


# **Guidance on the Application of the Competition Act 1998 in the Water and Sewerage Sectors**

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OFT 422

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This guideline Guidance on the Application of the Competition Act 1998 in the Water and Sewerage Sectors is published with 

Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) and the Competition Act 1998 (CA98) are applied and enforced in the United Kingdom by the Office of Fair Trading (the OFT). In relation to the regulated sectors these provisions are applied and enforced, concurrently with the OFT, by the regulators for communications matters, gas, electricity, water and sewerage, railway and air traffic services (under section 54 and schedule 10 of the CA98) (the Regulators). Throughout the guidelines, references to the OFT should be taken to include the Regulators in relation to their respective industries, unless otherwise specified.

The following are Regulators:

- the Office of Communications (OFCOM)
- the Gas and Electricity Markets Authority (Ofgem)
- the Northern Ireland Authority for Utility Regulation (NIAUR)
- the Director General of Water Services (OFWAT)
- the Office of Rail Regulation (ORR), and
- the Civil Aviation Authority (CAA).

This guideline provides general advice and information about the application and enforcement by Ofwat and the OFT of Articles 101 and 102 of the TFEU and the Chapter I and Chapter II prohibitions contained in the CA98. It is intended to explain these provisions to those who are likely to be affected by them and to indicate how Ofwat and the OFT expects them to operate. Further information on how the OFT has applied and enforced competition law in particular cases may be found in the OFT's decisions, as available on its website from time to time.

This guideline is not a substitute for the TFEU nor for regulations made and notices provided under it. Neither is this guideline a substitute for the CA98 and the regulations and orders made under it. It should be read in conjunction with these legal instruments, community case law and United Kingdom case law. Anyone in doubt about how they may be affected by the TFEU and the CA98 should seek legal advice

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# 1 INTRODUCTION

- 1.1 On 3 March 2010, the Water Services Regulation Authority (Ofwat) published its revised strategy 'Delivering sustainable water'. This sets out our vision of sustainable water, in which we are able to meet our needs for water and sewerage services while enabling future generations to meet their own needs, and the part we will play in delivering it.
- 1.2 An element of the strategy is our commitment to harnessing market forces in the water and sewerage sectors, including introducing regulated markets where there are clear long-term benefits to customers and the environment.
- 1.3 As the development of competition proceeds, there may be scope for us to withdraw regulation where markets offer the same level of protection to consumers. Even then, we will continue to monitor market performance closely. The Competition Act 1998 (CA98) is an important tool in ensuring well-functioning markets.
- 1.4 The CA98 as amended by SI 2004, No 1261<sup>1</sup> confers on the Office of Fair Trading (OFT) and concurrently on Ofwat and other sectoral regulators in relation to their respective sectors, powers to apply and enforce the Chapter I and Chapter II prohibitions of the CA98 as well as Articles 101 and 102 of the Treaty on the Functioning of the European Union (Article 101 and Article 102 respectively).
- 1.5 In practice, this means that Ofwat has all the powers of the OFT to apply and enforce Article 101, Article 102 and the CA98 in order to deal with anti-competitive agreements or abuses of a dominant position in relation to 'commercial activities connected with the supply of water or

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<sup>1</sup> The Competition Act 1998 and other Enactments (Amendment) Regulations 2004 SI 2004 No. 1261 entered into force on 1 May 2004 and provides for the implementation of the Council EC Regulation 1/2003 (the so-called Modernisation Regulation), which requires National Competition Authorities (NCAs) and the courts of Member States to apply and enforce Articles 81 and 82 of the EC Treaty (now Articles 101 and 102 of the Treaty on the Functioning of the European Union).

securing a supply of water or with the provision or securing of sewerage services' (see 'Concurrent Application to Regulated Industries' (OFT 405) for further details).

- 1.6 This guidance sets out how we will apply the CA98 to the water and sewerage sectors in England and Wales. It also provides advice and information about the factors that we will take into account when considering whether to exercise our powers under the CA98.<sup>2</sup> This guidance is not exhaustive and is not a substitute for the Treaty on the Functioning of the European Union, European Union notices or guidelines, or UK legislation. We will consider the circumstances of each case on an individual basis, with reference to the issues set out in this guidance and the other sources of reference available to us (as noted above).
- 1.7 Guidance on the application of the CA98 in the water and sewerage sectors was originally published in February 2000 as OFT 422. This version of the guidance supersedes the original OFT 422 and reflects the changes in EU competition law, developments in sector-specific legislation, the development of case law, changes to Ofwat's structure and the development of our strategy. It also reflects our experience in the application of the CA98 to date
- 1.8 We may update this guidance in the future to take account of relevant developments in the water and sewerage sectors, including any legislative changes. When doing so, we will take account of any changes to competition law guidance issued by the OFT, other regulators or the European Commission, as well as the development of relevant case law and administrative practice in the UK and at the European level.
- 1.9 Chapter 2 of this guidance sets out our powers and duties under the CA98. It explains our jurisdiction, the application of UK and EU

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<sup>2</sup> This guidance should be read in conjunction with the other guidance in the series – see the OFT's website ([www.ofwat.gov.uk](http://www.ofwat.gov.uk)).

competition law, our discretion over the use of our CA98 and sectoral powers and our powers under the Enterprise Act 2002 (EA02).

- 1.10 Chapter 3 sets out our process of investigation and explains in more detail the interaction between our powers under the CA98 and sector-specific legislation.
- 1.11 Chapter 4 considers competition issues specific to the water and sewerage sectors.

