - e. what types of evidence and/or indicators Ofwat might consider in order to assess whether the appropriate conditions are in place to allow for effective competition in the provision of contestable services for new connections in Bristol Water's area of appointment.
- 1.10. Ofwat will consider such representations before making a final decision whether to accept Bristol Water's commitments. Formal acceptance of the commitments would result in the termination of Ofwat's investigation without proceeding to a decision on whether or not Bristol Water has infringed Chapter II of the Act or Article 102 of the TFEU. If accepted, the commitments will be binding and enforceable.

## 2. Introduction

- 2.1. The Water Services Regulation Authority (**Ofwat**) hereby gives notice that it proposes to accept the commitments offered by Bristol Water plc (**Bristol Water**) to address competition concerns expressed by Ofwat during the course of an investigation into a potential abuse of a dominant position by Bristol Water. As required by paragraph 2 of Schedule 6A of the Competition Act 1998 (**the Act**), Ofwat invites representations from interested parties on this proposed course of action.
- 2.2. The draft text of the commitments offered is set out in appendix 1 of this document.
- 2.3. Formal acceptance of the commitments by Ofwat would result in the termination of the investigation, with no decision made on whether or not the Act has been infringed by Bristol Water. If accepted, the proposed commitments will be binding and enforceable under section 31E of the Act.
- 2.4. This document outlines:
- Ofwat's investigation to date;
  - the candidate markets in which anti-competitive conduct is alleged to have taken place and in which the investigation has been carried out; and
  - the parties involved.
- It also:
- sets out Ofwat's competition concerns;
  - summarises the commitments offered by Bristol Water; and
  - explains why Ofwat provisionally considers that the proposed commitments address the competition concerns.
- 2.5. Ofwat now invites interested parties to make representations on the proposed commitments. Ofwat will consider such representations before making its final decision whether to accept the commitments.
- 2.6. Details of how to submit representations are set out in chapter 7 of this document. The closing date for representations is Friday 18 July 2014.

### 3. Ofwat's investigation

#### The complaints

- 3.1. On 14 January 2013, Ofwat received a complaint from Aquamain Limited (**Aquamain**), an accredited self-lay organisation<sup>2</sup> (**SLO**) operating in the south-west of England. The complaint alleged that Bristol Water was abusing its dominant position as the company appointed under section 6 of the Water Industry Act 1991 (the **WIA91**) as the water undertaker<sup>3</sup> (otherwise known as water company) for its specified area of appointment by discriminating against SLOs in the market for new connections.
- 3.2. Aquamain alleged that Bristol Water was abusing its dominant position as the area's appointed water company to apply dissimilar cost offerings for equivalent transactions in the provision of new connections infrastructure. Aquamain claimed that this was due to Bristol Water's approach to the calculation of the asset payment for self-laid infrastructure being different from its calculation of the requisition charge<sup>4</sup>, due to how Bristol Water allocated costs in the two calculations and treated future income from the new premises being connected. Aquamain claimed that this resulted in the requisition option appearing cheaper to developers (the customers in these circumstances) than the self-lay option, making it difficult for SLOs to compete with Bristol Water's own 'developer services' arm. Aquamain also alleged that Bristol Water was abusing its dominant position as the area's appointed water company by introducing a requirement for SLOs to pay security payments ('sureties') for self-laid mains and service connections.
- 3.3. On 13 February 2013, Ofwat received another complaint, this time from Energetics Design & Build (**Energetics**), an accredited SLO operating throughout Great Britain. Energetics also alleged that Bristol Water was abusing its dominant position as the area's appointed water company by introducing a requirement for SLOs to pay sureties for self-laid mains and

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<sup>2</sup> A self-lay organisation is a contractor or multi-utility infrastructure provider that provides water supply infrastructure for developers.

<sup>3</sup> A company that has an appointment (otherwise known as a licence) to supply water services to a specific geographic area of England and Wales is called a water undertaker.

<sup>4</sup> The asset payment and requisition charge are explained further in chapter 4 ('Industry background').

service connections. Energetics alleged that this behaviour was damaging Energetics' opportunities to trade within Bristol Water's area of appointment.

- 3.4. Both complaints raised concerns that Bristol Water could be leveraging the dominant position afforded by its appointment under the WIA91 from its core upstream regulated business (to supply water services) into the provision of downstream contestable services to provide new water supply connections. Both complaints raised concerns that Bristol Water had discriminated in the price and non-price terms it had applied for the services it provided to SLOs, offering different terms for equivalent transactions to SLOs as compared to its own downstream developer services business. Such behaviours could have an exclusionary effect on competition by making the offer of Bristol Water's developer services arm more attractive to developers (the customers in these circumstances) on price and non-price terms than the offer SLOs can provide. This could restrict the entry and expansion of SLOs in the provision of contestable services<sup>5</sup> in Bristol Water's area of appointment.

## Decision to open an investigation

- 3.5. Ofwat has concurrent powers with the Competition and Markets Authority (**CMA**)<sup>6</sup> to investigate potential infringements of the prohibitions in Chapters I and II of the Act and/or Articles 101 and 102 of the Treaty on the Functioning of the European Union (**TFEU**) so far as relating to "commercial activities connected with the supply of water or securing a supply of water or with the provision or securing of sewerage services"<sup>7</sup>.
- 3.6. Under section 25 of the Act, Ofwat may open an investigation into a possible infringement of the prohibitions in Chapters I and II of the Act and/or Articles 101 and 102 of the TFEU if it has reasonable grounds for suspecting an infringement. Subject to meeting this threshold, Ofwat will use its powers under the Act if it considers that it is appropriate to do so in order to address any adverse effects on competition.

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<sup>5</sup> Details of contestable and non-contestable activities are explained further in chapter 4.

<sup>6</sup> The Competition and Markets Authority assumed the functions of the Office of Fair Trading and the Competition Commission on 1 April 2014.

<sup>7</sup> See section 31 of the WIA91.

3.7. Ofwat decides whether to open or continue an investigation under the Act with reference to its prioritisation principles<sup>8</sup> and those used by the CMA. These balance the impact the investigation is expected to have on Ofwat's strategic goals against the risks and resources it will involve. In particular, Ofwat considers:

- the impact (both direct or indirect) of any decision on consumers;
- the strategic significance of the issue;
- the likelihood of a successful outcome; and
- whether the resources required are proportionate to the expected benefits of investigating the matter and the best use of our finite resources in light of alternative priorities.

3.8. Ofwat considered that the features of this case were such that it was appropriate to open an investigation under the Act. Ofwat has a primary statutory duty to carry out its functions so as to protect the interests of consumers, wherever appropriate by promoting competition<sup>9</sup>. At present new connections is one of only a few areas of competition in the market in the water and sewerage industry. Ofwat considered the case to be strategically significant since the issues it raises are relevant to the industry as a whole and will grow in importance as more competition occurs in the industry as a result of the pro-competition clauses in the Water Act 2014<sup>10</sup>. Ofwat also considered that an investigation could potentially bring both direct benefits to SLOs and their customers in Bristol Water's area, as well as indirect benefits for customers in other areas arising from the awareness and deterrence effects that an investigation could have for the wider industry.

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<sup>8</sup> For further information on how Ofwat prioritises its Competition Act 1998 cases please refer to: [http://www.ofwat.gov.uk/competition/ca98/prs\\_inf\\_100920ca98priority.pdf](http://www.ofwat.gov.uk/competition/ca98/prs_inf_100920ca98priority.pdf).

<sup>9</sup> See section 2(2B) of the WIA91.

<sup>10</sup> The Water Act 2014 will bring significant reforms to the water industry. Amongst other measures it will introduce greater competition, enabling all non-household customers in England to switch their water and sewerage retailer; making it easier for water companies to trade water; and allowing businesses to provide new sources of water or sewerage treatment services. Further details about the Water Act 2014 can be found at: <https://www.gov.uk/government/policies/reforming-the-water-industry-to-increase-competition-and-protect-the-environment/supporting-pages/reform-of-the-water-market-the-new-water-bill>.

## Process

- 3.9. In accordance with Regulation 4(2) of the Competition Act 1998 (Concurrency) Regulations 2004, Ofwat informed the Office of Fair Trading (**OFT**) of its intention to exercise prescribed functions under the Act in this case on 5 March 2013. The OFT subsequently confirmed on 7 March 2013 that Ofwat was best placed to exercise the functions in this case.
- 3.10. On 11 March 2013, Ofwat launched a formal investigation under section 25 of the Act, on the basis that there were reasonable grounds to suspect that Bristol Water had infringed Chapter II of the Act and/or Article 102 of the TFEU<sup>11</sup>.
- 3.11. Ofwat served notices under section 26 of the Act to Bristol Water on 28 March 2013, and to Aquamain and Energetics on 10 April 2013. The section 26 notice sought from Bristol Water details of its general strategy and operational approach for interacting with SLOs and developers, including details of its price and non-price terms for quoting for requisitioned and self-laid infrastructure<sup>12</sup>. The notice also requested details of its specific interactions with Aquamain and Energetics. The section 26 notices to Aquamain and Energetics sought details of their interactions with Bristol Water since the beginning of 2012.
- 3.12. Ofwat received responses to the section 26 notices between 25 April and 6 June 2013. Having considered the evidence provided in these responses, Ofwat identified four specific competition concerns related to Bristol Water's potential exclusionary conduct (including pricing and other behaviours). Ofwat's view was that these four concerns (see below for details) could potentially restrict entry and expansion of competitors in the provision of water mains and service pipes to new development sites.
- 3.13. Ofwat held a series of discussions with Bristol Water to explain its competition concerns. On 5 July 2013, Bristol Water notified Ofwat that it was interested in

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<sup>11</sup> Press notice of case opening: [http://www.ofwat.gov.uk/mediacentre/ibulletins/prs\\_ib0413ca98slc](http://www.ofwat.gov.uk/mediacentre/ibulletins/prs_ib0413ca98slc).

