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Competition law constraints on access charges in the England and Wales water industry

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Abstract

Water industry regulation in the UK does not require a network owner to grant access to third parties. The regulator instead enforces common carriage on network owners through the application of the Competition Act 1998. This legislation, however, enables the regulator, the Director General of Water Services, to require only dominant companies to grant access; and gives the regulator no *ex ante* powers. The DGWS can intervene only when a dominant network owner has failed to grant access, and only in relation to aspects of the network that are “essential facilities”. The regulator will require access in these circumstances to be given on a non-discriminatory basis, at a price that is not “excessive”. Long run average incremental cost based prices will not be excessive. Prices calculated by reference to fully allocated cost or the efficient component pricing rule may on occasion be excessive. © 2003 Elsevier Science Ltd. All rights reserved.

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1. Introduction

Common carriage and the need for a facility owner to grant access to would be competitors are not issues that are unique to the water industry. These issues arise in all network industries where it is not economically viable to duplicate the network and where, as a result, third parties cannot compete with the network owner without gaining access to the network on economic terms. Indeed the water industry in England and Wales (*E&W*) is probably the last (or at least the latest) major UK network industry to encounter these issues. The telecommunications industry in the UK faced these issues in the mid 1980s, the gas and electricity industries at the end of the decade. The rail industry has been facing these issues since the mid 1990s.

In each of these industries, the question of how to resolve the questions of when and on what terms the facility owner should grant access have been resolved

by a combination of regulation and the application of competition law. Thus, for example, in 1990 and the following years, the European Commission introduced a series of “Open Network Provision” or “ONP” directives which specified which facilities telecommunications operators with “significant market power”¹ were required to make available and on what basis (generally on a transparent, non-discriminatory basis related to cost). In parallel, the Commission considered a number of questions and issued general guidance as to when

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¹ In Directive 97/33/EC of the European Parliament and of the Council of 30 June 1997 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP) (OJ L199, 26/07/1997) the Commission indicated that a company would have “significant market power” when it had a market share exceeding 25%.

competition law required a dominant telecoms operator² to grant access to its “essential facilities”.³

The UK gas and electricity codes for access (the Network Code and RETA—Grid Code Master Connection and Use of System Agreement (*NGC*) and Distribution and Use of System Agreement (*PES*)) have been negotiated against a similar background, where the imperatives of regulation and the constraints of competition law have led to the conclusion of “voluntary” codes to the (relative) satisfaction of the industry regulators and industry players.

It is important to note, at the outset, that the purpose and scope of regulation and of competition law are significantly different. Utility regulation is generally political and structural in nature and objective. Thus, the ONP telecommunications regulations were introduced as part of a structural plan to bring to an end the pre-existing national telecommunications monopolies and to facilitate the introduction of an internal market in telecommunications services by introducing harmonized conditions for access to networks across Europe, thereby permitting interconnection and interoperability. The ONP directives applied to operators with significant market power and specified the basis for access. Competition law has an important but a more limited goal—to prevent abuse of market power (and the creation of anti-competitive agreements). Because of their different goals and system of enforcement, regulation often operates on an *ex ante* basis, i.e. it prescribes what companies will do: competition law, by contrast, prohibits anti-competitive acts, but investigates those acts generally only an *ex post* basis.

The distinction between both the goals and the systems of regulation and competition law is crucially important. Regulation on access has tended to be far

² According to the jurisprudence of the European Courts (*Case 27/76 United Brands Company and United Brands Continentaal BV v Commission of the European Communities* [1978] ECR 207), a company is dominant when it has the ability to behave in a manner independently of its competitors and, ultimately, its consumers. In the case of *AKZO (Case C-62/86 AKZO Chemie BV v Commission of the European Communities* [1991] ECR I-3359), the Court indicated a company with a market share of 50% would in most cases be found to be dominant. Dominance can, however, exist at market shares of 30% or 40%, depending on market structure (see, for example IV/D-2/34.780 - *Virgin/British Airways*, Commission Decision of 14 July 1999 relating to a proceeding under Article 82 of the EC Treaty (OJ L030, 4/2/2000) when a market share of 39.7% was found to be dominant). Section 60 of the Competition Act 1998 provides that the act is to be interpreted, in as far as is possible, in accordance with European case law so European precedents therefore provide important guidance.

³ A facility is essential if a company has a dominant position in the provision of facilities which are essential for the supply of goods or services on another market (*Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co KG and Mediaprint Anzeigengesellschaft mbH & Co KG*, Opinion of Mr Advocate General Jacobs delivered on 28/5/1998, ECR 1998 page I-7791).

reaching, a tool of “deep intervention”,⁴ competition law a somewhat more modest mechanism for controlling abuses. This distinction is vital given that, in the England and Wales water sector, there is little or no relevant regulation (see for example the comments of the Office of Fair Trading and Ofwat in *Competition Act 1998: application in the water and sewerage sectors* where they state “[t]here is no specific statutory framework for common carriage...”).

Two simple examples show why the distinction is so important:

- *First*, imagine a position where three neighbouring water and sewerage companies (WASCs) have sewage treatment works situated quite close to each other. Newco wants access to sewage works in the region and any one of the works would meet its requirements. Under a regulatory system designed to encourage new entry by mandating that all companies with a 25% market share must provide open access, each of the three companies would almost certainly have to make their works available on economic terms related to cost. Under competition law, Newco could complain only if it could show it had been refused access, that the company refusing access was dominant and that it could not arrange economic treatment either by contracting with one of the other two WASCs with works in the area, or by transporting the dirty water to a more distant works or by building an additional works.
- *Second*, consider a position where a number of companies indicated to the regulator they would be more inclined to enter the market were the WASCs and water only companies (WOCs) to publish information on the costs of serving particular customers or groups of customers. Once again, publication of confidential information can be dealt with (and often is) by regulation (including appropriate conditions in an operator’s licence or terms of appointment). But, absent an abuse, a regulator would find it difficult to call on competition law to provide the called for level of transparency.

The distinction becomes particularly important when one considers what rules and constraints apply to a WASC or WOC in determining the terms it will offer for common carriage.

This paper considers first when competition law will constrain the freedom of a WASC or WOC to set access prices as it chooses (or indeed to refuse access); then turns to the more detailed question of what pricing struc-

⁴ See, for example, *Notice on the application of the competition rules to access agreements in the telecommunications sector*, paragraph 14, OJ C265/2, 22/8/1998.

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