
March 2017

Trust in water

**Summary of responses to the
consultation on Ofwat's approach to
the application of the Competition
Act 1998 in the water and
wastewater sector in England and
Wales**

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1. Purpose of this document

On 21 November 2016 we issued a [consultation document](#) setting out our draft guidance on Ofwat's approach to the application of Competition Act 1998 (CA98) and the equivalent provisions under Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) to the water and wastewater sector in England and Wales.

Our aim in updating our guidance is to provide more clarity on how the competition law prohibitions may apply in the sector, given the imminent opening of the business retail market. It also provides an opportunity to reflect developments in legislation and case law that have taken place since the publication of our previous guidance in 2008¹ as well as our experience of applying competition law to date. In addition, we have used the guidance to provide greater clarity on the procedural approach that we will adopt when investigating potential breaches of competition law as well as the range of options available to us to resolve investigations under the CA98.

This document summarises the responses we received and the steps we have taken to finalise our guidance document.

¹ Notably the guidance reflects changes introduced by the Enterprise and Regulatory Reform Act 2013 to strengthen the primacy of competition law and to improve the operation of the competition concurrency regime. We have also updated our procedures to reflect improvements in best practice.

2. Responses to the consultation

The consultation on our draft guidance closed on 20 January 2017, with a total of 21 responses received². These included:

- four responses from water only companies;
- nine responses from water and wastewater companies;
- four responses from current retailers;
- a response from a new appointee;
- a response from a consultancy;
- a response from Home Builders Federation; and
- a response from the Consumer Council for Water.

Details of the responses we received and our response to them are summarised in Table 1 below. Copies of the responses are published separately on our website.

In general, the responses to our consultation were very supportive of the proposed updates to our guidance document, with respondents welcoming the greater clarity provided on our proposed approach.

Of the 21 responses, nine simply confirmed that they were content with the approach to competition law proposed in our draft guidance.

Anglian Water Business, for example, told us that they “*welcome Ofwat’s review of Competition Law Guidance, which is timely as we head towards business retail market opening. We agree that it is useful to reflect recent developments in legislation and relevant case law and provide greater clarity on how competition law will be applied in the sector. We have reviewed the revised guidance and have no comment at this time*”.

Similarly, Bristol Water in its response told us that they “*recognise and welcome the consultative and engaged approach Ofwat has taken in developing the proposed guidance ... We have reviewed the guidance and don’t have any further comments to make.*”

² Affinity Water, Anglian Water Services, Anglian Water Business, Bristol Water, Business Stream, Consumer Council for Water (CCWater), Clear Business Water, Home Builders Federation (HBF), Independent Water Networks Ltd (IWNL), Northumbrian Water Wholesale Business, Northumbrian Water Group Business, Oxera, Portsmouth Water, Severn Trent Water, Southern Water, South Staffs Water, South West Water, Thames Water, United Utilities, Welsh Water and Yorkshire Water.

Northumbrian Water Wholesale Business told us that they “*particularly appreciate the level of explanation and detail in the guidance and the broad range of approaches considered*”.

Southern Water told us that it “*welcomes the draft guidance in helping companies not only understand their obligations but also understand how Ofwat will apply its powers...and ... is confident that the clarity provided in the guidance will provide an important resource for companies in ensuring they meet their competition law obligations at a time of change for the sector, including the requirement to protect the level playing field.*”

The 12 respondents who provided more substantive comments on the draft guidance also welcomed the guidance and were supportive of our overall approach.

A number of these respondents suggested that the guidance could be improved by the provision of greater detail, or further clarification, in some areas. These requests related, in particular, to the level of detail provided on market definition within the water and wastewater sector³ and the costing methodologies and benchmarks that Ofwat might use when assessing abuse of dominance cases⁴.

In relation to market definition, for example, Affinity Water told us that they “*welcome the confirmation that Ofwat will follow the framework set out in the CMA guidance on market definition when defining the relevant market, based on the facts of each individual case... [but] ... would like further insight into the application of the framework to specific markets in the water and wastewater sector*”.