<sup>12</sup> Requisitioned infrastructure is provided by the water company, while self-laid infrastructure is provided by a SLO. Where self-laid, the water company ultimately adopts water infrastructure and on doing so makes an asset payment to the constructor/developer providing it. This is explained further in chapter 4.

offering commitments to address Ofwat's competition concerns. Between July 2013 and January 2014, Ofwat further discussed with Bristol Water the form and content of the commitments that would be likely to be considered appropriate in light of its competition concerns. Under section 31A of the Act, Ofwat may accept such commitments as it considers appropriate for the purposes of addressing the competition concerns that it has identified. When considering whether to accept any commitments offered, Ofwat is required to have regard to the CMA's (formerly the OFT's) guidance as to the circumstances in which it may be appropriate to accept commitments<sup>13</sup>.

- 3.14. Ofwat outlined its competition concerns in writing to Bristol Water on 12 July 2013. On 2 August 2013, Ofwat shared a draft second section 26 notice with Bristol Water with the intention to request further details to help identify the relevant economic market(s) and the extent of competition in Bristol Water's areas of appointment.
- 3.15. In light of Bristol Water's notification of its interest in offering commitments and the emerging development of those draft commitments, Ofwat subsequently agreed to pause its investigation, including not issuing the second section 26 notice to Bristol Water, such that discussions could focus on the proposed commitments. However, Ofwat made clear to Bristol Water that it was able to continue the investigation and issue the section 26 notice at a later point if deemed appropriate. Ofwat presented its competition concerns to Bristol Water again on 1 November 2013, alongside broad weightings to demonstrate the relative importance Ofwat would attach to each concern when considering proposed commitments. This reflected that three of the concerns identified by Ofwat in relation to areas of conduct were potentially symptoms of one overarching concern which Ofwat considers to be the most significant.
- 3.16. Ofwat concluded discussions with Bristol Water on the proposed commitments in January 2014. As a result of having paused the investigation when entering into discussions with Bristol Water on commitments, Ofwat had not reached the point of gathering complete evidence or representations from the parties on the allegations and legal issues; nor had it completed its market definition exercise. However, Ofwat is satisfied that it has gathered sufficient information to enable it to assess effectively whether accepting commitments

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<sup>13</sup> [http://www.ofwat.gov.uk/shared\\_ofwat/business\\_leaflets/ca98\\_guidelines/ofwat407.pdf](http://www.ofwat.gov.uk/shared_ofwat/business_leaflets/ca98_guidelines/ofwat407.pdf)

is appropriate for this case and whether the commitments proposed by Bristol Water fully meet the competition concerns identified for this case.

- 3.17. Ofwat provisionally considers that the commitments Bristol Water has offered address the competition concerns for the reasons set out in this notice. Ofwat proposes to exercise its discretion to close its investigation by way of a formal decision accepting the commitments. Formal acceptance of commitments would result in the termination of Ofwat's investigation without proceeding to a decision on whether or not Chapter II of the Act or Article 102 TFEU has been infringed by Bristol Water.
- 3.18. Ofwat hereby gives notice that it proposes to accept the commitments offered in this case in accordance with section 31A(2) of the Act. As required by paragraph 2 of Schedule 6A of the Act, Ofwat invites representations from interested parties on this proposed course of action. Ofwat will consider such representations before making a final decision whether to accept Bristol Water's commitments.

## 4. Industry background

### The provision of new water supplies

- 4.1. Water and sewerage companies appointed under section 6 of the WIA91 to provide water and sewerage services are subject to a series of statutory duties, set out primarily in the WIA91, reflecting their monopoly position in providing vital water and sewerage services. These duties include complying with requests to provide water supplies to sites and premises for domestic purposes, both via water mains requisitions<sup>14</sup> and service connections to individual premises<sup>15, 16</sup>.
- 4.2. Following amendments made by the Water Act 2003, parties other than the appointed water company are now able to lay water mains and service connections. As such, an owner or occupier of a premises, or more commonly a developer, who requires a water supply for domestic purposes has a choice between requesting that the water company provide the associated infrastructure (referred to as 'a requisition') or having the water mains and/or service connections infrastructure provided by an accredited SLO. Any SLO installing new water mains and/or service connections must be fully accredited for the work they are undertaking. Lloyds Register operates the Water Industry Registration Scheme (**WIRS**) on behalf of water companies to provide this accreditation<sup>17</sup>.
- 4.3. All water companies in England and Wales recognise the WIRS, removing the need for them to operate their own approval scheme for SLOs providing new water mains and services for adoption by them as the appointed water company. As such, appropriate WIRS accreditation provides a water company with the same level of reassurance it would expect if it were providing the infrastructure itself or via its own contractors.

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<sup>14</sup> Section 41 of the WIA91.

<sup>15</sup> Section 45 of the WIA91.

<sup>16</sup> Water mains are the large pipes that distribute water around the company's network. They are usually, but not always, laid under highways. A service connection is the provision of a communication pipe between the water mains and the boundary of the private property, where it connects (usually at the point of a stop-tap) with a supply pipe running between the property boundary and the premises being connected, which is provided by the owner or occupier.

<sup>17</sup> <http://www.lloydsregister.co.uk/schemes/WIRS/>.

## Contestable and non-contestable services

- 4.4. Providing a water supply involves a series of activities from the time at which the request from the customer is received until water starts to flow through the infrastructure provided. There are limits to which of these services SLOs are able to provide in relation to new connections (and which are therefore contestable) due to water companies' duties in relation to: public safety; the operation of the live network to existing customers; and the legal requirement that the water company adopt any water infrastructure provided by a SLO. As a result, there are some non-contestable services that the appointed water company must always provide, either directly for a developer customer as part of a requisition, or for an SLO to enable the SLO to provide contestable services for a developer customer. The SLO (or the developer who has contracted the SLO) must therefore liaise with the water company to secure and where appropriate pay for these non-contestable services.
- 4.5. For the reasons discussed in paragraph 3.16 above, Ofwat did not complete a market definition exercise before stopping its investigation. However, in broad, high-level terms, the following table sets out the range of new connections services that are typically considered within the industry to be contestable and non-contestable. This list is not comprehensive and may vary with different aggregations of service type.

Contestable services	Non-contestable services
<p>Liaising with the customer.</p> <p>Designing and installing new water mains and service connections in accordance with water companies' specifications.</p> <p>Carrying out on-site (ie, within the perimeter of a new development) diversions and reinforcements, where existing customers are not affected.</p> <p>Disinfection and pressure testing.</p> <p>Supplying and fitting water meters.</p> <p>In-line connections to new mains.</p>	<p>Designing and installing infrastructure that involves works to the existing live network and/or that could affect existing customers.</p> <p>Confirming point(s) of connection to the existing network.</p> <p>Approval of on-site water system designs.</p> <p>Water sampling and quality testing.</p> <p>Inspecting works to ensure compliance with water supply regulations<sup>18</sup>.</p>

## SLO interaction with an appointed water company

- 4.6. Where a customer chooses to use an SLO, section 51A of the WIA91 provides for the appointed water company to adopt the infrastructure constructed by the SLO into its existing network. A self-lay agreement will be agreed with the appointed water company. This agreement may be made with the SLO or with the SLO's developer customer. This will set out the financial and non-financial terms and conditions that must be complied with in order for the water company to adopt the new infrastructure.
- 4.7. On adoption of a water main the WIA91 provides that the water company will make payment (this payment is referred to as the 'discounted offset amount', but is commonly referred to as an '**asset payment**') to either the SLO or the developer (subject to the self-lay agreement put in place with the water company), reflecting the value of this infrastructure, which now vests in the appointed water company. This payment is only made for water mains, not adopted service connections.
- 4.8. Section 51C of the WIA91 sets out a formula for calculating this asset payment<sup>19</sup>. The formula's method of including the costs reasonably incurred in

<sup>18</sup> The Water Supply (Water Fittings) Regulations 1999.

providing the main and offsetting estimated income generated through the new premises being connected to the water company's network broadly mirrors that used to calculate the requisition charge a water company can recover from a customer should they choose to requisition the main rather than use an SLO (as set out in section 43A of the WIA91). Where non-contestable works are required, the water company can charge either the SLO or developer for these as part of the self-lay agreement, but they should also form part of the costs used to calculate the asset payment, in the same way as they would were the works to be requisitioned from the water company.

