

Utilities Regulators and the Competition Act 1998

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(This paper is a draft of a chapter that is forthcoming in B. Rodger and A. McCulloch (eds) *Ten Years of UK Competition Law Reform*.

ABSTRACT

The chapter reviews the application of the Competition Act 1998 by utilities regulators that have concurrent enforcement powers, with specific emphasis on three sectors: electronic communications, energy, and water. While a detailed procedure governs how cases are allocated, utilities regulators have made little use of competition law. However, in a number of disputes, issues that could have been addressed by competition law have been resolved through the application of sector specific regulation. Accordingly the chapter calls for the Authorities to work collectively towards establishing criteria to decide when competition law should be applied and when sector specific regulation would be preferable. This suggestion rejects the view that regulation should be phased out as markets become more competitive and rests instead on the legitimacy of both competition law and regulation as complementary means to address the failures in these markets.

1. Introduction

In addition to the Office of Fair Trading (OFT), six Authorities, whose main role is the regulation of a particular economic sector, have ‘concurrent powers’ to enforce the provisions of the Competition Act 1998 (hereinafter CA98) and Articles 81 and 82 EC.¹ These are: the Office of Communications (Ofcom);² the Water Services Regulation Authority (Ofwat);³ the Office of Rail Regulation (ORR);⁴ the Gas and Electricity Markets Authority (GEMA) for England and Wales;⁵ the Northern Ireland Authority for Utility Regulation (NIAUR);⁶ and the Civil Aviation Authority (CAA).⁷ Postcomm (the Authority regulating the postal sector) does not have concurrent

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¹ See s. 54 and Schedule 10 of the Competition Act 1998 (establishing concurrency for UK competition law). Regulation 3 of the Competition Act 1998 and Other Enactments (Amendment) Regulations 2004 (S.I. 2004/1261) (designating the OFT and regulatory authorities as national competition authorities for the purposes of Art 35 Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1/1).

² S.371 Communications Act 2003. (Unless otherwise indicated all further references to the publications of Ofcom (or OfTel as it was) are available from www.ofcom.gov.uk).

³ S.31(3) Water Industries Act 1991. Originally the industry was regulated by the Director General of Water Services. He and his staff were called the Office of Water Services (abbreviated Ofwat). Since 2006 a regulatory body was set up (Part 2 Water Act 2003) to replace the Director General, but the new agency is still known as Ofwat. (Unless otherwise indicated all further references to the publications of Ofwat are available at: <http://www.ofwat.gov.uk/>).

⁴ S.67(3) Railways Act 1993 (Unless otherwise indicated all further references to the publications of ORR are available at: <http://www.rail-reg.gov.uk/>).

⁵ s. 36A(3) Gas Act 1986; S. 43 Electricity Act 1989 (Unless otherwise indicated all further references to the publications of Ofgem are available at <http://www.ofgem.gov.uk>).

⁶ Regulation 46 The Electricity (Northern Ireland) Order 1992 (No. 231 (N.I. 1)); Regulation 23 The Gas (Northern Ireland) Order 1996 (No. 275 (N.I. 2)).

⁷ S.86 Transport Act 2000.

powers, but has used its regulatory powers to monitor the dominant player (Royal Mail) and it is believed that if it did have concurrent powers, these would not affect its approach much.⁸ Concurrency means that these authorities may exercise, in the markets they are empowered to regulate, the same powers as the OFT, which include: considering complaints, imposing interim measures, seeking information from undertakings, imposing financial penalties, and accepting commitments from undertakings. The justification for empowering the Authorities to apply competition law is threefold: first, when utilities markets were opened to competition, it became apparent that the Authorities needed to apply competition law powers to ensure markets remained competitive (indeed some tried to deploy their regulatory powers to monitor competition);⁹ second it was considered that Authorities, by dint of their close scrutiny of the relevant markets would be best placed to apply competition law and to evaluate complaints about restrictive practices; third concurrency allows the Authority to decide which enforcement powers (competition law or regulation) is most appropriate in a given case. That said, there was criticism that having multiple competition enforcers created significant practical risks: duplication of work, inconsistency, and opacity.¹⁰ To avoid these, considerable effort has been devoted to ensuring effective coordination among the seven competition authorities.

The chapter begins by explaining the provisions that govern the allocation of cases among the authorities, the relationship between CA98 powers and sector regulation, and the relationship between regulators and the courts. Then it considers two government reviews that studied the application of competition law by the Authorities. The remainder of this essay examines the decisions of three Authorities that have used their competition powers (Ofcom, GEMA, Ofwat). The first two have been selected because they are the Authorities that have used CA98 the most, and Ofwat provides an interesting case study on the relationship between Authorities and the Competition Appeals Tribunal, and between sector regulation and competition law. The survey focuses on two issues: first, what competition concerns have arisen and whether there are distinctive issues that arise in these sectors (whether because of the economic conditions of newly liberalised, network industries or because of the authority's approach in a given sector); second, the relationship between competition law and other regulatory powers and objectives. The major preoccupation of the authorities has been the investigation of abuses of dominance, and readers are referred to the chapter by Renato Nazzini in this volume for further discussion of the application of the Chapter 2 prohibition of CA98.¹¹

2. Coordination

2.1 Coordinating enforcement among the agencies

The principle that underpins the Concurrency Regulations is that one Authority should be involved in each case, to avoid double jeopardy.¹² Therefore, if an Authority wishes to take action it must first inform the other six, and

⁸ Memorandum of Understanding between Postcomm and the OFT (June 2003).

⁹ E.g. Oftel inserting a condition on BT's licence that was modelled on Articles 81 and 82 EC. Upheld in *R v Director General for Telecommunications ex parte British Telecom plc* [1996] EWHC Admin 391.

¹⁰ For a review of the debates, see T. Prosser "Competition, Regulation and Public Service" in B.J. Rodger and A. MacCulloch *The UK Competition Act* (Oxford: Hart, 2000).

¹¹ **See Chapter X detail [editor to fill in]**

¹² Regulation 6, The Competition Act 1998 (Concurrency) Regulations 2004 SI 2004/1077.

upon notification all must agree which of them is to take the case forward, no action being allowed before this is done. Only the Authority with jurisdiction will apply CA98, although it is possible to transfer the case to another Authority at a later date. The criteria applied when deciding on the allocation of a case is who is 'better or best placed' to deal with it, with four considerations that help make this determination: the Authority's knowledge of the economic sector; whether the case affects more than one economic sector; any previous contacts between the parties and the Authority; and an Authority's recent experience with the undertakings or with similar issues.¹³ Any investigation to which criminal penalties might apply (e.g. into a cartel) will be taken by the OFT.¹⁴ The Department of Trade and Industry and HM Treasury report, *Concurrent Competition Powers in Sectoral Regulation*, noted that the process of allocating cases appeared to work well, indicating that the OFT would pass cases to the relevant regulator when it concerned that regulator's economic sector. However, no difficult case has yet arisen to test the effectiveness of the system of case allocation.¹⁵ It is worth bearing in mind that the six sector-specific Authorities are also national competition authorities for the purposes of EC competition law. Therefore, if a practice is one to which Articles 81 or 82 EC apply, then a second case allocation may take place to determine which Community competition authority is well placed to pursue the case.¹⁶

Coordination is also achieved through the Concurrency Working Party established in 1997 and designed to facilitate a consistent approach by the authorities in applying the CA98. It meets six times a year and is a forum to discuss how the cooperation arrangements function and matters of common interest, to share information, and to coordinate the application of competition law.¹⁷ With regard to the latter, the OFT, in conjunction with each Authority has published guidelines explaining how the provisions of CA98 and Articles 81 and 82 are to be applied in each sector.¹⁸ These are discussed further below, for now we merely highlight their importance in ensuring that there is a coordinated approach to the interpretation of competition law among the Authorities, which ensures a uniform application of the law for the most part, while taking into account the specific features of each sector.

2.2 Coordinating competition law and regulatory powers

A second issue that requires consideration is how an Authority chooses between applying competition law and its regulatory powers to address a given practice when both might apply. Three questions arise: first, how the authority should go about deciding whether to apply CA98 or its sector specific powers; second, if it chooses to apply CA98 whether it is able to use these powers to pursue regulatory goals; third, if there has been an intervention by the regulator whether this prevents a subsequent application of CA98.

¹³ OFT *Concurrent application to regulated industries* (OFT405) (2004) para 3.13.

¹⁴ URN 06/1244 *Concurrent Competition Powers in Sectoral Regulation* May 2006 para 2.3 fn 17 (Available at: <http://www.berr.gov.uk/files/file29454.pdf>). (Hereinafter, DTI/Treasury Report).

¹⁵ *ibid* para 3.2.

¹⁶ Commission Notice on Cooperation within the Network of Competition Authorities [2004] OJ C101/43.

¹⁷ Further information is available in OFT405 above n 13.

¹⁸ The OFT has sole power to issue soft law guidance, but it must consult the relevant regulatory authorities when the guidance applies to them. SS.38(7) and 51(4) Competition Act 1998.

The first two questions can be treated together. Consider a situation where there is a condition in a licence that is akin to a prohibition under competition law. For example, operators of gas distribution networks have a monopoly over the territory where they operate and a duty not to discriminate under the Gas Act 1986,¹⁹ but also a duty not to discriminate arising from competition law. If the practice in question does not affect trade between Member States (so that EC Law does not apply) then the Authority's duty is to apply competition law where it is more appropriate to proceed under CA98 than under sector-specific powers.²⁰ However, little guidance is offered to explain how this determination is to be made. If the practice in question affects trade between Member States, the matter affected by the requirements of Article 3 of Regulation 1/2003: if the Authority decides that it is more appropriate to use competition law it must apply EC competition law as well as national law and must avoid the application of stricter national law. Regarding the second question: when proceeding under CA98, the Authority should not have regard to the broader policy goals it has as regulator of the sector, but it may do so if the policy goal is one to which the OFT could have regard in exercising its powers under CA98, and all statutes give effect to this with provisions that are worded similarly.²¹ This is designed to ensure that competition law is not used in a regulatory manner. Similarly, if the proceedings involve EC competition law the Authority must ensure its approach is consistent with that set out by the competition acquis.²² Thus, non-competition considerations may be taken into account by the authorities only insofar as they may also be taken into account by the OFT, the Commission, or as determined by the relevant appellate courts.

According to the Court of Appeal, the rule forbidding the consideration of wider regulatory tasks in applying competition law 'serves to underline the separation between the competition law powers and the wider regulatory powers of the Authority.'²³ However, a complication arises because of Article 3(3) of Regulation 1/2003. This allows the application of national law which is stricter than EC competition law provided that the 'provisions of national law ... predominantly pursue an objective different from that pursued by Articles 81 and 82 of the Treaty.' The OFT suggests that on a case by case basis, the Authority will have to consider whether, in applying its regulatory powers, it may be considered to be applying competition law (e.g. when enforcing a non-discrimination obligation that falls foul of a licence condition but which may also be characterised as an abuse of dominance).²⁴ If so, then the Authority is forbidden from making reference to its broader policy objectives even when applying its regulatory powers. On the other hand, if the Authority is exercising its regulatory powers to pursue an objective that is different from competition law, then it is free to apply its powers without having regard to EC competition law.²⁵ The upshot is that even when the Authority chooses not to use its powers under CA98 or Articles 81 and 82, but relies on its sector specific powers, it may be deemed to be pursuing a competition law-related objective anyway, and so be limited in what steps it may take. This might apply to the

¹⁹ See s.9 Gas Act 1986, Condition 4 of the Gas Transporters Licence Standard Conditions.

²⁰ S.28(5) Gas Act 1986; OFT 405 above n 13, para 4.3.

²¹ S.371(11) and (12) Communications Act 2003; S.4B Gas Act 1986; S.2(6A) and (6B) Water Industry Act 1991; S.4(7A)(7B) Railways Act 1993; OFT 405 above n 12, para 4.1.

²² Article 3(1) Regulation 1/2003. With some exceptions provided in Articles 3(2) and (3).

²³ *Dwr Cymru Cyfyngedig v Albion Water Limited and Water Services Regulation Authority (formerly Director General of Water Services)* [2008] EWCA Civ 536 para 22.

²⁴ OFT 405 above n 13, para 4.4.

²⁵ OFT 405 above n 13, para 4.8.

non-discrimination obligation imposed on gas transporters, as section 9(2) of the Gas Act imposes a duty on it to ‘facilitate competition in the supply of gas.’ Enforcement of this duty might be seen as enforcement of a rule that pursues the same objective as Articles 81 and 82. However, this case by case approach has been criticised because Article 3(3) requires that one should look at the objective of the national legislation, and not its exercise in an individual case.²⁶ On this basis, every time the Authority chooses to enforce its sector specific powers, its actions are *de jure* not enforcement using competition law, but are taken having regard to the wider duties imposed on the regulator by statute.²⁷ That said, as will be illustrated below, there is no neat division between the Authorities’ competition law enforcement functions and their other regulatory duties since often these other duties must be pursued by promoting competition. From a broader policy perspective this suggests that the role played by regulatory authorities may require reconsideration in order to articulate more clearly the division between competition law and sector specific regulation.²⁸

As regards the third question, CA98 provides that the Chapter 1 and 2 prohibitions are excluded when the conduct in question is in compliance with a legal requirement.²⁹ For example, Vodafone’s agreements with its distributors fixing the retail price for pre-pay mobile phone vouchers would have constituted an infringement of the Chapter 1 prohibition but it was found that this practice was required by Vodafone’s licence, and therefore no action could be taken under CA98.³⁰ However there is no immunity if a regulator merely authorises a practice which may be anticompetitive, although the Competition Appeals Tribunal (CAT) has taken the view that the fine may be reduced if the regulator was aware of a possible infringement and appears to have encouraged the practice. We discuss this point further in section 5 below with reference to the *National Grid* case.

2.3 The role of the courts

Decisions by the Authorities may be appealed to the CAT whose task is to determine the appeal on the merits, and whose powers go beyond confirming or quashing the decision, but also extend to making any decision that the authority could have made.³¹ The CAT has interpreted the reference to an appeal ‘on the merits’ to mean that it has ‘full jurisdiction to find facts, make its own appraisals of economic issues, apply the law to those facts and appraisals, and determine the amount of any penalty.’³² These extensive powers are not exercised on every appeal but they show that the Tribunal is a considerable player not only in developing the law but in scrutinising the decisions of the authorities in detail. However, the Court of Appeal has placed certain limits on the Tribunal’s powers.

²⁶ E. O’Neill and E. Saunders *UK Competition Procedure* (Oxford: Oxford University Press, 2007) paras 3.29-3.31. Similarly, *ORR Competition Act Guideline: Application to Services Relating to Railways* (August 2005) paras 3.7-3.11.

²⁷ Section 4AA Gas Act 1986.

²⁸ T. Prosser, “Theorising Utility Regulation” (1999) 62 MLR 196.

²⁹ Paragraph 5(1) of Schedule 3 Competition Act 1998.

³⁰ Oftel ