

Welcome and introduction to Ofwat's approach to CA98

Speech from Cathryn Ross at Competition Law event, 21 November 2016

Welcome

Good morning everyone. Thank you for being here at today's event.

We are here today to launch the consultation on our refreshed competition law guidance to the sector.

It's the first refresh in six years, and we felt it was particularly important to do this now – at a time when the sector is undergoing significant change and markets are evolving.

We are also delighted with the commitment shown to this event from the sector. This includes existing companies. But also some of those who will be entering the sector in the near future. Welcome.

I would also like to thank the CMA for providing a number of expert speakers and for hosting our event in their Bloomsbury offices, which are particularly familiar to me as a former place of work!

Introduction

Today I would like to talk about Ofwat's refreshed guidance to the sector and how we may approach competition law issues that arise in the future.

And I also want to talk about the challenges and opportunities that the introduction of markets will bring for all of us: for companies, investors and customers. And for Ofwat too.

Some of these we will be able to anticipate based on experience from other sectors. Some will of course be unique to water.

But before I talk about the guidance, let's start with some context...

It is becoming something of a cliché to say that there is a lot of change going on in the water sector. But it is true...

And we have been playing a key role in that change...

... with the changes we brought in at PR14 to the way we regulate...

... and with our work on Water2020 builds on this, developing markets for incremental new water resources, and for bioresources. And also challenging companies to test the market for significant new projects, i.e. those with more than £100mn whole life totex, through direct procurement for customers.

... and you know with our work with our Open Water partners and companies across the sector to open the business retail market in England to competition in April next year. I shouldn't pass up the chance to thank everyone who has been involved in this for the immense effort it has taken. .

... and I hope you will also recognise that there have been markets operating in the sector for some time. Notably through the supply chain. But also in respect of local distribution through new appointments and variations. And in self-lay. And for the very largest business customers.

The opportunities from all of these markets, especially taken together in the complex system that ultimately result in these public services on which we all depend, are immense.

All these markets - retail and wholesale - creates a fantastic set of opportunities to create value - value that can be shared between investors and customers and the environment.

Markets create the opportunity for transactions to take place - providing companies with opportunity to contract with others to do things they may not be best placed to do themselves... where others have an advantage, or where companies simply want to focus their management time and effort in some areas and not in others.

We have seen this already happening in the business customer market - with some of the incumbent companies such as Portsmouth and

Thames and Southern choosing to exit altogether, and others, such as Severn Trent and UU having made an early move to change size and shape to maximise their own advantage in the market.

And we will soon start to see customers benefitting from competition in the retail market - through better account management, through multi-site billing and through water efficiency. And probably in other ways that none of us have yet thought of!

I'm very excited to see what opportunities the new wholesale markets will throw up after 2020 too - in particular to see ways in which the contribution of players outside the traditional vertically integrated water companies, actors in catchments and through the supply chain - could be maximised for the benefit of customers and society.

The opening up of markets also opens opportunities in regulation too.

In particular for regulation to be more proportionate and targeted - for us to focus our interventions where they are really needed. Although we do see these new markets very much as regulated markets. We see scope for regulation to be lighter touch - more focused on setting the frameworks within which these markets can operate, and on intervening where there are problems, rather than as a matter of course.

You can see us doing this - changing our regulatory approach in precisely this way - in the business customer retail market at the moment.

And, as the regulator, where we do need to intervene we will be able to use the information that markets generate about price, cost and value. Even in those parts of the value chain where we don't expect to see effective competition, and so where we need to set price limits - we can make good use of information about transactions that have taken place to adopt a less onerous approach to setting those price limits.

But, having spoken about the opportunities, I do need to recognise that there are challenges too.

It is clear that as markets opens up scope for new transactions to take place, people who have not met each other in a marketplace before will do so. New relationships will need to be formed. And - perhaps more challenging - some existing relationships will need to change.

When I spoke earlier about the sort of change in mindset, the sort of change in culture, that markets and competition require to succeed, it is precisely this sort of change in relationships I had in mind.

We know from experience in others sectors, and in the water sector in those markets that have been competitive for some time (such as new appointments and variations, and self lay) that particular tensions emerge when markets involve some very big, established players and some smaller new players, especially those who want to do things differently.

I'm conscious that this is a huge set of issues that extends into every activity that a traditional vertically integrated water company has historically performed. These could - and probably will - be written on it.

But one particular aspect of those changing relationships concerns companies with power in markets, and their relationship with other market participants - the whole question of 'level playing field'.

One very particular aspect of this concerns compliance with competition law. Which brings me back to the purpose of today's event.

Our refreshed guidance...