## **Appointed water companies' delivery of new connections activities**

- 4.9. When a water company is delivering activities to provide a water supply, these activities are typically provided by the part of that company's business referred to as the 'developer services' and/or 'network management' teams. Both contestable and non-contestable activities are often provided by the same part of the business.
- 4.10. In many cases, water companies choose to sub-contract the carrying out of physical infrastructure works to a term contractor. These contracts usually are in place for a five-year period reflecting the industry's regulated price control cycles. These contractors, who are acting on behalf of the water company, tend to deliver both the activities required for a requisition and those non-contestable activities required to enable self-lay activities, as well as activities for the day-to-day management and maintenance of the existing live network.
- 4.11. This structure largely reflects the vertically integrated nature of water and sewerage companies. It means that water companies, and in particular their

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<sup>19</sup> As detailed in section 51C of the WIA91, the discounted offset amount is the sum of the estimated offsets for each of the 12 years following the vesting of the main by the water company. The estimated offset for each year is the lesser of: the estimated revenue (if any) in respect of the adopted main for that year; and the annual borrowing costs of a loan of the amount required for the provision of that main. Section 51C(7) provides that these amounts shall be calculated in accordance with the provisions (3) to (5) of section 43(A), which apply where the water main requisitioned – as such the costs and income considered should be the same regardless of whether the infrastructure is requisitioned or self-laid. The estimated offset is discounted in order to determine its net present value.

developer services function, have two different roles in providing services to customers. In providing upstream non-contestable services they are the monopoly provider due to their statutory appointments. SLOs are customers for these upstream services. In providing downstream contestable services the water company competes with SLOs. Developers are customers for these downstream services.

- 4.12. The fact that water companies provide different services to different customers in two candidate markets (one in which they are highly likely to hold a dominant position as a supplier of non-contestable services, and the other where they are competing with SLOs and where they can be their own customer for the non-contestable activities required to fulfil a requisition) is often not organisationally reflected in their traditionally integrated structure. The provision of these different services requires different roles from the water company.

## Changing competition landscape

- 4.13. For the most part, water companies are vertically integrated businesses delivering the full value chain for the provision of water service(s). For example, in the case of water services companies tend to be involved in:
- wholesale activities, including the abstraction, treatment and the distribution of water through their network; and
  - retail activities, whereby they interface with the customers using their water and provide related services.
- 4.14. The Water Act 2014 provides for greater competition in the industry, both by widening retail markets to allow all non-household customers of water and sewerage services in England to choose their supplier; and by allowing new entrants to provide wholesale services including the supply of water and sewerage treatment services<sup>20</sup>. The opening of these markets to greater competition will be facilitated by much greater transparency around the distinct roles incumbent water and sewerage companies play in different

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<sup>20</sup> Further details about the Water Act 2014 can be found at:  
<https://www.gov.uk/government/policies/reforming-the-water-industry-to-increase-competition-and-protect-the-environment/supporting-pages/reform-of-the-water-market-the-new-water-bill>.

markets. The Water Act 2014 provides for a range of new regulatory mechanisms, including:

- the approval of market codes;
- the issuing of charging rules to promote effective competition; and
- the issuing of codes and rules relating to the adoption of infrastructure such as water mains.

4.15. In particular, appointed companies will be required to ensure and demonstrate that there is a level playing field that allows effective competition, especially where a water and sewerage company's dominance in providing non-contestable, upstream services could potentially adversely impact on competition in the provision of contestable, downstream services. In September 2013, in preparation for the opening of the new retail and wholesale markets, Ofwat published a discussion document on level playing field issues, including the range of ex ante and ex post tools available to prevent and remedy anti-competitive behaviours<sup>21</sup>.

4.16. This direction of travel is reflected in Ofwat's current price review (PR14) methodology<sup>22</sup>, where there will be separate price controls from April 2015 for:

- retail water and wastewater services to household customers;
- retail water and wastewater services to non-household customers;
- wholesale water services; and
- wholesale wastewater services.

Regulatory financial reporting will be aligned with these separated price controls. In relation to developer services activities, Ofwat's PR14 methodology distinguishes between customer-facing activities, the costs of which are part of the non-household retail activities for water and sewerage (including where development sites include household premises)<sup>23</sup>, and the physical connections and network activities, the costs of which are remunerated by revenues subject to wholesale revenue controls. The

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<sup>21</sup> [http://www.ofwat.gov.uk/competition/review/pap\\_tec201309levelplayingfield.pdf](http://www.ofwat.gov.uk/competition/review/pap_tec201309levelplayingfield.pdf).

<sup>22</sup> [http://www.ofwat.gov.uk/pricereview/pr14/prs\\_web201307finalapproach](http://www.ofwat.gov.uk/pricereview/pr14/prs_web201307finalapproach).

<sup>23</sup> Because the relevant retail activities are already contestable, Ofwat will not be controlling the prices of retail developer services from April 2015 although the relevant costs and revenues will need to be separately reported.

contestable services which SLOs can compete to provide will sit in both the retail and wholesale parts of the water company's business (as set out in the diagram in paragraph 6.16 below).

- 4.17. Future regulatory accounting requirements for appointed companies will build on this and further reinforce the need for companies to better understand in which of their business functions specific activities and costs sit<sup>24</sup>.

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<sup>24</sup> <http://www.ofwat.gov.uk/future/monopolies/separation/>.

## 5. Ofwat's competition concerns

### Legal analysis

5.1. Section 18(1) of the Act imposes the Chapter II prohibition, which prohibits any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market if it may affect trade within the UK or any part of it<sup>25</sup>. 'Dominant position' in section 18 means a dominant position within the UK or any part of it<sup>26</sup>. Section 18(2) of the Act provides a non-exhaustive list of conduct which may constitute such abuse.

5.2. Article 102 of the TFEU states that:

“[a]ny abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States”.

5.3. Ofwat has not reached any conclusions regarding whether the alleged abuse may have affected trade between Member States. However, since the Chapter II prohibition is closely modelled on Article 102, and given the duty already imposed upon Ofwat (by section 60 of the Act) to apply the Act consistently with Community law<sup>27</sup>, Ofwat's substantive analysis of its competition concerns would not be materially different under Article 102 from that identified under Chapter II.

5.4. The European Court has defined the concept of an abuse as:

“...an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in

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<sup>25</sup> The Chapter II prohibition does not apply in cases in which it is excluded pursuant to section 19 of the Act. None of the excluded cases are applicable in respect of this case.

<sup>26</sup> Section 18(3) of the Act.

<sup>27</sup> Having regard to any relevant differences between the provisions concerned.

products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance or the degree of competition still existing in the market, or the growth of that competition.”<sup>28</sup>

- 5.5. Dominant firms have a ‘special responsibility’ not to allow their behaviour to impair competition in the market in which they are dominant or a related market. Conduct which is permissible by non-dominant firms may amount to an abuse if carried out by a dominant firm<sup>29</sup>.
- 5.6. Case law of the Court of Justice of the European Union has established that conduct in one market which has its effects on another market can constitute abuse, and that it is not necessary for an undertaking to be dominant on both markets for conduct to constitute an infringement of competition law in such cases. In *Tetra Pak II*<sup>30</sup>, the Court distinguished three different scenarios.
- Abusive conduct in dominated markets which has effects on markets other than the dominated markets<sup>31</sup>.
  - Abusive conduct in a separate non-dominated market which is intended to strengthen the undertaking’s position in the dominated market<sup>32</sup>.
  - Abusive conduct in a separate non-dominated market where the anti-competitive effects are experienced in that non-dominated market.
- 5.7. One of the ways in which a company holding a dominant position can abuse that position and infringe UK or EU competition law is through leveraging its dominance into a separate market so as to engage in abusive conduct. The

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<sup>28</sup> Case 85/76 ‘Hoffmann-La Roche v Commission’ [1979] ECR 461, paragraph 91.

<sup>29</sup> Case T-203/01 ‘Michelin v Commission’ [2003] ECR II-4071.

<sup>30</sup> Case C-333/94P *Tetra Pak International v Commission* [1996] ECR I-5951.

<sup>31</sup> *Joined Cases 6/73 and 7/73 ‘Commercial Solvents v Commission’* [1974] ECR 223 and Case 311/84 ‘*CBEM v CLT and IPB*’ [1985] ECR 3261. In *Commercial Solvents* for example, *Commercial Solvents* held a dominant position on the market for the raw materials necessary for producing the drug in question, and its refusal to supply constituted an abuse of its dominant position within the dominated market, but whose effects extended to the market for anti-tuberculosis drugs, which *Commercial Solvents* wished to penetrate.

<sup>32</sup> Case C-62/86 ‘*AKZO v Commission*’ [1991] ECR I-3359 and Case T-65/89 ‘*BPB Industries and British Gypsum v Commission*’ [1993] ECR II-389.