Similarly, Anglian Water Services told us that “*it is helpful to have confirmation as to Ofwat’s approach to market definition*” but believes it would be of benefit to the sector “*if Ofwat could offer a fuller opinion as to the definition of the downstream retail market... in particular... Ofwat’s view of both the service and geographical dimension of the non-household retail market*”.

In its response Business Stream commented too on the importance of market definition for Chapter II investigations, noting that whether a market is defined at a regional or national level could have significant implications for how any competition case would be considered. In its view, therefore, it is “*important to keep an open mind in terms of which definition is the appropriate one in a given case.*”

³ Affinity Water, Anglian Water Services, Business Stream, IWNL, Oxera, Welsh Water.

⁴ Severn Trent Water, Oxera

On cost benchmarks, Severn Trent Water suggested that it would be helpful to understand Ofwat's view on the relevant cost thresholds to use in abuse of dominance cases e.g. predatory pricing, margin squeeze. Similarly, in its response, Oxera noted that there is little detail provided on the price-cost tests that would be used to assess predation cases or the imputation tests in margin squeeze cases as well as little detail on cost benchmarks that would be used in either type of case.

Oxera also suggested that in considering the type of conduct that could give rise to allegations of abuse of dominance, we had given insufficient attention to potential "horizontal" abuses (e.g. when a dominant position in one market (A) is leveraged horizontally into another market (B)) and instead had focussed almost exclusively on "vertical" abuses such as margin squeeze.

In addition to requests for greater clarity in some areas, a number of respondents took the opportunity to highlight their concerns about potential competition issues or concerns about whether there would be a genuine level playing field in the new business retail market. Some also focused on encouraging Ofwat to make it clear to companies that we are ready to take enforcement action - at a level that incentivises compliance and provides deterrence. Some also noted that binding commitments can appear to be a "soft" remedy which does not drive a step change in behaviour.

In its response, CCWater queried whether a separate reporting protocol is required where it or other stakeholders become aware of possible competition law infringements or whether, in cases where fines might be considered, Ofwat could first look to restorative justice (where appropriate and allowable under competition law) to put money back into customer services. In addition, CCWater suggested that where it has a role in triggering enforcement, it should also be consulted about potential remedies.

3. Further revisions to the guidance and next steps

Having reviewed the consultation responses, we have made a number of revisions to the guidance document. On the whole these are relatively minor. In many instances, we have concluded that the guidance already addresses the issue sufficiently or provides the appropriate level of detail. Whilst we have, for example, made a number of changes to the section on market definition to improve clarity, our overall position that market definition will depend on the specific circumstances of a case remains unchanged. This is in line with the approach adopted by the CMA and other concurrent regulators. Similarly, while some respondents have requested greater

detail on the cost benchmarks and costing methodologies that we might use in margin squeeze or predatory pricing cases, we have made only minor amendments to the text in this section, as the appropriate methodology will be applied in the specific circumstances of each case. Again, our approach is similar to that of the CMA and the other concurrent regulators.

One area where we have developed the guidance more extensively is in relation to abuse of dominance. We have taken on board suggestions that the draft guidance had not focused sufficiently on some forms of potentially abusive conduct (e.g. tying and bundling, price discrimination, exclusive dealing or rebates). We have added a further section to address this.

We have also taken note of concerns raised in the consultation responses about the functioning of the market generally, rather than the draft guidance specifically. In relation to the concerns raised by respondents about potential competition issues or concerns about whether there would be a genuine level playing field in the new business retail market, these issues will be logged for inclusion in our market monitoring work.

A copy of the final guidance will be published on our website alongside this summary of responses document.

Table 1 Main issues raised in responses to the consultation

The following table provides a summary of the key issues raised by respondents, under a number of broad themes, and Ofwat's response to those issues. This is not intended to be an exhaustive list of all the issues raised.