## 2 POWERS AND DUTIES

2.1 Our competition powers derive principally from the CA98, but also from sectoral and national legislation:

- the Water Industry Act 1991 (WIA91), as amended by the Water Act 2003 (WA03), and
- the EA02.

2.2 This section explains our powers and duties in respect of competition.

### The Competition Act 1998

2.3 Article 101 and the Chapter I prohibition contained in section 2(1) of the CA98 prohibit agreements between undertakings,<sup>3</sup> decisions by associations of undertakings and concerted practices that have the object or effect of preventing, restricting or distorting competition. Article 101 applies to agreements that may appreciably affect trade between Member States in the EU. The Chapter I prohibition applies to agreements implemented or intended to be implemented in the whole or part of the United Kingdom, which may affect trade within the United Kingdom.

2.4 Article 102 and the Chapter II prohibition contained in section 18(1) of the CA98 prohibit conduct by one or more undertakings which amounts to an abuse of a dominant position in a market. Article 102 applies to

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<sup>3</sup> The term 'undertaking' is used in this document to refer to any natural or legal person engaged in economic activity, regardless of its legal status and the way in which it is financed. It includes companies, firms, businesses, partnerships, individuals operating as sole traders, agricultural cooperatives, associations of undertakings, non-profit making organisations and (in some circumstances) public entities that offer goods or services on a given market. See case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, [1993] 4 CMLR 306 and case T-319/99 *Fenin v Commission* [2003], ECR II-357, 4 March 2003 [2003] CMLR 1. It should not be confused with the term 'undertaker', which is often used to describe a company holding an appointment under the WIA91 as a monopoly supplier of water and/or sewerage services.



conduct within the common market or in a substantial part of it in so far as it may affect trade between Member States. The Chapter II prohibition applies if the dominant position is held within the whole or part of the United Kingdom and the conduct in question may affect trade within the whole or part of the United Kingdom.

2.5 As set out in paragraphs 1.4 and 1.5 above, we have all the powers of the OFT to apply and enforce Article 101, Article 102 and the CA98 in order to deal with anti-competitive agreements or abuses of a dominant position in relation to 'commercial activities connected with the supply of water or securing a supply of water or with the provision or securing of sewerage services'. In this context, we may:

- consider complaints about possible infringements of any of Article 101, Article 102, the Chapter I prohibition and the Chapter II prohibition
- impose interim measures to prevent serious and irreparable damage or to protect the public interest
- carry out investigations, both on our own initiative and in response to complaints, including requiring the production of documents and the provision of information, and searching premises (for further details see 'Powers of Investigation' (OFT404))
- impose financial penalties on undertakings, taking account of the statutory guidance on penalties issued by the OFT<sup>4</sup>
- give and enforce directions to bring an infringement to an end
- accept commitments that are binding on an undertaking

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<sup>4</sup> See the 'OFT's guidance as to the appropriate amount of a penalty' (OFT423).

- offer information and confidential informal advice on how Article 101, and Article 102 and the prohibitions in the CA98 apply to the water and sewerage sector, and
- publish written guidance in the form of an Opinion where a case raises novel or unresolved questions about the application of Article 101, Article 102, the Chapter I and/or the Chapter II prohibition in the UK, and where we consider there is an interest in issuing clarification for the benefit of a wider audience.

2.6 Our jurisdiction extends to all commercial activities connected with the supply of water or securing a supply of water or with the provision or securing of sewerage services in England and Wales, and includes conduct by undertakings that are not appointed under the WIA91, to the extent that the conduct falls within this definition (see 'Concurrent Application to Regulated Industries' (OFT 405) for further details). It is therefore possible that we may investigate under the CA98 or Articles 101 and 102 companies that are not subject to any form of regulation by us.

2.7 The CA98 also provides the OFT with powers to assist, or act on behalf of, the European Commission in connection with European Commission investigations regarding Articles 101 and 102. The OFT can also carry out an inspection on behalf of a national competition authority (NCA) of another Member State, if requested. While we do not have equivalent powers under the CA98, we may assist the OFT fully in investigations which relate to our areas of jurisdiction and where we have expertise.

## Ofwat's sectoral and national powers

### The WIA91

2.8 The WIA91, as amended by the Water Act 2003 (WA03), sets out detailed powers and provisions to facilitate the development of competition, including:

- chapter 2A of the WIA91, which sets out a regulatory regime for market competition in public water supply
- sections 6-9 of the WIA91, which govern new appointments and variations to existing appointments<sup>5</sup> and
- sections 40 and 40A of the WIA91, which govern bulk supply determinations.

2.9 We will be seeking a number of legislative changes to facilitate the progressive development of competition where it benefits consumers.

## The EA02

2.10 The EA02 empowers the OFT and certain regulators (including Ofwat) to make references to the Competition Commission (CC) for the investigation of particular markets. We may make a market investigation reference to the CC where we have reasonable grounds for suspecting that any feature, or combination of features, of that market prevents, restricts or distorts competition. As set out in section 31 of the WIA91, we may make such references in relation to commercial activities connected with the supply of water or the provision of sewerage services in England and Wales. In specified circumstances the appropriate minister may also make a market investigation reference. Following a market investigation reference it will be for the CC to conclude whether competition is prevented, restricted or distorted, and, if it is, what (if any) action should be taken to remedy the adverse effect on competition or any detrimental effect on customers resulting from it. Further details of Ofwat's powers under the EA02 are set out in the OFT guidance 'Market investigation references' (OFT 511).