Competition Appeal Tribunal (**CAT**) stated in *Genzyme Ltd*<sup>33</sup>, that the relevant case law:

“demonstrate[s] that it may well be an abuse for an undertaking which is dominant in one market to act without objective justification in a way which tends to monopolise a downstream, neighbouring or associated market.”<sup>34</sup>

5.8. A discussion of the case law relating to ‘related-market abuse’ is set out in the OFT’s decision in *Flybe*<sup>35</sup>. In its decision in *Genzyme Ltd*<sup>36</sup>, the OFT also noted that:

“the process of extending market power in one market into another can be achieved in a number of ways”<sup>37</sup>.

5.9. In *Microsoft*<sup>38</sup>, an abuse was found where Microsoft used its dominant position on the client PC operating systems market to extend that dominant position to two adjacent markets (for work group server operating systems and for streaming media players)<sup>39</sup>.

5.10. The non-exhaustive list of conduct which may in particular constitute abuse of a dominant position contained at section 18(2) of the Act and at Article 102 includes applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.

## Economic analysis

5.11. Ofwat’s initial competition concerns centred on potential exclusionary conduct that restricts entry and expansion in a relevant market by leveraging dominance from a related market in which a vertically integrated appointed water company has persistent and enduring market power into a contestable market, including but not limited to:

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<sup>33</sup> Case No 1016/1/03 *Genzyme Ltd v OFT* [2004] CAT 4, [2004] CompAR 358.

<sup>34</sup> *Ibid*, paragraph 489.

<sup>35</sup> OFT decision of 25 November 2010, paragraphs 6.1–6.15.

<sup>36</sup> OFT Decision of 27 March 2003.

<sup>37</sup> *Ibid*, paragraph 296.

<sup>38</sup> Case T-201/04 [2007] ECR II-3601. [2007] 5 CMLR 846.

<sup>39</sup> *Ibid*, para 1344.

- applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and
- other exclusionary conduct or exploitative behaviour with the effect of excluding or restricting competition or expansion in the relevant market.

5.12. Market definition provides a framework for competition analysis and is a key step in identifying whether an appointed water company has market power in a relevant market and any competitive constraints that an appointed water company may face. For the purposes of the Chapter II prohibition, Ofwat would not consider an undertaking to be dominant unless that undertaking had substantial market power<sup>40</sup>.

5.13. Ofwat's initial investigation indicated two candidate relevant economic markets.

- An 'upstream' market comprising the non-contestable supply and maintenance of water infrastructure in Bristol Water's area of appointment.
- A 'downstream' market comprising the contestable supply of water mains and service pipes for providing water for domestic use to new development sites in Bristol Water's area of appointment.

5.14. The initial investigation also considered Bristol Water's market power in these candidate markets. In the upstream market in which Bristol Water's wholesale services are provided (which includes provision of non-contestable services) Ofwat considers that Bristol Water's exclusive and enduring right to serve its appointed area and to carry out non-contestable activities relevant to the effective supply of contestable services by SLOs is sufficient to establish Bristol Water's dominance. By virtue of its statutory duties under the WIA91 relating to the operation of the live water infrastructure, in its own area of appointment Bristol Water is the only undertaking able to:

- provide information about and allow access to the live water infrastructure network (including point of connection details);

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<sup>40</sup> See 'Abuse of a Dominant Position' (OFT402), paragraph 4.11.

- deliver non-contestable activities works (such as those on the live network and sampling to ensure infrastructure meets safety standards); and
- adopt self-laid infrastructure (including paying the associated asset payment)<sup>41</sup>.

- 5.15. SLOs need Bristol Water to provide these services in order to compete to provide downstream services in Bristol Water's area.
- 5.16. Ofwat considers that Bristol Water provides a substantial share of the downstream services delivered in its area of appointment, with initial indications that it completed around 75% of new connections in its appointed area in 2010-11 (the most recently available data). There are 62 currently licensed national or regional SLOs that could potentially serve Bristol Water's area of appointment, but only three are active in Bristol Water's area of appointment.
- 5.17. Following a review of the evidence collated from Ofwat's initial investigation, Ofwat had concerns that the limited proportion of new connections work undertaken by licensed SLOs (relative to Bristol Water's share) could potentially have resulted, at least in part, from Bristol Water leveraging its role in the provision of non-contestable upstream services with the effect of making it more difficult for equally efficient operators to compete to provide downstream services. However, there may also be other factors at play. Since Ofwat's investigation has been put on hold pending the consideration of the commitments offered by Bristol Water, no decision has been made on whether there is sufficient evidence to demonstrate whether Bristol Water was leveraging its position to harm competition.

## **Ofwat's competition concerns**

- 5.18. Having reviewed the evidence provided in response to the section 26 notices, Ofwat's competition concerns can be summarised into four specific concerns related to potential exclusionary conduct by Bristol Water (including pricing and other behaviours). The first of these is Ofwat's overarching concern, while

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<sup>41</sup> As explained in chapter 4.

the remaining three concerns, which relate to areas of conduct, are potentially symptoms of the first. Ofwat considers the first to be a particular systemic concern in its own right since it generates risk of further exclusionary anti-competitive behaviours arising, beyond the three specific areas of conduct identified by Ofwat's initial investigation.

5.19. Ofwat considers that Bristol Water's conduct could potentially restrict entry and expansion of competitors in the provision of water mains and service pipes to new development sites. The four concerns are as follows:

- 1) **Potential leveraging of a dominant position in upstream services to harm effective competition for downstream services.** Bristol Water's dominance in the provision of non-contestable upstream services and it being a vertically integrated business with significant market power in providing the upstream services necessary for SLOs to compete in its area of appointment, makes it possible to conduct the following practices of competition concern (detailed in concerns 2–4 below). Bristol Water being a vertically integrated business that competes to provide downstream services, creates the potential and incentive for it to leverage its dominance in upstream services into the provision of downstream services, so as to foreclose effective competition. The alleged practices detailed at 2–4 below raise concerns about whether potential future leveraging by Bristol Water could give rise to further, different practices which could have anti-competitive effect. Ofwat attached the highest weight to this concern, and the need for any commitments to address concerns about potential future leveraging, when considering the commitments offered by Bristol Water.
- 2) **Differences in the treatment of costs in the calculation of self-lay and requisition quotations which can result in the amount presented to the customer as being recovered by Bristol Water being less for the requisition than the self-lay option.** This conduct has the potential to exclude equally efficient operators from competing against Bristol Water's requisition activities. Differences in Bristol Water's quotations were

driven by differences in Bristol Water's calculation of the requisition charge and asset payment values<sup>42</sup>, in particular as a result of:

- a. differences in the costs included in the calculations for the same work depending on whether it was requisitioned or self-laid; and
- b. the exclusion of the costs of non-contestable off-site works from the total costs reasonably incurred against which income is offset within the asset payment calculation.

- 3) **The additional charges Bristol Water requires of SLOs without a clear objective justification for and transparency around the reasons for the charges, the level of the charges and differences in their application between SLOs.** The evidence gathered suggests that Bristol Water levies a range of charges when infrastructure is being self-laid as part of the commissioning of the essential upstream services that are needed by SLOs to compete in providing downstream services. These charges included a requirement to pay Bristol Water a deposit or surety in respect of the SLO's works (to cover the possibility of defective work or other construction issues) and a range of administrative fees in relation to applications and inspections. There may be justification for additional charges as a result of additional services being provided. But where the service provided is equivalent Bristol Water does not always apply these charges in the same way to its own downstream developer services business. These additional charges could increase costs for SLOs and put them at a disadvantage when competing for developer customers with Bristol Water's downstream developer services business. This has the potential to prevent the entry and expansion of equally efficient SLOs in providing downstream services.
- 4) **Bristol Water's interactions with SLOs in terms of communicating information to SLOs and developers on the processes and the prerequisite requirements they need to satisfy in order to access the upstream services provided by Bristol Water.** The complaints and evidence reviewed highlights concerns that Bristol Water's conduct with SLOs may be applying non-price constraints on the ability of SLOs to enter

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<sup>42</sup> As explained in chapter 4, the formulae set out in legislation for calculating these broadly mirror each other.

and expand in the provision of downstream services. The alleged conduct includes:

- a. limited or no communication of changes in information requirements for particular services;
- b. difficulties SLOs experience in finding public information on expected processes and levels of services;
- c. delays in Bristol Water's provision of information and upstream services impacting on the work schedule of SLOs; and
- d. examples of Bristol Water choosing to or requiring that they liaise directly with the SLO's developer customer rather than via the SLO (who are Bristol Water's customer), for whom the developer is their customer.

This conduct has the potential to discriminate against SLOs by making it more difficult for them to operate in the provision of contestable downstream services given that they must rely on the provision of non-contestable upstream services from Bristol Water. This conduct potentially makes a requisition choice more attractive to a developer on non-price terms due to the possibility of delay, additional information requirements and process requirements imposed on SLOs.

## 6. The commitments offered by Bristol Water

- 6.1. Bristol Water has offered commitments to address the competition concerns Ofwat has identified above. The commitments are set out in full in appendix 1. They are summarised below alongside Ofwat's analysis of their suitability in this case.
- 6.2. Ofwat provisionally considers that the proposed commitments would address the competition concerns in this case. A decision formally to accept the commitments as binding would result in Ofwat closing the investigation and not proceeding to a decision on whether or not Bristol Water has infringed Chapter II of the Act and/or Article 102 of the TFEU.
- 6.3. For the avoidance of doubt, a decision by Ofwat to accept binding commitments will not include any statement as to the legality or otherwise of the conduct of Bristol Water under the investigation either prior to acceptance of the commitments or once the commitments are in place.

### The CMA guidance

- 6.4. Ofwat is required to have regard to the guidance produced by the CMA (formerly the OFT) under section 31D of the Act<sup>43</sup> (the **guidance**) when considering whether to accept any commitments offered to it.
- 6.5. The guidance states that it is appropriate to accept binding commitments in cases where the:
  - competition concerns are readily identifiable;
  - competition concerns are fully addressed by the commitments offered; and
  - proposed commitments can be implemented effectively and, if necessary, within a short period of time.

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<sup>43</sup> [http://www.ofwat.gov.uk/shared\\_ofwat/business\\_leafllets/ca98\\_guidelines/ofwat407.pdf](http://www.ofwat.gov.uk/shared_ofwat/business_leafllets/ca98_guidelines/ofwat407.pdf).

- 6.6. The guidance notes that the CMA (and by extension, Ofwat) will not accept, other than in exceptional circumstances, binding commitments in cases involving serious abuse of a dominant position. Whether commitments are appropriate will be assessed on a case-by-case basis, taking account of all the circumstances of the case. The guidance also states that the CMA (and Ofwat) will not accept binding commitments in circumstances where compliance with and the effectiveness of any binding commitments would be difficult to discern, and/or where not to complete an investigation and make a decision would undermine deterrence.

### Appropriate case for commitments

- 6.7. In line with the guidance, Ofwat provisionally considers that this is an appropriate case in which to consider binding commitments for the following reasons.
- **Identifiable competition concerns.** Ofwat's initial investigation has highlighted a series of specific competition concerns regarding Bristol Water potentially leveraging dominance from its regulated upstream business supplying non-contestable upstream services, with the effect of making it difficult for SLOs to enter and compete with it in the provision of contestable, downstream services. These concerns are set out in chapter 5 above.
  - **Ofwat provisionally considers that the proposed commitments fully address the competition concerns Ofwat has identified for this case.** Ofwat provisionally considers that the package of commitments proposed by Bristol Water fully addresses the identified competition concerns. This is further explained in paragraphs 6.9 to 6.24 below.
  - **The commitments are capable of being implemented effectively and, if necessary, within a short period of time.** Bristol Water has set out a detailed timetable for implementing the proposed commitments and a significant number of the proposals will take immediate effect. Bristol Water is already taking steps to deliver a number of these and

has committed to providing Ofwat with regular monitoring information to demonstrate their delivery and future compliance. A longer timeframe is set out for the commitment relating to organisational structure<sup>44</sup>, which will require more time and planning to be implemented effectively. This commitment will be in place by 30 November 2014. Ofwat's provisional view is that the proposed timetable demonstrates that the commitments are capable of being implemented in an effective and timely manner.

- **Accepting commitments in this case would not undermine deterrence.** Ofwat considers that accepting commitments in this case would not undermine deterrence in this market and indeed the effective and efficient use of its competition powers in this case serves to reinforce the deterrence effect across the water and sewerage industry. Ofwat considers that the package of commitments offered by Bristol Water is comprehensive and, in particular, the largely immediate timing of their implementation means that they are likely to have a greater impact than could have been achieved by completing the investigation with a view to making a potential infringement decision and taking enforcement action. As well as addressing the specific competition concerns for this case in Bristol Water's area of appointment, the case and the resulting commitments have the potential to generate wider indirect benefits, by contributing to a culture of competition compliance and setting out potential level playing field issues and possible solutions to them that might arise more widely across the industry. This will be particularly important as competition in the sector grows in future years and requires greater transparency in terms of appointed water companies' different roles.

6.8. The proposed commitments offered by Bristol Water are specific to Bristol Water as a company and are designed to address the particular competition concerns identified in this case. It is Ofwat's view that there is a range of potential alternative ways of addressing its competition concerns. It was for Bristol Water to decide and propose the most appropriate means for its business of addressing the identified competition concerns. This is particularly true of its organisational structures, policies and procedures, which are matters for Bristol Water to manage itself. We note that whilst similar

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<sup>44</sup> Commitment 5 (section 7 in appendix 1).

principles would apply in other cases and circumstances, the commitments put forward by Bristol Water are not intended to be an industry-wide solution to demonstrating compliance with the Act and ensuring a level playing field that allows effective competition. The package of commitments offered is not proposed as being a solution suitable to all appointed water and sewerage companies.

## **Commitments offered**

- 6.9. The commitments offered by Bristol Water are set out in full in appendix 1 and summarised below. The proposed commitments address the competition concerns identified as follows:

Competition concern	Addressed by commitment
1. Potential unfair leveraging of a dominant position in upstream services to harm effective competition for downstream services.	Commitment 4 – policies and procedures (see paragraph 6.13 for further details). Commitment 5 – Bristol Water’s internal structure and processes (see paragraph 6.14 for further details).
2. Differences in the treatment of costs in the calculation of self-lay and requisition quotations, which can result in the amount presented to the customer as being recovered by Bristol Water being less for the requisition than the self-lay option.	Commitment 1 – calculation and presentation of costs of new infrastructure (see paragraph 6.10 for further details).
3. The additional charges Bristol Water requires of SLOs without a clear objective justification for and transparency around the reasons for the charges, the level of the charges and differences in their application between SLOs.	Commitment 2 – broad equivalence of new development charges (see paragraph 6.11 for further details).
4. Bristol Water’s interactions with SLOs in terms of communicating to SLOs and developers on the processes and the prerequisite requirements they need to satisfy in order to access the upstream services provided by Bristol Water.	Commitment 3 – interaction with self-lay organisations (see paragraph 6.14 for further details).

6.10. **Commitment 1 – calculation and presentation of costs of new infrastructure**<sup>45</sup>. Bristol Water proposes to provide consistency and greater transparency in its treatment of costs when calculating quotations for the requisition charge and self-lay asset payment. In particular, Bristol Water proposes to ensure that when calculating the requisition charge (for works entirely provided by Bristol Water) and asset payment (where some or all

<sup>45</sup> Section 3 in appendix 1.

works are self-laid by an SLO) the income offset is applied against the same total set of costs. Bristol Water proposes to ensure that cost information that it provides is clear and enables developers to make an informed choice between requisition and self-lay options. Bristol Water also commits to work closely with its customers (developers and SLOs) to develop a clear and more easily understood approach to budget quotations.

6.11. **Commitment 2 – broad equivalence of new development charges**<sup>46</sup>.

Bristol Water proposes to ensure that the charges it imposes are fair and non-discriminatory where the service or transaction being undertaken is equivalent, regardless of whether this is for requisition or self-lay works. Bristol Water also proposes to provide greater transparency around the purpose and make-up of its charges for requisition and self-lay activities such that developers and SLOs can better understand what charges are being recovered and why. Bristol Water proposes to embed this approach in its annual review of charges to ensure the charges do not cause undue preference or discrimination. Bristol Water has committed to stopping the requirement for SLOs to pay sureties (as of 11 June 2013) and has returned those it held at that date.

6.12. **Commitment 3 – interaction with self-lay organisations**<sup>47</sup>. Bristol Water proposes to ensure that its day-to-day interactions with developers and SLOs will not cause undue preference, delay or discrimination in favour of either the requisition or self-lay options. Bristol Water proposes to ensure it provides the same type and quality of information within the same timescales, regardless of whether for its own downstream business under a requisition offer or for SLOs under a self-lay query. Bristol Water also proposes to ensure that the obligations imposed and services provided by it are clearly communicated and do not provide undue preference or discrimination between requisition or self-lay provision in terms of the timing and nature of their delivery – for example, in terms of the information required from a SLO in order for Bristol Water to progress non-contestable activities and the timetabling of the provision of non-contestable services such as inspections.

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<sup>46</sup> Section 4 in appendix 1.

<sup>47</sup> Section 5 in appendix 1.

6.13. **Commitment 4 – policies and procedures**<sup>48</sup>. Bristol Water proposes to update its internal and external policy and procedural documents to reflect the package of other commitments proposed and to ensure they do not cause any undue preference or discrimination between requisition and self-lay options. Bristol Water commits to ensuring its revised policies are clear and take into account customers' suggestions (including SLOs) and to ensuring they are easily identifiable and accessible for those seeking copies. Bristol Water will also ensure that revised versions of these documents are available within 20 working days of any changes being made.

6.14. **Commitment 5 – Bristol Water's internal structure and processes**<sup>49</sup>. Bristol Water proposes to make a series of changes to its organisational structure and processes to demonstrate a clearer distinction between its wholesale and retail functions and the contestable and non-contestable services it provides. This functional separation of Bristol Water's wholesale business from its downstream retail business for providing contestable developer services will see:

- those parts of the organisation that provide services to developers and SLOs for self-lay queries being separate from those letting and managing Bristol Water's term contract for delivering its competing requisition option;
- the introduction of a Network Site Agent role as a liaison point for both requisition and self-lay works; and
- greater transparency in terms of the flow of information and services between Bristol Water's wholesale and retail functions.

6.15. The proposed structure recognises SLOs as customers of Bristol Water's non-contestable upstream services and as Bristol Water's competitors in downstream wholesale and retail services. It will also direct developer customers of requisition services to its retail function such that it is this part of the business that will incur the costs of engaging with customers. This reflects the expectations of the PR14 methodology in terms of separate price controls supported by separated activity costs. Bristol Water proposes that it will ensure that the information and services provided by its non-contestable upstream function will be provided in the same manner to both its own

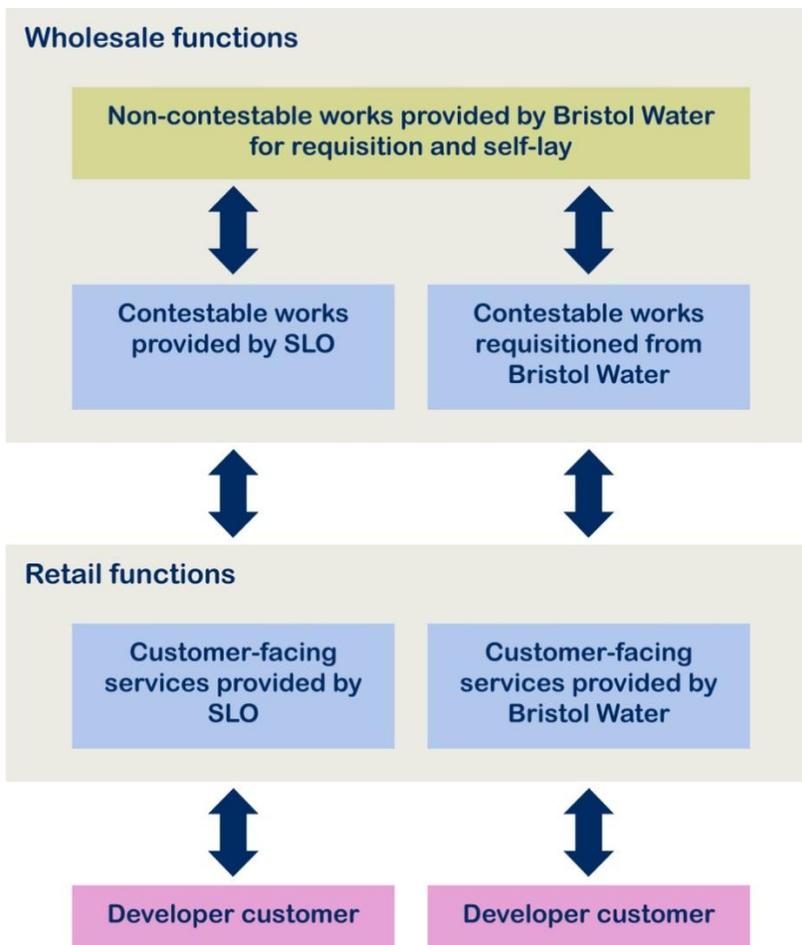
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<sup>48</sup> Section 6 in appendix 1.

<sup>49</sup> Section 7 in appendix 1.

competitive business and SLOs. Bristol Water will also safeguard sensitive customer information provided to it by SLOs for upstream services and will not inappropriately pass this onto its own competing business.

- 6.16. Appendix 1 includes a detailed diagram of Bristol Water’s structural proposals. The intended outcome is simplified in the diagram below. The arrows highlight the customer–provider relationships between functions for both the self-lay and requisition options. The green box reflects Bristol Water’s upstream role, while the blue boxes reflect the related downstream services that are contestable. The latter are split between the water company’s retail and wholesale functions (as defined by the PR14 methodology<sup>50</sup>).



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<sup>50</sup> This retail/wholesale definition is not an operational distinction typically used by SLOs but is made in the diagram for illustrational and comparison purposes.

## Effectiveness of commitments

- 6.17. Ofwat provisionally considers that as a complete package the five commitments proposed by Bristol Water comprehensively address the competition concerns identified in this case.
- 6.18. The commitments relating to Bristol Water's internal structure and processes and its policies and procedures (commitments 4 and 5) recognise and respond to the fact that for some non-contestable services SLOs are customers of Bristol Water as the appointed water company, while for other (contestable) services SLOs are Bristol Water's competitor. The structural and policy and procedure changes proposed in these two commitments address the competition concern Ofwat considered to have greatest weight in terms of the potential leveraging of a dominant position to the effect that it is harder for SLOs to enter and compete in the provision of contestable services. These two commitments demonstrate how Bristol Water will distinguish and separately manage information and services derived from their two roles, including reflecting when they are their own customer. The proposed structure would reduce Bristol Water's potential ability (although not the potential incentive) to leverage its dominant position to discriminate in the contestable market.
- 6.19. The commitments relating to the calculation and presentation of costs and to the broad equivalence of charges required by Bristol Water (commitments 1 and 2) address the competition concerns relating to the price terms offered by Bristol Water in order for the affected parties to access the upstream services required to enter and compete in the provision of downstream services (concerns 2 and 3). These two commitments will ensure costs are treated in the same way for requisition and self-lay options and provide greater transparency in the charges Bristol Water requires of SLOs. Commitment 3 addresses the concern relating to Bristol Water's interaction with SLOs and the resulting non-price terms Bristol Water offers to access its upstream services.
- 6.20. **Implementation and duration.** Bristol Water has set out a detailed timetable for the implementation of the commitments<sup>51</sup>, including some actions taking

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<sup>51</sup> Section 8 in appendix 1.

immediate effect. Bristol Water has proposed to provide Ofwat with information regularly to demonstrate the implementation of and compliance with the commitments during and following the completion of their implementation timetable.

- 6.21. Binding commitments are generally adopted for a specified period of time. They are treated as released on the expiry of this period. Ofwat has provisionally concluded that a duration of approximately three years is appropriate for the commitments in this case. This will mean that the commitments would be in place for the period until the opening of the new retail market for all non-household customers in England in April 2017 (as provided by the Water Act 2014). It is expected that the market codes that will be developed for the new market arrangements will provide a framework for ensuring a level playing field between water companies' own requisition activities and competing self-lay activities more generally after 2017. This framework will supersede Bristol Water's own proposed commitments.
- 6.22. The proposed commitments include provision for either Bristol Water or Ofwat to request an amendment to the commitments at any point in light of, for example, changes in market circumstances or legislation. Any decision regarding amendments to the commitments would be made by Ofwat.
- 6.23. Acceptance of commitments does not prevent Ofwat from taking any action in relation to any competition concerns subsequently arising which are not addressed by the commitments.
- 6.24. Acceptance of commitments also does not prevent Ofwat from continuing its investigation, making a decision or giving a direction where it has reasonable grounds for:
- believing that there has been a material change of circumstances since the commitments were accepted;
  - suspecting that an undertaking has failed to adhere to one or more of the terms of the commitments; and/or
  - suspecting that information which led it to accept the commitments was incomplete, false or misleading in a material particular.

## 7. Ofwat's intentions and invitation to comment

- 7.1. In light of the above, Ofwat provisionally considers that the commitments offered by Bristol Water, as set out in appendix 1:
- will fully address Ofwat's competition concerns;
  - can be implemented effectively; and
  - will not undermine deterrence.
- 7.2. Ofwat hereby gives notice to interested parties pursuant to paragraph 2 of Schedule 6A of the Act that Ofwat proposes to accept commitments in this case in accordance with section 31A(2) of the Act. Ofwat invites representations from interested parties on this proposed course of action and will consider such representations before making a final decision whether to accept Bristol Water's commitments.
- 7.3. Formal acceptance of the commitments by Ofwat would result in the termination of Ofwat's investigation, with no decision on whether the Act has been infringed by Bristol Water. If accepted, the commitments will be binding and enforceable.
- 7.4. Bristol Water's timetable for implementing the commitments (as detailed in appendix 1) includes a number of actions taking immediate effect and Bristol Water is already implementing or has already implemented these. The timing of this notice intentionally runs in parallel with this early stage of implementation so that interested parties may have an opportunity to comment on whether they are aware of these actions and whether they are beginning to address the competition concerns identified.
- 7.5. Given the relevance of this case for the wider industry, interested parties will have an extended period of eight weeks to submit representations. Ofwat is particularly interested to hear the views of other SLOs and water companies. Specifically, Ofwat would welcome views on:
- a. whether the commitments fully address the competition concerns identified by Ofwat for this case;
  - b. the efficacy of the commitments in the context of the day-to-day operations of water companies, SLOs and developer customers;

- c. the visibility and effectiveness of those elements of the commitments that Bristol Water is implementing with immediate effect;
- d. the type(s) of information that Bristol Water should provide to Ofwat to evidence its implementation of and compliance with the commitments; and
- e. what types of evidence and /or indicators Ofwat might consider in order to assess whether the appropriate conditions are in place to allow for effective competition in the provision of contestable services for new connections in Bristol Water's area of appointment.

## Invitation to comment

- 7.6. Any person wishing to comment on the commitments and Ofwat's intention to accept them should submit written representations by 5pm on Friday 18 July 2014 to:

Sally Irgin  
Principal Case Officer  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA  
Email: [BristolWaterCA98@ofwat.gsi.gov.uk](mailto:BristolWaterCA98@ofwat.gsi.gov.uk)

## Confidentiality

Ofwat does not intend to publish the responses to this consultation with any commitments decision or notice to provisionally accept modified commitments. However, the information contained in the responses may be used or summarised on an anonymous basis in either or both of these documents.

In the event that the commitments are not accepted and Ofwat is considering disclosing any information so provided (such as in or with a statement of objections), it will revert to the provider of that information to obtain representations on confidentiality. Ofwat will then consider those representations before deciding whether the information should be disclosed under part 9 of the Enterprise Act 2002.

## Appendix 1: Commitments given by Bristol Water pursuant to section 31A of the Competition Act 1998

Bristol Water plc (Bristol Water) gives to the Water Services Regulation Authority (Ofwat), without in any way acknowledging or accepting that it has infringed applicable competition law, the following commitments (the Commitments) under section 31A(2) of the Competition Act 1998 in order to meet Ofwat's concerns as set out inter alia in Ofwat's letter to Bristol Water dated 12 July 2013.

### A1.1 Interpretation

The Interpretation Act 1978 shall apply to these Commitments as it does to Acts of Parliament.

In these Commitments the word "including" shall mean including without limitation or prejudice to the generality of any description, definition, term or phrase preceding that word and the word "include" and its derivatives shall be construed accordingly.

For the purpose of these Commitments, the following terms shall have the meaning ascribed to them below.

**Asset Payment** means the payment made by Bristol Water in the event that the mains are self-laid.

**Basic Supply Strategy Enquiry** means a basic enquiry which contains sufficient information to enable Bristol Water to provide an enquirer with an indication of the scope of the works needed to supply a development. No designs or Budget Quotation are provided.

**Budget Quotation** means the document setting out the budget costs for requisitioning and self-laying the infrastructure that is the subject of a Preliminary Mains Design Enquiry.

**Charges Scheme** means Bristol Water's Charges Scheme setting out connection, disconnection, development and infrastructure charges which is updated annually and published in April.

**Commuted Sum** means the payment required by Bristol Water from a developer in the event that mains are requisitioned.

**Licence** means Bristol Water's Instrument of Appointment.

**Pre-Development Enquiry** means either a Basic Supply Strategy Enquiry or a Preliminary Mains Design Enquiry.

**Preliminary Mains Design Enquiry** means a detailed enquiry which contains sufficient information to enable Bristol Water to provide an enquirer with a preliminary design for all of the required mains, and a Budget Quotation for their installation.

**Relevant Charges** means the charges identified in **A1.12**.

**Relevant Legislation** means the Competition Act 1998 and the Water Industry Act 1991.

**Requisition** means the installation, by Bristol Water or its designated contractor, of non-contestable and/or contestable water infrastructure (including mains and service connections) for new developments.

**Schedule of Rates** means the agreed rates for specified work items to be carried out by the Term Contractor as set out in the Term Contract for network maintenance and associated works.

**Self-Lay** means the laying of contestable water infrastructure (including mains and service connections) for new developments by the developer itself, or by an SLO appointed by the developer.

**Self-Lay Organisation (SLO)** means an entity engaged in the laying of water mains and service connections on behalf of developers.

**Sureties** means the self-lay sureties described in the 2013-14 Charges Scheme.

**Term Contract** means the contract to provide repair and maintenance services to Bristol Water for network maintenance and associated works, including the delivery of new connections when requisitioned from Bristol Water.

**Term Contractor** means the contractor appointed by Bristol Water under the Term Contract.

**Working Day** means any day of the week other than a Saturday or a Sunday or any day that is a public holiday in England.

## **A1.2 Commencement and duration**

These Commitments shall take effect from the date that, having been signed by Bristol Water, Ofwat's acceptance of such Commitments is notified to Bristol Water and will continue in force until 31 March 2017.

Nothing in this provision will prevent either party from requesting an amendment to, or early termination of, the Commitments at any point in time in light of, for example, changed market circumstances or legislative requirements.

## **A1.3 Calculation and presentation of cost of new infrastructure**

### **Principle**

Bristol Water will take all reasonable steps to ensure that the costs quoted for the provision of water infrastructure on a new development are calculated in a way which does not cause undue preference to, or unduly discriminate against, either the self-lay option or the requisition option, and which is consistent with all Relevant Legislation and the Licence.

### **Specific actions**

In particular, Bristol Water will:

- a. calculate self-lay asset values by reference to the total installation cost of all relevant contestable work and all relevant non-contestable work (including the proportion of any broader non-contestable schemes that are being undertaken to meet the needs of multiple developments and/or existing customers) that is attributable to the development in question;
- b. ensure that Budget Quotations provided in response to a Preliminary Mains Design Enquiry contain information relating to both the self-lay and the

requisition options, unless specifically requested by the entity that submitted the Preliminary Mains Design Enquiry to do otherwise; and

- c. take all reasonably practicable steps to ensure that the cost information provided by Bristol Water allows developers to make an informed choice between the self-lay and requisition options. To achieve this, Bristol Water will:
  - i. engage with developers and SLOs to discuss the form and the content of the Budget Quotation as part of an informal consultation process; and
  - ii. taking into account the views expressed during the consultation, produce a Budget Quotation which is clear and easily understood, allows the self-lay and requisition options to be compared through the provision of equivalent information for each option, and explains any differences between the cost of the two options.

## **A1.4 Broad equivalence of new development charges**

### **Principle**

Bristol Water will take all reasonably practicable steps to ensure that charges applied to SLOs, or charged in circumstances where mains and/or service connections are being self-laid, are broadly equivalent to charges applied for equivalent services in the context of the requisition of mains and/or service connections, and that they do not cause undue preference to, or unduly discriminate against, SLOs in a way which is inconsistent with the requirements contained in Relevant Legislation and the Licence.

## Specific actions

In particular, Bristol Water will:

- a. stop requiring the payment of sureties by SLOs in respect of mains laying and service connections;
- b. ensure any and all sureties held by Bristol Water will be, or have been, returned to the SLOs, with the payment of interest where applicable;
- c. ensure equivalent application of charges where services provided are equivalent, regardless of whether the mains and/or service connections are being self-laid or requisitioned;
- d. review the calculation of the Relevant Charges as part of the annual revision of the Charges Scheme to ensure that the Relevant Charges:
  - i. charged in a self-lay context are broadly equivalent to the charges applied in a requisition context;
  - ii. do not cause undue preference or undue discrimination; and
  - iii. are compliant with the Relevant Legislation and Licence; and
- e. provide an explanation of the purpose of each Relevant Charge, including what each one covers, and why each is charged, in the appropriate policy document(s). In particular, these explanations will be included in:
  - i. the external facing self-lay policy, as revised in accordance with Commitment 6(b); and
  - ii. the 2014-15 Charges Scheme, and subsequent annual versions.

## A1.5 Interaction with self-lay organisations

### Principle

Bristol Water will, using its best endeavours and acting in good faith, take all reasonably practicable steps to ensure that in its dealings with developers and SLOs it does not cause undue preference to, or unduly discriminate against, SLOs in a way which is inconsistent with Relevant Legislation and the Licence.

## Specific actions

In particular, Bristol Water will:

- a. respond to Pre-Development Enquiries made by SLOs in a way which does not cause undue preference to, or unduly discriminate against, SLOs and is inconsistent with Relevant Legislation and the Licence. In particular, Bristol Water will:
  - i. set out clear timeframes for the handling of, and response to, Pre-Development Enquiries in its external policy and procedural documents;
  - ii. ensure that those timeframes apply equally to all equivalent enquiries; and
  - iii. ensure that the nature of the information provided by Bristol Water in response to Pre-Development Enquiries is broadly equivalent;
- b. take all reasonably practicable steps to ensure that Bristol Water does not improperly use any information which it holds by virtue of its position as the appointed water company for the Bristol Water area, or information which it is given by third parties in order to comply with its statutory obligation to offer requisition services for mains and/or service connections, in a way which unduly distorts competition, causes undue preference or undue discrimination and is inconsistent with Relevant Legislation and the Licence. In particular, Bristol Water will ensure that:
  - i. the Term Contractor and those preparing quotations for contestable works are not provided with, or given access to, any information relating to a particular development held by Bristol Water on terms which differ from those on which equivalent information would be provided to an SLO in equivalent circumstances;
- c. remove any requirements from the self lay application form for the developer to counter-sign the form, unless it can be clearly demonstrated that there is an objective justification for the consent of the developer to be obtained;

- d. seek to ensure that once an SLO has been appointed for a particular development, all communications pertinent to that development will be directed to the appropriate party(ies), taking into account the roles performed by the parties involved in that particular development and any relevant instructions received by Bristol Water from the parties concerned;
- e. ensure that the obligations imposed on, and the services provided to, SLOs by Bristol Water in regard to the self-lay of mains and/or service connections are:
  - i. broadly equivalent to obligations imposed and services provided by Bristol Water in connection with the requisition of mains and/or service connections;
  - ii. clearly communicated and easily understood; and
  - iii. do not cause undue preference to, or unduly discriminate against, SLOs, in a way which is inconsistent with Relevant Legislation and the Licence; and
- f. For the avoidance of doubt, nothing in these Commitments will impose an obligation on Bristol Water to disclose to anyone any information, documents or materials which are provided to Bristol Water by third parties as part of a Pre-Development Enquiry.

## **A1.6 Policies and procedures**

### **Principle**

Bristol Water will, using its best endeavours and acting in good faith, take all reasonably practicable steps to provide external and internal policies and procedures relating to the provision of infrastructure for new developments which are clear and easily understood, do not cause undue preference or undue discrimination, and which are compliant with the obligations contained in Relevant Legislation and the Licence.

## Specific actions

In particular, Bristol Water will:

- a. amend and update its public and internal policy documents and relevant forms to reflect those commitments as identified herein which have immediate effect;
- b. review the existing external policy documents relating to the provision of infrastructure for new developments, namely the Developers' Charter, the Addendum to the National Code of Practice and the Self-Lay Policy, and relevant forms utilised by developers, SLOs and their agents, in order to produce materials which:
  - i. set out the relevant information in a clear and simple way;
  - ii. take into account the views expressed and suggestions made by customers, including developers, SLOs and their agents;
  - iii. enable developers, SLOs, and their agents to understand the service standards applicable to procedures under the self-lay and requisition options;
  - iv. do not cause undue preference or undue discrimination; and
  - v. are compliant with Relevant Legislation and the Licence;
- c. ensure that the external policy documents, and any relevant forms or other information, are easily identifiable and accessible;
- d. review the existing internal policy and procedural documents relating to the provision of infrastructure for new developments in order to produce materials and procedures which:
  - i. ensure equivalent treatment of equivalent transactions;
  - ii. do not cause undue preference or undue discrimination; and
  - iii. are compliant with Relevant Legislation and the Licence; and
- e. in the event of any changes being made to Bristol Water's policies and procedures in the future, in so far as they relate to self-lay, amend any relevant documents and publish revised versions within 20 working days of the changes being made.

## A1.7 Bristol Water's internal structure and processes

### Principle

Bristol Water will, using its best endeavours and acting in good faith, take all reasonably practicable steps to ensure that its approach to the provision of services relating to the provision of water mains infrastructure for new developments (referred to by Ofwat as '**Developer Services**') is not structured in such a way that it causes undue preference to, or unduly discriminates against, SLOs in a way which is inconsistent with Relevant Legislation and the Licence. In particular, Bristol Water will:

- a. ensure that Bristol Water's Development Services team (which provides specific services to developers and SLOs) involved in the provision of Developer Services is distinct from the team responsible for the letting and management of the Term Contract;
- b. ensure that the Development Services team involved in the provision of Developer Services does not have any direct decisive influence over the selection and appointment of the Term Contractor;
- c. ensure that the Term Contractor is not directly involved in the production of the Budget Quotation, with the exception of the provision of cost information for work items which are not covered by the Schedule of Rates;
- d. adopt an internal operational structure broadly equivalent to that set out in **A1.13**, which provides for two distinct and separately staffed functions, namely the Wholesale Interface and Retail Interface. These functions will have the following roles and responsibilities:
  - i. the Retail Interface will be created and will operate as the main interface with developers, their agents and any other customers in relation to new mains connections ('**Retail Interface Customers**');
  - ii. the Retail Interface will respond to Pre-Development Enquiries from Retail Interface Customers in accordance with the timescales and standards set out in Bristol Water's public policies and procedures and in these Commitments;
  - iii. in order to respond to Pre-Development Enquiries, the Retail Interface will engage with the Wholesale Interface;

- iv. the Wholesale Interface will operate as the main interface with the Retail Interface, SLOs and their agents, and other entities performing an equivalent retail function in relation to new mains connections (**‘Wholesale Interface Customers’**);
  - v. the Wholesale Interface will be responsible for the assessment of the capacity of the network, identification of the infrastructure requirements for the proposed development, and calculation of the estimated installation cost, Commuted Sum and Asset Payment. Where necessary, the Wholesale Interface will interact with, and request services and obtain information from, other departments within Bristol Water;
  - vi. the Wholesale Interface will respond to Pre-Development Enquiries from Wholesale Interface Customers in accordance with the timescales and standards set out in Bristol Water’s public policies and procedures and in these Commitments;
  - vii. the internal procedures relating to the activities of the Wholesale Interface and the Retail Interface will reflect the timescales and standards set out in Bristol Water’s public policies and procedures and in these Commitments; and
  - viii. for the purpose of ongoing compliance with Commitments 7(a) and 7(b), the Wholesale Interface and Retail Interface are equivalent to the Development Services team and will comply with those commitments accordingly;
- e. introduce the role of Network Site Agents, who will be responsible for oversight and management of the delivery of works in relation to any new development; and
- f. amend and update its public and internal policy, procedures and associated documents and forms to reflect the revised structure and in a way which is consistent with the principles set out in Commitment 6(b), (c), and (d).

## A1.8 Timetable

Bristol Water will carry out the actions described above in accordance with the timetable set out below.

Relevant commitments	Date
<b>Calculation and presentation of cost of new infrastructure</b>	
3(a), 3(b)	With immediate effect
3(c)	1 June 2014
<b>Broad equivalence of new development charges</b>	
4(a), 4(b), 4(c)	With immediate effect
4(d), 4(e)(i)	1 April 2014
<b>Interaction with SLOs</b>	
5(a), 5(b)(i)	With immediate effect
5(c)	Requirements changed with immediate effect and communicated to SLOs. Standard forms to be revised and published by 31 January 2014
5(d)	With immediate effect
5(e)	31 January 2014
5(f)	With immediate effect
<b>Policies and procedures</b>	
6(a) – to reflect 3(a), 3(b), 4(a), 4(b), 5(a), 5(c), 5(d) and 7(c)	16 April 2014
6(b), 6(c), 6(d)	1 May 2014
<b>Bristol Water’s internal structure and processes</b>	
7(a), 7(b), 7(c)	With immediate effect

Relevant commitments	Date
7(d), 7(e), 7(f)	30 November 2014 The following milestones will apply: <ul style="list-style-type: none"><li>• Advertising of jobs created by introduction of Retail Interface – 30 April 2014</li><li>• Completion of recruitment process – 31 July 2014</li><li>• Development of internal and external policies and procedures to reflect new structure – 31 August 2014</li><li>• Briefing to customers on new structure and procedures – 30 September 2014</li><li>• Formal launch of new structure – 30 November 2014</li></ul>

## A1.9 Reporting and provision of information

While these Commitments remain in force and effective, Bristol Water shall:

- a. from time to time as agreed with Ofwat, report in writing to Ofwat setting out the steps it has taken in fulfilling these Commitments; and
- b. provide to Ofwat any information and documents which Ofwat reasonably considers necessary in relation to, or in connection with, the implementation and/or enforcement of and/or the compliance with these Commitments.

## A1.10 Extension of time limits

Ofwat may, in response to a written request from Bristol Water, or otherwise at its own discretion, grant an extension to any time period referred to in these Commitments.

## A1.11 Acknowledgement of market reform programme

The Open Water programme aims to facilitate the implementation of market reform in the water sector. This will involve the creation of a new market for retail water and wastewater services for non-household customers in England and Wales. It is anticipated that there will be changes to the regulatory framework for Developer Services as a result of this reform programme.

To the extent that any changes are needed to these Commitments as a result of market reform, Ofwat and Bristol Water will engage and seek to revise the Commitments appropriately.

## A1.12 Relevant Charges

The Relevant Charges are those identified in the table below.

Name of charge	Brief explanation
Application Fee	The application fee charged by Bristol Water is set out in the Charges Scheme. It is a fee charged to cover the costs of assessing the network capacity, determining the point of connection, designing the mains and/or checking the design provided by the SLO, preparing the quotation, and other administrative work associated with progressing the application.
Re-Design Fee	Re-design fees are charged in circumstances where material amendments are required to a point of connection plan, mains design or quotation (eg, to reflect updated or revised plans).
Administration Charge	<p>The administration charge is charged in relation to each new connection. It is intended to cover the cost of the ‘back-office’ functions carried out by Bristol Water in order to record each new connection within its systems. This includes tasks such as:</p> <ul style="list-style-type: none"><li>• processing the application to connect;</li><li>• updating the connection information on Bristol Water’s systems, including the as laid information and meter details for billing purposes;</li><li>• providing any necessary quotations for the cost of connection; and</li><li>• inspection by the technical liaison officers of the installation of the customer’s part of the pipe, which is installed by the developer.</li></ul> <p>For self-lay, this is listed as a stand-alone administration charge. An amount for administration costs is also charged in the requisition option, as a component of the connection charge.</p>

The names used herein are accurate at the time that these Commitments were entered into. The names of the Relevant Charges, and the explanatory comments, may change from time to time.

### A1.13 Operational structure for Bristol Water's developer services function