It against this backdrop of greater use of markets in the sector - not only in retail but also in wholesale markets - that we have refreshed our guidance on competition law.

Our aim in doing so is to provide some sector specific insight into how we will apply competition law going forward. And ultimately to help many of you get your heads around what this means for your businesses, so that we can all make these markets work as well as they can for customers and society.

We think it will be an important resource for you. And hopefully a useful one.

However, all companies must be clear that it is their responsibility to ensure their own compliance with competition law. This guidance is not a cookbook or an alternative for exercising judgement.

And I should call out now that this is I think going to be another one of those cultural change challenges for the sector. Much as systems and

process can help with competition law compliance - and I'm sure many of you have been on your courses and got your pricing model spreadsheets! - they only get you so far. Competition law is an effects based regime - one in which you need to think not only about the processes you have gone through but about the implications of your behaviour in markets for the functioning of those markets. Tricky stuff.

How will Ofwat's new competition law guidance help?

I am sure Rachel [Rachel Merelie of the CMA] will remind us later this morning that one of the key changes that government has introduced over the last few years is to enshrine the primacy of considering competition enforcement action before regulatory powers.

We take this obligation seriously and routinely consider if we are using the correct tool as part of our prioritisation principles. If companies and businesses operating in the water and sewerage sector do not meet their competition law obligations, we will not hesitate to use our concurrent powers where appropriate to help markets function effectively.

In deciding whether and when to do so, we will use our Competition Act Prioritisation Principles.

Our prioritisation principles are unchanged and they apply only to our Competition Act powers. We particularly wanted to take the opportunity to re-emphasise them as we do anticipate the scope of for us to do more competition work especially following business market opening, so being clear how we choose what to take forward feels important.

In terms of how we handle cases, for the first time the guidance outlines in detail how Ofwat will consider early resolution of potential infringements of CA98.

This includes settlement of CA98 investigations, where a parties' admitting and settling a matter early could well be in the best interests of everyone. Customers benefit, if detriment minimised as soon as possible. And those being investigated benefit where we can reduce financial penalties reflecting, and of course by avoiding the pain of a drawn out investigation.

Similarly, offering commitments and agreeing voluntary redress schemes can be an effective means of resolving disputes under the

CA98 and a meaningful way to put customers first when mistakes have been identified.

We have also highlighted in our guidance other parts of the CA98 toolkit.

For example, we will make best use of warning letters to parties that, in our view, have stepped over the line with regard to CA98. These letters can provide an important opportunity for companies to put matters right before they escalate and cause greater detriment to customers.

But, to go back to the theme of culture change...

...none of this will ultimately lead to success without a culture change taking place across the sector toward competition law compliance. And compliance, that as I have said, is quite different in nature to what some companies have been used to...

Historically, I think it's fair to say that the sector's track record hasn't been great. And, while I can see great efforts being made on this front, I do worry that we aren't yet where we need to be, especially given that the business market in England is opening in April.

For example;

- Anecdotally, we hear associated retailers claiming to be able to provide a better service because of their relationship with their wholesaler. Even just as marketing spin, that's not great. But if it is actually true, then some companies are in very hot water.
- We also heard of an appointee who have organised its CCG meetings believing just one retailer should be in attendance - the one that appointee had exited to.
- We also sometimes get asked or told that companies' charges are compliant with Ofwat's "margin squeeze" test. There is no such test! Companies with market power need to grasp competition law jurisprudence for themselves. Think about the effects of what you are doing on the market...
- We want incumbents to also be aware of their existing brand and the associated market power that it carries relating to CA98. If they are not careful they could exploit this market power unintentionally, which by the way is no defence to competition law.

Cultural change for Ofwat too

If there is a big cultural change for the sector coming, I should also acknowledge there is one for Ofwat too. I hope you can see how our CA98 guidance is an important building block in our developing our own systems and process to regulate competitive markets, and we are putting a great deal of effort into building our skills and experience too.

We are working closely with other regulators too, through UkRN and UKCN, not only on specific issues such as application of competition law but also more broadly for example, learning from the experience of others - such as Ofgem and the FCA - on how to maximise customer engagement in competitive markets and ensure they are treated fairly.

Conclusion

So... a lot to do. For us and for the sector.

As I said at the start, I hope you will find our revised CA98 guidance useful. The process of pulling it together has been immensely useful for us, and I hope it will help the sector - incumbents and entrants alike - to get their head around successful operation in quite a different environment.

But I think we all agree that the hardest challenge isn't writing documents like this, or indeed in reading them, but in creating a new set of relationships throughout the sector that really enable markets to deliver their full potential in the creation of value for customers, the environment and investors.