Key issues raised	Ofwat response
<p>The purpose and scope of the guidance</p>	
<p>United Utilities suggested that it would be helpful to make a clear statement upfront about the purpose of the guidance and to make it explicit that it is the responsibility of companies to decide on appropriate steps they may need to ensure compliance with competition law. It also felt it important for us to stress that the guidance provides no indemnity from non-compliance with CA98 and that ultimately it will be companies and their directors who are responsible for ensuring that the mitigation they deem necessary is in place. Moreover, United Utilities suggested that it should be made clear that the guidance is not legal advice and should not be taken as such or as a manual for companies to follow to ensure compliance with CA98.</p>	<p>Our guidance is intended to provide businesses with an important resource in both understanding and meeting their obligations and in understanding how Ofwat will apply its powers. We have, however, also emphasised that the obligation for ensuring compliance with competition law rests with companies alone.</p> <p>Whilst this point was made in the draft guidance, we have modified the text in a number of places (e.g. About this document and section 1.2 Our approach to regulation) to underline the fact that it is the responsibility of all companies operating in the sector to assure themselves that they have taken the necessary steps to ensure compliance with competition law.</p> <p>We will also stress this point in communications we issue to publicise the guidance.</p>
<p>Respondents were generally very supportive of the guidance and welcomed the clarity it provides. However, some also felt that the provision of additional information would be valuable. CCWater, for example, requested more information on the set out behaviours that might contravene a level playing field and suggested that the guidance be supplemented with case studies that come to light.</p>	<p>Whilst we have not made any specific changes to our guidance, Ofwat is also putting in place a framework to monitor how the business retail market is working.</p>

<p>Similarly, United Utilities suggested that additional information in terms of horizon scanning could help to guide continuing compliance activities. It suggested, for example, that the sharing of information across the sector would support the minimisation of a recurrence of the same issue across different companies, and that real examples of issues would help companies to make the issues real for those employees in a similar position, bringing home the importance of making sure a level playing field is maintained.</p>	<p>We will also keep under review the need for Ofwat to provide additional information, or to provide further updates to the guidance, to ensure that companies are complying with their obligations under CA98.</p>
<p>In its response, Welsh Water noted that in the draft guidance we state that the effective application of competition law will be a key tool for us in protecting the development of new markets, ensuring their market dynamics and realising the benefits for customers and the environment. It queries whether this is consistent with the discussion on margin squeeze (pp32) which refers to enforcement in this area being “not to protect new entrants per se”.</p>	<p>Competition law enforcement does not seek to protect new entrants for the sake of those entrants, but, rather, is concerned with protecting new entrants as this in turn enables competition to develop. We have added a short paragraph under section 1.3 to highlight the point that our focus is on ensuring that competition works well for the benefit of consumers.</p>
<p>Our competition law powers</p>	
<p>Role of the European Commission: In its response, Oxera noted that the guidance highlights in various places the roles of Articles 101 and 102 of the TFEU and which remain complementary to CA98 where there is an issue that affects competition between member states. It suggests, however, that as the legal framework could develop further as a consequence of the UK vote to leave the EU, a note to reflect this could be included in the final guidance.</p>	<p>Footnote 2 on page 1 of the guidance makes it explicit that the guidance does not take into account the result of the referendum in June 2016 or the consequences of the UK ceasing to be an EU member. The guidance reflects current UK and EU law which Ofwat must follow. We have, however, noted that we would expect to update the guidance in light of developments in this respect.</p>
<p>The ‘primacy’ of the Competition Act: Oxera also noted in its response that whilst Ofwat should assess at an early stage whether it uses its CA98 powers or its WIA91 powers, our sector specific (WIA91) powers go further than our competition law</p>	<p>Whilst the difference between our sector specific powers and our competition law powers is recognised, the focus of this guidance is specifically on our competition law powers. Therefore, we do not consider that the guidance is</p>

<p>powers in that they provide for compliance with ex-ante obligations (such as licence conditions) rather than only considering on an ex-post basis whether there has been compliance with competition law.</p>	<p>the appropriate route to set out the scope of our other regulatory powers and their potential application.</p>
<p>The requirement of competition law</p>	
<p>A number of respondents commented on the framework for competition analysis. Affinity Water, for example, welcomed the publication of the guidance but considered that it would more fully achieve its aim of providing clarity on how competition law prohibitions will apply in the sector if it provided further insight into the application of the framework to specific markets in the water and wastewater sector.</p> <p>Oxera too noted that whilst Ofwat's approach provides welcome clarity, there are some gaps where further explanation would be helpful – though Oxera also noted that being over prescriptive could have unintended consequences.</p>	<p>The guidance is intended to provide an overview as to the application of competition law in the sector, and Ofwat has sought to strike a balance between the applicable principles and examples that may illustrate the application of these principles in different factual circumstances.</p>
<p>Market definition: The requests for the provision of greater detail, or further clarification, related, in particular, to the level of detail provided on market definition within the water and wastewater sector.</p> <p>Welsh Water would like Ofwat to provide information on cases where it has already identified relevant markets for the purposes of competition law and the determining factors for defining such markets, since consideration of potential relevant markets is essential to companies' consideration of competition law issues.</p> <p>Anglian Water also suggested that it could be of considerable benefit to the sector if Ofwat could offer a fuller opinion as to the definition of the</p>	<p>In our guidance we have stressed that the relevant market definition will depend on the specific circumstances of each case and may change over time. For instance, considering a regional market for water services would be appropriate where the substitution of products or services can only usefully be considered within that geographic area. Similarly, the market can widen beyond what appears to be substitutable products if that is how consumers purchase the product. For instance, in the business retail market, if customers purchase water as part of a bundle with gas and electricity then it may be more appropriate to consider retail water services as part of a wider market for utilities bundles. This will, however, have to be determined on a case by case basis.</p>

<p>downstream retail market and, in particular, would welcome greater clarity as to Ofwat's view of both the service and geographical dimensions of the non-household retail market.</p> <p>In its response, Business Stream also highlighted the importance of geographic market definition for Chapter II determinations, noting that if each water region is treated as an individual market, then the incumbent will start off with close to 100% market share, whereas if the market is defined as the whole of England, then no company will start off with more than 38% share. It noted this would have significant implications for how any competition case would be considered. Business Steam also suggested, however, that there are arguments in favour of both approaches: and therefore, it is important to keep an open mind in terms of which definition is the appropriate one in a given case.</p> <p>In the context of the bundling of services, IWNL referred to the reference in the guidance to the CA98 investigation we carried out in respect of the Fairfield site. IWNL expressed concern that incumbents might draw comfort from the fact, noted in the guidance, that no finding of infringement was ultimately found. From IWNL's perspective, it is important for incumbents to realise that Fairfield was exceptional because it represented a situation where the customer was only interested in purchasing both water and wastewater from the same supplier.</p>	<p>We have reviewed the text in the guidance, and have provided further clarification that the relevant market is defined as the "narrowest set of products and geographic areas where a hypothetical monopolist could profitably raise prices" (page 19).</p> <p>In relation to IWNL's comments on the Fairfield CA98 investigation, we have reviewed the text to make it clear that in referring to the Fairfield investigation, we are doing so only in the context of market definition and it should not be read as a commentary on the 'no grounds for action' decision taken by Ofwat.</p>
<p>Vertical agreements: CCWater, in its response, suggested that the guidance should include more information on the type of vertical agreements which may or may not be contravening competition law. This is important as incumbent retailers have been required to adopt arm's length separation from their parent water companies rather than full legal separation in order to establish a level playing field in the market.</p>	<p>We understand this concern to be about vertical integration, where there is a single undertaking active on two levels in a market. The guidance already addresses this in some detail, in the context of anticompetitive behaviour that is particularly relevant in the sector (see for example, the section on margin squeeze).</p>
<p>Abuse of dominance - predation, margin squeeze and refusal to supply: In its response, Severn Trent Water agreed that these matters raise complex issues which will be case specific. However, it noted that the</p>	<p>We have considered what level of detail is appropriate to include on cost benchmarks in developing the guidance and we have added an additional</p>

<p>European Commission has issued guidance on its enforcement priorities in relation to Article 102 TFEU and that this guidance contains detail on the economic concepts underpinning some of these issues. This includes guidance on the principles which companies can follow in terms of understanding the relevant threshold to measure pricing. Severn Trent Water suggested that it would be helpful to understand Ofwat's view on the Commission's guidance and whether the information in respect of cost thresholds (AAC, LRAIC, etc.) can be of assistance to companies.</p> <p>Similarly, Oxera noted that the guidance contains little detail on the price-cost tests that would be used to assess predation cases or the imputation tests in margin squeeze cases, as well as little detail on cost benchmarks that would be used in either type of case.</p>	<p>paragraph to provide more detail on cost benchmark analysis. However, in general we have made only minor amendments to the text in this section as we consider it is important to make clear that the analysis will depend on the circumstances of each case. This approach is similar to that of the CMA and the other concurrent regulators.</p> <p>We consider that in respect of the Commission's guidance, that this deals with abusive conduct in a general context and does not address different regulatory contexts such as the specific features of the water/sewerage sector.</p>
<p>Other abuses of dominance: In its response, Oxera suggested that the draft guidance did not adequately reflect the fact that one way in which bundling or tying can be anticompetitive is when a dominant position in one market (A) is leveraged horizontally into another market (B). Whilst this was discussed in a vertical sense in the draft guidance, Oxera highlighted the importance of recognising that that leveraging between markets can also take place horizontally. In Oxera's view, it is important that dominant companies are aware of how they bundle offerings in the non-household retail market – notwithstanding that many forms of bundling are pro-competitive, efficient and serve customer needs.</p>	<p>We have taken on board suggestions that the draft guidance had not focused sufficiently on other forms of potentially abusive conduct (e.g. tying and bundling, price discrimination). We have added a further section "Other abuses of dominance" to address this.</p>
<p>Competition law and regulation: In its response, Thames Water suggested that it would be helpful if the guidance expanded on our understanding of 'services of general economic interest' ("SGEI") and the characteristics of a revenue-producing monopoly (page 33 in draft guidance). It said this would help facilitate the smooth and timely execution of future investigations of competition law issues which touched on these situations.</p>	<p>We have expanded the text in this section to provide more detail on how it applies and have cross-referred to the relevant CMA guidance.</p>

Our procedural approach: investigations and enforcement	
<p>Our enforcement powers: CCWater suggested that it would be useful for some retailers (particularly new entrants) to understand the form and severity that enforcement action by Ofwat could take and suggested that we outline our enforcement powers more clearly in the guidance document.</p>	<p>The guidance already provides detail on our enforcement powers at chapter 4. However, we have amended the title of this chapter to sign-post this more clearly i.e. in the draft guidance the chapter was entitled 'Our procedural approach' and we have amended this to 'Our procedural approach: investigations and enforcement'.</p>
<p>Using our competition powers: In its response, Business Stream highlighted the challenges in submitting a competition case. It noted, for example, that the level of evidence required to open a competition investigation creates a high bar to clear; the costs for a complainant in terms of both time and resources will be substantial (meaning that a formal complaint under the Competition Act is likely to be used as a last resort and in cases where the evidence is clear and the damage caused is substantial) and the timescales around a full investigation can be lengthy, which can be a powerful disincentive to raise a complaint. It also noted that in the recent energy market investigation, the referral to CMA was driven by the regulator rather than by one of the competitors to the incumbent companies.</p> <p>In Business Stream's view this demonstrates that while it is an important backstop, competition law cannot be relied upon to ensure a well-functioning market that is not distorted by any participant misbehaviour - it can only function as part of a suite of enforcement tools available to the relevant authorities. As a result, it considers that it is crucial that Ofwat is able to proactively intervene in a targeted and proportionate manner to prevent risks of harm to customers, the market or other competitors – rather than requiring complainants to produce conclusive evidence of actual harm before taking action.</p>	<p>Competition law is not the only tool available to us to ensure a well-functioning market. In dealing with complaints, we will look to use the most appropriate tool from our regulatory toolkit. We have sought to re-inforce this point on page 8 of the guidance document and the fact that we will be proportionate and targeted in our approach to protect customers.</p>
<p>Opening cases and key decisions: Welsh Water requested that Ofwat clarify which individual or team within Ofwat would fulfil the role of Senior Responsible Officer and how key decisions would be taken. It also sought clarification on whether the role of the Casework Committee differs from</p>	<p>We have clarified that our current approach is that the Senior Director, Market Outcomes and Enforcement will act as the Senior Responsible Officer in CA98 investigations.</p>

<p>the role of the Case Decision Group for the CMA, as Ofwat had stated on page 47 of the draft guidance that “we will generally follow the CMA’s approach”. In Welsh Water’s view, this could cause administrative uncertainty.</p>	<p>The role played by the Casework Committee is similar to that played by the Case Decision Group (CDG) in CMA investigations.</p> <p>The Casework Committee (like the CDG) is appointed to act as the decision-maker, to decide whether the legal test for establishing an infringement has been met. It is responsible for taking decisions both on whether to issue an infringement decision (with or without directions) or a "no grounds for action" decision and the appropriate amount of any penalty. The role of the Casework Committee can be found in its terms of reference.</p>
<p>Investigation findings – commitments: In its response, IWNL noted that whilst binding commitments are good if Ofwat is resource constrained, they do not act as a deterrent for infringement or provide an incentive for a level playing field. It was concerned, therefore, that commitments could appear to be a ‘soft’ remedy which does not drive a step change in behaviour. In its view, action taken to address competition law infringements must be at a level that incentivises compliance and provides deterrence to other incumbents.</p>	<p>We recognise the importance of this point and we will be monitoring existing and new competitive markets closely. We will not hesitate to intervene – using the right tools, including enforcement under competition law - to ensure that competition works well for the benefit of consumers.</p> <p>We have sought to capture this point in revisions to section 1.3 on page 9 of the guidance.</p>
<p>Financial penalties: In its response, Oxera suggested that the guidance could provide more detail on our penalties methodology e.g. the gravity of the offence, the treatment of aggravating or mitigating factors, and the overall cap on penalties. While noting that there is a trade-off between prescription and flexibility, in its view, setting out these factors can increase the deterrence effect while providing a consistent basis for Ofwat decision making.</p> <p>In its response, CCWater expressed support for the principle of penalising companies that behave inappropriately, but suggested that where fines might be considered, Ofwat should first look to restorative justice (where appropriate and allowable under competition law) to put money back into customer services – as otherwise customers do not benefit from fines - which are paid to the Treasury.</p>	<p>As set out our guidance, we will have regard to the CMA penalty guidance in considering the imposition of a penalty on an infringing undertaking.</p> <p>Ofwat will continue to consult and work with industry participants when considering and conducting enforcement action as appropriate, and in accordance with the procedural approach set out in the guidance.</p>

<p>CCWater also suggested that should it have a role in triggering enforcement, and it should be consulted about potential remedies.</p>	
<p>Voluntary redress: CCWater suggested that the guidance should clearly distinguish between the voluntary redress schemes in relation to a Competition Act infringement and the redress schemes that retailers are required to use as part of their complaints procedures (as required by the Customer Protection Code of Practice).</p>	<p>We have added a footnote to the guidance (footnote 91 on page 50) to address this point.</p>
<p>Reporting protocol: Consider whether a separate reporting protocol is required where CCWater or other stakeholders become aware second hand of possible competition law infringement (e.g. from a whistle blower).</p>	<p>We do not consider that a separate reporting protocol is required for submitting complaints to Ofwat. We consider our existing complaints process is appropriate to deal with any type of complaints including those from whistle-blowers.</p>
<p>Other issues</p>	
<p>A number of respondents also used their responses to highlight particular areas of concern, or issues, that they consider Ofwat should address.</p> <p>In its response, Clear Business Water expressed concern about the accuracy of the true costs of retail separation and of operating in the new competitive market. In its view, PR14 allocated costs to serve, not only do not include all costs, and there may be - where current participants are exiting the retail market - a level of unidentified cross subsidisation between retail and wholesale operations resulting in an incorrect allocation of cost to serve for retail operations.</p> <p>Clear Business Water would like Ofwat to review the terms of all retail exit arrangements and transactions and verify that comprehensive arms-length commercial arrangements reflective of actual practices are in place between the wholesale and retail operations of current participants, covering all ongoing services to be provided to the retailer, particularly where such services are also provided to household customers of the wholesaler, or where resources and employee costs are shared.</p>	<p>Whilst noting the concerns raised by these respondents, we consider that the guidance is not the appropriate route to address them directly. We will, however, highlight these concerns at the appropriate level within Ofwat.</p>

<p>Developer services: The Home Builders Federation expressed the view that the greatest potential exposure to anti-competitive behaviour exists in the developer services departments of some companies – and cited a number of examples that they feel raise concerns.</p>	
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