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<sup>5</sup> Water services in England and Wales are provided by companies that have been appointed as statutory regional monopoly providers for a given geographical area. The WIA91 allows for new appointments to be made within existing monopoly areas, these are often referred to as 'inset appointments'. It also allows for variation of existing appointments to change the geographical area served by that appointee.

## Obligation to apply Articles 101 and 102

- 2.11 Article 3(1) of the Modernisation Regulation requires NCAs (including Ofwat) to apply Articles 101 or 102, where they apply national competition law and when such legislation is applied to agreements or conduct which may affect trade between Member States. This obligation does not apply if the national law being applied pursues an objective which is predominantly different from those pursued by Article 101 and Article 102.

## Conforming with Community law

- 2.12 In applying Articles 101 and 102, the OFT and the national courts are bound by the fundamental principle of the primacy of Union law and must follow the case law of the European Courts in interpreting Union legislation. Further, section 60 of the CA98 places an obligation on us, so far as possible and having regard to relevant differences in the provisions, to answer questions arising under Part I of the CA98 (which includes the Chapter I and Chapter II prohibitions) consistently with Union law in relation to competition within the Union. The competition law guidance 'Modernisation' (OFT 442) contains further detail on conforming to EU law.

### **3 PROCESS FOR INVESTIGATION AND ENFORCEMENT**

- 3.1 In this section we set out in broad terms the processes we will follow in investigating under and enforcing the CA98. Each case is different and the way we investigate and enforce will necessarily reflect the facts and circumstances of each case.
- 3.2 We have set out the principles we will use when deciding whether to open or continue with an investigation under the CA98 in separate guidance (see 'Prioritisation Principles: Application to the Competition Act 1998'). We may launch an investigation into a possible breach of Article 101, Article 102, the Chapter I and/or Chapter II prohibitions in reaction to a complaint made by a customer, competitor or other third party (for example, a whistleblower). We may also decide to investigate a possible breach on our own-initiative. In order to open an investigation, either as a result of a complaint or on own initiative, we must have reasonable grounds for suspecting a breach (see paragraph 3.10 below).
- 3.3 We generally decide whether we will open or continue a CA98 investigation balancing the impact and strategic significance of the investigation with the risks and resources it will involve. We will also compare the opening or continuation of a CA98 investigation with other courses of action open to us. Our sectoral powers may provide the most appropriate way of addressing a particular issue. However, we take exploitative or exclusionary behaviour very seriously, and will not shy away from using our CA98 powers if it is appropriate for us to do so.
- 3.4 CA98 cases regarding water and/or sewerage services in England and Wales are generally dealt with by us, although there may be circumstances in which the OFT might deal with the case.<sup>6</sup> In deciding how best to allocate a case between themselves, Ofwat and the OFT will follow the principles and procedures set out in 'Concurrent

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<sup>6</sup> See The Competition Act 1998 (Concurrency) Regulations (SI 2004 No. 1077) and 'Concurrent application to regulated industries' (OFT 405).

application to regulated industries' (OFT 405). Factors which may affect the decision include:

- the sectoral knowledge of a Regulator
- whether a case affects more than one regulatory sector
- any previous contacts between the parties or complainants and a Regulator or the OFT, and
- any recent experience in dealing with any of the undertakings or similar issues which may be involved in the proceedings.

3.5 Where an agreement or conduct has an effect upon competition in the markets regulated by us and on trade between EU Member States, the case will be allocated to the NCA in the Member State well-placed to act.<sup>7</sup>

3.6 The remainder of this chapter explains how we will proceed to investigate possible breaches of Article 101, Article 102 or the Chapter I and II prohibitions and how we will proceed with any enforcement action. It also explains how we will exercise our powers under the WIA91, the EA02 and the CA98 to ensure that any anti-competitive behaviour is most effectively addressed and without undertakings facing double jeopardy.

## Applying Articles 101 and 102

3.7 We have a duty to apply Articles 101 and 102 where we are applying national competition law to an agreement or conduct has an actual or potential effect on trade between member states.

3.8 Where the Chapter I or Chapter II prohibitions are applied and there is an actual or potential effect on trade between member states, we will apply

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<sup>7</sup> European Commission Notice on cooperation within the network of competition authorities (OJ C101, 27.04.2004, p.43).

Article 101 and/or 102 in accordance with Article 3 of the Modernisation Regulation. We will decide, depending on the facts of the case, whether to apply the Chapter I or Chapter II prohibitions in parallel to the application of Articles 101 or 102.<sup>8</sup>

- 3.9 We may apply our sectoral-specific powers (set out in the WIA91), as appropriate, to agreements or conduct having an effect on trade between Member States, in so far as the predominant purpose of these provisions pursues objectives that are different from those pursued by Articles 101 and 102.
- 3.10 We will consider each case individually in conjunction with the principles developed through EU case law and will have regard to the notice issued by the European Commission 'Guidance on the effect on trade concept contained in Articles 81 and 82 of the EC Treaty' (2004/C/101/07).

