serle court

Bristol Water commitments: Reflections on Ofwat's role in opening up the market to competition

In an Expert Focus article for Waterbriefing, Suzanne Rab, barrister from Serle Court discusses why Bristol Water's decision to split its upstream and downstream businesses following Ofwat's investigation of a dispute with Self-Lay Organisations has raised issues of fundamental importance for the water sector in the run-up to the introduction of further competition in 2017.

In an Expert Focus article for Waterbriefing, Suzanne Rab, barrister from Serle Court discusses why Bristol Water's decision to split its upstream and downstream businesses following Ofwat's investigation of a dispute with Self-Lay Organisations has raised issues of fundamental importance for the water sector in the run-up to the introduction of further competition in 2017.

Suzanne Rab: Bristol Water's separation of its downstream and upstream businesses highlights the opportunities and incentives that may be presented to a vertically integrated business which operates in non-contestable (upstream) and contestable downstream businesses.

Ofwat has confirmed that Bristol Water has committed to change its procedures and structures to address an alleged abuse of dominance in the provision of water infrastructure.

Ofwat's investigation into Bristol Water concerns competition in the market for building new water connections. In broad summary, where a new development needs water connections a developer may ask the regional water company to install the mains or grant the contract to another independent contractor ('self-lay organisation').

Once the self-lay organisation has completed the work, the regional water company will take over the responsibility for operating it. Due to the structure of the UK water industry this is one of the few areas where the sector is currently open to competition.

Companies operating in the regulated industries in the UK will be familiar with the "concurrent" application of competition by the competition authority – currently the Competition and Markets Authority (CMA)– and the various sector regulators, including Ofwat.

The sector regulators share, broadly, the same powers as the CMA to enforce UK and EU competition law in their respective sectors (i.e. Article 101/102 TFEU and their national law equivalents under Chapter I/II of the Competition Act 1998).

Water sector regulator Ofwat received complaints that downstream infrastructure providers were being forced out of the local market for self-lay connections and contrary to Bristol Water's duty to act fairly.

In order to resolve the competition law investigation and address Ofwat's concerns Bristol Water has given a commitment to ensure the functional separation of its downstream development business - which competes with the self-lay organisations - and its upstream business via the creation of two distinct and separately staffed functions in the form of retail-facing and wholesale-facing business units.

It has also agreed to provide greater consistency and transparency for the calculation of costs for its own infrastructure service and the work of a self-lay organisation.

As a result of these commitments, Ofwat has stated that it is satisfied that the ability for Bristol Water to discriminate between its own downstream business and competitors is reduced.

Issues will become more significant when market opens in 2017

As competition is expected to increase when the relevant provisions of the Water Act 2014 come into force in 2017, ensuring that new entrants can compete effectively will become more significant.

As a wider reflection the Bristol Water investigation was launched in 2013 before the CMA came into operation on 1 April 2014 as the UK's newly merged competition regulator and taking over former functions of the Office of Fair Trading and the Competition Commission. The Ofwat decision is especially relevant in the wake of the reforms introduced by the Enterprise and Regulatory Reform Act 2013 which are expected to contribute to a greater use by the sector regulators of their competition powers.

This is only the second time that Ofwat has secured commitments under the Competition Act 1998. In 2013 Severn Trent offered to divest certain assets in order to address concerns of below-cost pricing.

Sector regulators have traditionally favoured use of sector regulatory powers over competition powers

Under the regime for the "concurrent" application of competition by the CMA and sector regulators like Ofwat and Ofgem, the regulators broadly have the same powers as the CMA to enforce UK and EU competition law in their respective sectors.

When concurrency was introduced, arguments were made both for and against the system. In favour of concurrency it was argued that:

(i) sector regulators had developed specialist expertise and knowledge of their sectors that could be applied effectively in competition cases;

(ii) there was overlap between the sector licensing regimes and competition law; and

(iii) concurrency would encourage sector regulators to move away from reliance on ex ante regulation to using ex post competition law.

Against concurrency it was argued that:

(i) concurrency is rare in other jurisdictions including in the EU;

(ii) the sector regulators lacked expertise in EU competition law analysis and investigations experience;

(iii) there would be less efficient use of regulatory resources given the number of bodies that could potentially apply competition powers;

(iv) there was a risk of inconsistency in decision making; and

(v) there was a risk of "double jeopardy" where companies operating in more than one sector might face multiple investigations.

It was initially expected that reliance on regulatory powers would be lessened in favour of a more general application of competition law. However, in general, and with some exceptions, sector regulators have tended to favour use of sector regulatory powers over their competition powers.

The coming years will tell whether the new regime will bring in more use of competition powers by the sector regulators. In certain circumstances the sector regulators are obliged to consider the use of their competition powers before resorting to their sector regulatory powers. This may be expected to fuel greater use of competition powers, where appropriate. While cases may be transferred between concurrent authorities, only one authority can exercise competition law functions in respect of a case at any moment. Concurrency Regulations and Concurrency Guidance set out how information will be shared between relevant authorities and how cases will be allocated. The general principle is that the regulator that will be responsible for a case depends on which one is better or best placed to do so Against this there may still be cases which call for targeted and measured use of sector regulatory powers where, for example, competition law cannot be expected to bring benefits in a sufficiently timely or effective manner.

In its draft forward programme published in January, Ofwat said it will use its casework activity in the coming months to ensure that the opening of the non-household retail market to competition is effective and delivers benefits for customers as provided for in the Water Act 2014.

The water sector and potential new entrants to the marketplace will undoubtedly be watching all of Ofwat's decisions with interest.

About Suzanne Rab:

serle court

Suzanne Rab is a barrister at Serle Court Chambers in London. She has wide experience of EU law and competition law matters combining cartel regulation, commercial practices, IP exploitation, merger control, public procurement and State aid. Suzanne's practice has a particular focus on the interface between competition law and economic regulation. She advises governments, regulators and businesses across the regulated sectors including in the communications, energy, financial services, healthcare/ pharmaceuticals, TMT and water sectors.

E. srab@serlecourt.co.uk

About Serle Court:

Serle Court is a leading Chambers based in Lincoln's Inn in London. Serle Court offers expertise across the range of commercial law and chancery matters.