### CA98 investigations

- 3.11 Once it has been determined that we will investigate a case using our CA98 powers, we will attempt as quickly as possible to determine whether the case meets the requirements of section 25 of the CA98. Under section 25 of the CA98 we may open an investigation if there are reasonable grounds for suspecting an infringement of the Chapter I prohibition and/or the Chapter II prohibition.
- 3.12 In determining whether to open a CA98 investigation (whether in response to a complaint or on our own initiative), we will consider carefully all available information. This might include our existing knowledge of the issues, information provided by members of a cartel, statements from current or former employees, or a complaint. We may seek additional information informally before deciding whether we should

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<sup>8</sup> In cases where an undertaking has committed an infringement of both EU competition law (Article 101 or Article 102 of the Treaty on the Functioning of the European Union) and national competition law (Chapter I or Chapter II of the CA98), the undertaking will not be penalised twice for the same anti-competitive effects (paragraph 4.13 of 'Modernisation' (OFT 442)).

open an investigation. As noted in paragraph 3.2 above, we may open a CA98 investigation following a complaint or on our own initiative and in deciding whether to open an investigation we will have regard to our prioritisation principles.

- 3.13 We may open a CA98 investigation only when we are satisfied that the section 25 test (see above) is met. Where we are considering opening an investigation as a result of a complaint, we will expect the complainant to provide us with evidence in order to inform our decision as to whether to open an investigation or not. We have published guidance<sup>9</sup> setting out the information we will most likely require from a complainant in order to be able to take forward a complaint under CA98.
- 3.14 If we reach the view that the section 25 test has not been met, we will not commence a formal CA98 investigation. If we reach the view following a complaint that the section 25 test has not been met we will inform the complainant of this decision in writing.

### Leniency

- 3.15 The 'OFT's guidance as to the appropriate amount of a penalty' (OFT 423) also sets out the OFT's policy and practice on leniency in cartel cases (including, subject to certain conditions, granting total immunity from financial penalties to a participant in cartel activity who is the first to come forward). Where cartel cases are allocated to us under the concurrency arrangements, we will always adopt the OFT's approach to leniency.

### Information gathering

- 3.16 We have a range of information gathering powers under competition and sector-specific legislation. Sections 26-28A of the CA98 provide us with

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<sup>9</sup> '[A Guide to Complaining to Ofwat Under the Competition Act 1998](http://www.ofwat.gov.uk/legacy/aptrix/ofwat/publish.nsf/AttachmentsByTitle/complaining_to_ofwat_guide280406.pdf/$FILE/complaining_to_ofwat_guide280406.pdf)', published 24 April 2006 ([http://www.ofwat.gov.uk/legacy/aptrix/ofwat/publish.nsf/AttachmentsByTitle/complaining\\_to\\_ofwat\\_guide280406.pdf/\\$FILE/complaining\\_to\\_ofwat\\_guide280406.pdf](http://www.ofwat.gov.uk/legacy/aptrix/ofwat/publish.nsf/AttachmentsByTitle/complaining_to_ofwat_guide280406.pdf/$FILE/complaining_to_ofwat_guide280406.pdf))



various powers to investigate suspected anti-competitive behaviour. Generally, we can require any person to produce documents on information that is related to the relevant matter of the investigation (subject to certain specific limitations applying). These powers are set out in detail in the OFT guidance 'Powers of Investigation' (OFT 404).

- 3.17 When requesting information under the CA98, we will specify the potential infringement that we are investigating. We are likely in the first instance to seek information from the firm we are investigating and from the complainant, if a complaint has been made. But we may also seek information from third parties as appropriate. Such third parties may include competitors, customers, and suppliers of the undertaking(s) under investigation.
- 3.18 Where information has been gathered using powers under the CA98, Ofwat may use that information to investigate other matters under the CA98, the WIA91, or Part 4 of the EA02, subject to, and in accordance with, the provisions of these Acts, relevant EU legislation, administrative practice and case law. Similarly, Ofwat may use information gathered using its powers under the WIA91 or Part 4 of the EA02 to investigate matters under the CA98
- 3.19 We will only use information received from the European Commission or another NCA in accordance with Article 12 of the Modernisation Regulation. This provides for information sharing (which can include confidential information) amongst NCAs and/or the European Commission, which is an important practical principle of concurrency. This means that, generally, information which is shared will only be used in evidence for the purpose of applying Article 101 and 102 and in respect of the subject-matter for which it was collected by the transmitting competition authority. If the information has been collected for a European Commission case and an NCA is applying national competition law in the same case (and will not be arriving at a different outcome to the decision in the Commission's case) the information can be used by the NCA.

## Making representations

- 3.20 Section 31 of the CA98 states that, following an investigation, Ofwat may make a decision in relation to an alleged infringement of Article 101 or Article 102 or the Chapter I or Chapter II prohibitions. Before doing so, we must provide written notice to the person or persons likely to be affected (a 'statement of objections') and provide them with an opportunity to make representations. Although we are only required to provide written notice to the person or persons likely to be affected, we may decide to publish an appropriately redacted version for public consultation.
- 3.21 Following receipt of a statement of objections, parties may make written representations to us. We may, in some circumstances, also allow oral representations to be made.

## Enforcement action

- 3.22 Our enforcement powers under sections 31A-36 of the CA98 allow us to, amongst other things:
- give directions to bring an infringement (which has been proven) to an end
  - give interim measures directions during an investigation
  - accept binding commitments offered to us, and
  - impose financial penalties on undertakings for infringing Article 101, Article 102, the Chapter I and/or Chapter II prohibitions.
- 3.23 The OFT's guidance, 'Enforcement' (OFT 407), and the OFT's website sets out more details of how the OFT and concurrent regulators, including Ofwat, will apply their powers of enforcement.
- 3.24 In deciding which (if any) of our enforcement powers to use, we will have regard to our prioritisation principles.

## Directions

- 3.25 The CA98 provides that we may give such directions as we consider appropriate to bring an infringement (which has been proven) to an end where we have made a decision that Article 101, Article 102, the Chapter I and/or Chapter II prohibitions has, or have been, infringed. Such directions might require a company to (amongst other things) modify or terminate an agreement or modify or cease its conduct. Directions may also require positive action (or structural changes) on the part of the person concerned.
- 3.26 The directions may be given to such person(s) as Ofwat considers appropriate, which includes individuals and undertakings. Ofwat is not limited to giving directions to the infringing parties.

## Interim measures directions

- 3.27 Under section 35 of the CA98, we may give interim measures directions pending our final decision as to whether or not there has been an infringement of Article 101, Article 102, the Chapter I and/or Chapter II prohibitions. Interim measures directions are temporary directions which require certain steps to be taken while a CA98 investigation is carried out. Interim measures directions will not affect the final decision.
- 3.28 We have the power to give interim measures directions if:
- we have reasonable grounds to suspect an infringement but have not yet completed our investigation, and
  - we consider that it is necessary to do so as a matter of urgency:
    - to prevent serious, irreparable damage to a particular person or category of persons, or
    - to protect the public interest.
- 3.29 For further guidance on the application of these principles see OFT Guidance 'Enforcement' (OFT 407).

## Accepting commitments

- 3.30 We may accept binding commitments from undertakings suspected of infringing Article 101, Article 102, the Chapter I and/or Chapter II prohibitions. Under section 31D of the CA98, we are required to have regard to the OFT's guidance when considering whether to accept commitments offered (part 4 of 'Enforcement' (OFT 407)). We are only likely to consider it appropriate to accept commitments in cases where the competition concerns are readily identifiable, where the concerns are fully addressed by the commitments offered and the proposed commitments are capable of being implemented effectively, and, if necessary, within a short period of time. In relation to any one investigation, we may accept commitments in respect of some of our competition concerns and continue our investigation in respect of other concerns arising from the same agreement or conduct.
- 3.31 In line with the OFT's guidance, set out in the Annexe to 'Enforcement' (OFT 407), we will not, other than in exceptional circumstances, accept binding commitments in cases involving secret cartels between competitors which include:
- price-fixing
  - bid-rigging (collusive tendering)
  - establishing output restrictions or quotas
  - sharing markets, and/or
  - dividing markets.
- 3.32 Nor are we likely to accept binding commitments in cases involving a serious abuse of a dominant position.

## Imposing penalties

- 3.33 Section 36 of the CA98 gives us the ability to impose a financial penalty in relation to a breach of Article 101, Article 102, the Chapter I and/or

Chapter II prohibitions. Section 38 of the CA98 requires Ofwat to have regard to the OFT's guidance when determining the appropriate level of a penalty it will impose for an infringement of Article 101, Article 102, the Chapter I prohibition and/or the Chapter II prohibition. This relevant guidance is 'OFT's guidance as to the appropriate amount of a penalty' (OFT 423); the OFT or concurrent regulators presently may impose a financial penalty on an undertaking of up to 10 per cent of the undertaking's worldwide turnover.

- 3.34 This guidance also stipulates that, in cases where an undertaking has infringed both Articles 101 or 102 and the Chapter I or the Chapter II prohibition, the undertaking will not be penalised twice for the same anti-competitive effects. When determining the appropriate amount of any penalty, we will therefore take into account any penalty imposed by the European Commission, or by a Court or a body in another Member State, in relation to the same anti-competitive agreement or conduct.
- 3.35 In accordance with section 22A(13) WIA91, we will not impose a penalty under the WIA91 if a penalty is being imposed under section 36 of the CA98.

### Publishing decisions

- 3.36 Where we make a decision that an infringement of Article 101, Article 102, the Chapter I and/or Chapter II prohibitions has occurred we will publish our decision on our website and on the OFT's public register.<sup>10</sup> We also publish, when appropriate, formal 'no grounds for action' decisions on our website and the OFT's public register.
- 3.37 When making public the outcome of our investigation, we will have regard to whether the information to be published is market sensitive (which will include considering the position of listed companies (as

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<sup>10</sup> Competition Act 1998 decisions are published on Ofwat's website ([www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/navigation-ca98decisions](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/navigation-ca98decisions)) and the OFT's public register ([www.ofwat.gov.uk/advice\\_and\\_resources/resource\\_base/ca98/decisions](http://www.ofwat.gov.uk/advice_and_resources/resource_base/ca98/decisions)).

appropriate)) or could otherwise harm a party's legitimate commercial interests. We will take this into account when deciding on the timing of announcements, as is current practice for the announcements relating to price control proposals.

## Appeals

- 3.38 Under Sections 46 and 47 of the CA98, certain decisions taken by us may be appealed to the Competition Appeal Tribunal (CAT). In particular, decisions by Ofwat as to whether Article 101, Article 102, the Chapter I and/or the Chapter II prohibition have been infringed may be appealed. The CAT may confirm or set aside our decision, impose, revoke or vary the amount of any penalty imposed by us, remit the matter to us or make any other decision, give any such directions or take such other steps that we ourselves could have made.

## 4 ASSESSING CASES IN THE WATER SECTOR

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

### Market definition

4.2 Defining the relevant market is a useful step in identifying the competitive constraints on an undertaking. Market definition is therefore generally a useful part of the framework for assessing market power and analysing the effects of agreements or conduct. Market definition is not an end in itself but provides a framework for competition analysis.

4.3 We will define the market for each individual case based on the facts of that case, as conditions of competition will depend upon the particular case. Market definition may contain product, geographical, and temporal dimensions, where appropriate.

4.4 In defining the relevant market, Ofwat will follow the framework set out in the guidance 'Market definition' (OFT 403). This will generally involve the use of the 'hypothetical monopolist' test, which entails asking how customers (the 'demand side') and other suppliers (the 'supply side') would react to an attempt by a hypothetical monopolist to raise prices of the product in question, in the area in question (and perhaps also at the time in question) significantly above the competitive level.<sup>11</sup> A significant

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<sup>11</sup> The competitive price need not be the prevailing price. If the hypothetical monopolist test were conducted by reference to a prevailing price in excess of the competitive price, the relevant market might be found to be wider than it would have been by reference to the competitive price. This is because purchasers and other suppliers may be better able to engage in substitution in response to a rise above the higher, prevailing price, than they would have been in response to a rise above the competitive price. This is known as the 'Cellophane fallacy' after the case *United States v El du Pont de Nemours & Co* 351 US 377 (1956), where the American Supreme Court erroneously accepted Du Pont's argument that cellophane was not a

price rise in this context is generally (and indicatively) taken to be in the region of five to 10 per cent.

4.5 The application of the 'hypothetical monopolist' test will generally include consideration of the following:

- the extent to which customers would switch to other products following a hypothetical price increase above the competitive price level, what would be involved in their doing so and how long it would take them to switch
- the extent to which suppliers not currently supplying that product would enter into its supply following a hypothetical increase in price above the competitive level, what would be involved in their doing so and how long it would take them to enter
- the extent to which customers would switch to suppliers in other geographical areas following a hypothetical price increase above the competitive level, what would be involved in their doing so and how long it would take them to switch, and
- the extent to which suppliers from other geographical areas would enter into supply in this area following a hypothetical increase in price above the competitive level, what would be involved in their doing so and how long it would take them to enter.

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

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separate relevant market but competed directly and closely with other flexible packaging materials.



- 4.7 In general, in order to be included in the relevant market, substitution to (on the demand side) or from (on the supply side) a product must be a genuine possibility and capable of ready implementation. Where substitution rests, for example, on the construction of new infrastructure, the time and cost needed for that construction will be taken into account.
- 4.8 While geographical factors may well be important in market definition in the water sector, our geographical market definitions will not necessarily follow company boundaries, water resource zones or catchment areas. Within the current industry framework, actual and potential new appointments, actual and potential water supply licensees, customer self-supply, private supplies and on-site services might be important influences on geographic market definitions. As with the product market, in order to be included in the geographical market definition substitution to or from supply in another area must be genuinely possible and capable of ready implementation.
- 4.9 In certain circumstances market definition in the water and sewerage sectors may include a temporal dimension. It is possible, for example, that varying resource constraints over time (for example, because of drought) may lead to different undertakings having market power at different points in time.
- 4.10 Further developments enabling greater entry or trading will have an effect on market definition in the water and sewerage sectors.

### Assessment of market power and dominance

- 4.11 Market power can be thought of as the ability to sustain prices significantly above competitive levels or restrict output or quality significantly below competitive levels. An undertaking with market power might also have the ability to harm the process of competition and might have the incentive to do so in order to maintain its market power. An undertaking could use its market power unfairly to disadvantage actual or potential competitors for example by raising their costs or raising entry barriers.

- 4.12 The assessment of market power can be useful under Article 101 and the Chapter I prohibition in considering the concept of 'appreciability' (see 'Assessment of agreements' below) and is central under Article 102 and the Chapter II prohibition in the identification of 'dominance'.
- 4.13 In respect of Article 102 and the Chapter II prohibition, Ofwat will assess whether the undertaking or undertakings in question occupy a dominant position in the relevant market. The European Courts have defined a dominant position as 'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers'.<sup>12</sup> Dominance may involve more than one undertaking (joint/collective dominance)<sup>13</sup> and may be present when independent undertakings are linked in such a way as to adapt a common policy on the market.
- 4.14 In assessing whether an undertaking enjoys a dominant position, we will have regard to the OFT guidance 'Assessment of Market Power' (OFT 415), and will look at a range of factors, including:
- the extent to which an undertaking faces competitive constraints (such as existing competitors, potential competitors or strong buyer power from the its customers)
  - customers' behaviour and options (for example, awareness of competition, the extent to which alternative providers are chosen, the extent to which substitutes are available, the time and costs involved in switching)

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<sup>12</sup> Case 27/76 United Brands v Commission [1978] ECR 207. This definition has been used in other cases.

<sup>13</sup> The concept of joint dominance was first defined in cases T-66, 77 and 78/89 Società Italiana Vetro v Commission (Italian Flat Glass) [1992] ECR II-1403, [1992] 5 CMLR 302 and clarified in case T-102/96 Gencor v Commission [1999] ECR II-753, [1999] 4 CMLR 971.

- competitors' behaviour and capacities (for example, their range of offers, their abilities to increase available supplies within the relevant time period, the time and costs involved in acquiring customers)
- market operation (for example the extent of barriers to entry and exit, switching costs, such as the regulation of water abstractions and discharges to the environment)
- an undertaking's conduct in a market with regard to price and output setting as well as its financial performance (such as persistently earning a rate of profit above competitive levels)
- market share and movements in market share over time, and
- the effect of regulation of prices, quality and other product characteristics.

4.15 Market share can be a useful indicator of market power, although it does not, on its own, determine whether an undertaking is dominant. In developing the case law on dominance, the European Courts have stated that dominance can be presumed, in the absence of evidence to the contrary, where an undertaking has a market share persistently above 50 per cent.<sup>14</sup> Dominance has rarely been established in case law where an undertaking has a market share of below 40 per cent.<sup>15</sup>

4.16 Market shares may be assessed by volume or by value, and may be collected from a number of sources. In general, assessments by value are more sensitive indicators of market power (because undertakings that are able to secure prices above the competitive level are more likely to have relatively high shares of value). In general, we will consider market shares by value and by volume. When assessing market share we

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<sup>14</sup> Case C62/86, AKZO Chemie BV v Commission [1993] 5 CMLR 215.

<sup>15</sup> But see case T-219/99 British Airways v Commission [2003] ECR II-5917, where British Airways was found to have a dominant position with a market share between 39 and 46 per cent.

will generally consider shares over a period of time, and we will consider movements in those shares over time.

- 4.17 As noted above, in order to be included in the relevant market substitution to or from a product or area must be a genuine possibility and capable of ready implementation. When considering the competitive constraints faced by an undertaking, we may well consider the constraints posed by substitution possibilities that were not capable of sufficiently ready implementation to be included in the relevant market.
- 4.18 A dominant undertaking is under a special responsibility<sup>16</sup> not to allow its conduct to impair undistorted competition. The existence or application of sectoral regulation does not absolve a dominant undertaking of this special responsibility.

### Buyer power

- 4.19 Undertakings may enjoy market power as sellers or buyers in a market. Analogously to market power as a seller, buyer power may be understood as the ability profitably to reduce prices below competitive levels. In order to assess buyer power, the tests applied to the assessment of market power for sellers may be applied in reverse. In assessing buyer power, we will consider the ability of a firm to secure prices persistently below the competitive level taking into account their share of purchases in the relevant market, and the alternative options open to sellers.

### Assessment of abuse

- 4.20 It is the abuse of, not the existence of, a dominant position that is prohibited by Article 102 and the Chapter II prohibition. Where an abuse of a dominant position is alleged or suspected it is not sufficient for us

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<sup>16</sup> Case 322/81 NV Nederlandsche Banden-Industrie Michelin v Commission [1983] ECR 3461, [1985] 1 CMLR 282.

to demonstrate dominance, we must also determine whether there has been an abuse.

- 4.21 In considering whether an abuse has occurred, we will look at the dominant undertaking's conduct and, crucially, on the effect of that conduct. Conduct may be abusive where it has an exploitative effect, that is, where customers have directly suffered higher prices and/or lower quality goods or services. Conduct may also be abusive where it is anti-competitive, that is, where it prevents, restricts or distorts the process of competition. Exclusionary conduct may include margin squeeze (see below), predation, bundling and tying, undue discrimination or selective discounting, refusal to supply (and constructive refusal to supply), and the use of long term and/or exclusive contracts. It is important to note that conduct unfavourable to competitors may not necessarily constitute an abuse; Article 102 and the Chapter II prohibition protect the process of competition and not competitors in themselves. Where a dominant firm's conduct has had neither exploitative nor exclusionary effect, we will not find an abuse.
- 4.22 The OFT guidance 'Abuse of a Dominant Position' (OFT 402) and DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses<sup>17</sup> provide further detail on the type of conduct which might be considered an abuse of a dominant position.
- 4.23 Given the widespread existence of vertically integrated undertakings in the water and sewerage sectors, and the existence of entry into the sectors at various points in the value chain, it is possible that the issue of margin squeeze will arise. A margin squeeze may occur in an industry where a vertically integrated undertaking is dominant in the supply of an important input for a downstream market in which it also operates. The vertically integrated undertaking could, either by using the 'wholesale' price for the input or the end retail price, squeeze an efficient

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<sup>17</sup> DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (December 2005) at

<http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf>.

downstream competitor's margin rendering it unable to compete effectively.

- 4.24 In assessing margin squeeze, we are likely to consider whether the dominant undertaking's downstream arm could make a normal profit if it paid its upstream arm the 'wholesale' price it is charging its competitor. We may need to do this in circumstances where there is no downstream business with its own accounts. In such cases, we will consider a 'notional' downstream business and will require information from the undertaking in order to allow us to do this.
- 4.25 Further detail on the test for margin squeeze and other aspects of assessment of abuse can be found in OFT 414a Assessment of Conduct (draft competition law guideline for consultation).

#### Related markets

- 4.26 As explained in OFT 402, Article 102 and the Chapter II prohibition apply where undertakings dominant in one market commit an abuse in a different but closely associated market. It is not necessary to show that the abuse was committed in the market in which the undertaking is dominant.

#### Assessment of agreements and concerted practices

- 4.27 The approach to assessing whether agreements and concerted practices are anti-competitive is described in the guidance 'Agreements and Concerted Practices' (OFT 401).
- 4.28 Article 101 and/or the Chapter I prohibition apply to an agreement only if it has as its object or effect the prevention, restriction or distortion of competition within the common market in the case of Article 101 or the United Kingdom in the case of the Chapter I prohibition. Any agreement between undertakings might be said to restrict the freedom of action of the parties. That does not, however, necessarily mean that the agreement is prohibited. An agreement will only be prohibited if it results in appreciable prevention, restriction or distortion of competition within:

- the common market in the case of Article 101, and/or
- the United Kingdom in the case of the Chapter I prohibition.

4.29 Article 101(1) and section 2(2) CA98 provide a non-exhaustive, indicative and identical list of agreements to which the provisions apply, namely those which:

- directly or indirectly fix purchase or selling prices or any other trading conditions
- limit or control production, markets, technical development or investment
- share markets or sources of supply
- apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage, or
- make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

4.30 In the water and sewerage sectors, examples of agreements that might prevent, restrict or distort competition to the detriment of consumers include agreements:

- between suppliers not to compete in each other's areas of appointment, for example in relation to cross-border supplies, new appointments or the Water Supply Licensing (WSL) regime
- between undertakings to collude on pricing conduct
- to collude in bidding for contracts (including agreements not to bid)
- to collude on purchase prices for inputs (for example, chemicals, infrastructure purchases, spare parts)

- leading to preference for related, or each other's related, suppliers in procurement or the outsourcing of contestable services.

4.31 Paragraphs 2.15 to 2.21 of 'Agreements and Concerted Practices' set out the factors Ofwat will take into account when assessing the 'appreciable effect on competition' test.

### Specific issues in the water and sewerage sectors

4.32 We have referred to examples from the water and sewerage sectors throughout this document and highlighted issues of particular note given the nature of the sectors. This section identifies a number of issues specific to the water and sewerage sectors where Ofwat may apply its competition law powers. The issues identified here are not exhaustive but are intended to provide some indication of how Ofwat might approach applying its CA98 powers in relation to the identified issues.

### Interaction with sector-specific regulation

4.33 For most services connected with the water and sewerage sectors there is currently some form of regulation which affects price and service levels. In many instances, price limits and minimum service standards are set by us. In relation to public water and sewerage provision, competition in the market has been limited to very large non-household users.

4.34 The limited extent of competition in the water sector to date and the extent of regulation of price and service has limited the extent to which undertakings have the ability to act exploitatively and has limited the extent to which they have the incentive to act in an exclusionary way. However, we are aware that as the sector evolves, undertakings' ability and incentive to exploit and exclude may increase.

4.35 It is important to note that the existence of sectoral regulation, including where prices are set by a regulator, does not remove the need for undertakings to comply with competition law. As an indication, case law has established that parties may be acting in breach of competition law



even though they are complying with regulated price caps for the industry (for instance, if a dominant undertaking were to operate a margin squeeze).<sup>18</sup>

- 4.36 We have set out in 'Prioritisation Principles: Application to the Competition Act 1998' the principles to which we will have regard when deciding whether to use our CA98 or sectoral regulatory powers.

### Use of information

- 4.37 In assessing conduct in relation to Articles 101 and 102 and the Chapter I and Chapter II prohibitions, we will make use of information already available to us through regulatory activities. However, even where we have extensive information for regulatory purposes, it is likely that we will need further information for the specific assessment of the conduct in question. This is because the information we hold for regulatory purposes will reflect our use of that information as part of the regulatory process, so that it may not correspond to information we will need to perform competition analysis.
- 4.38 Our work on accounting separation may improve the usefulness for competition analysis of the information we hold for regulatory purposes. However, it is still likely that we will need further information for the specific assessment of the conduct in question.

### Methodologies and approaches

- 4.39 Our role as sectoral regulator is extensive. It includes for example setting price limits and service standards, approving charges schemes, undertaking determinations, granting licences and settling disputes and appeals using our sectoral regulatory powers. As part of this work, and with regard to our strategic objectives, we have developed a set of

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<sup>18</sup> See case T-271/03 Deutsche Telekom AG v Commission [2008] 5 CMLR 631 and also case COMP/38.784 Wanadoo España v Telefónica, 2008 O.J. (C 83) 5.

methodologies and approaches to a wide range of issues, including issues such as cost allocation and transfer pricing.

- 4.40 When we are assessing conduct under Articles 101 and 102 or the Chapter I or Chapter II provisions we will use methodologies and approaches that are appropriate to the facts of the case and the analysis we are undertaking. While in some circumstances these may be the same approaches and methodologies we use for our regulatory work, in some circumstances they will be different. Where appropriate, we may use a number of different approaches and methodologies to provide cross-checks on our analysis.

#### The exclusion from the CA98 prohibitions for services of general economic interest

- 4.41 Under paragraph 4 of Schedule 3 to the CA98, neither Article 101, the Chapter I prohibition, Article 102 nor the Chapter II prohibition apply to an undertaking entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly in so far as the prohibition would obstruct the performance, in law or in fact, of the particular tasks assigned to that undertaking. We may therefore need to assess whether or not, in a particular case, a particular undertaking benefits from this exclusion.
- 4.42 The OFT's guidance 'Services of General Economic Interest Exclusion' (OFT 421), explains that the revenue-producing monopoly exclusion does not apply to any undertakings in the UK. OFT 421 also explains that the SGEI exclusion is applied strictly, with undertakings seeking to benefit from the exclusion having to prove that they meet all the requirements of it. Where an undertaking is able to satisfy all the requirements, the SGEI exclusion will only apply to particular obligations entrusted to the undertaking and will not apply to the undertaking itself or its activities generally.
- 4.43 In accordance with OFT 421, an undertaking seeking to benefit from the exclusion must show that:

- it has been 'entrusted' with the operation of a SGEI; and
- the application of Article 101, the Chapter I prohibition, Article 102 nor the Chapter II prohibition would obstruct the performance, in law or in fact, of the particular task entrusted to it.

4.44 Further information on the application of the exclusion is set out in OFT 421.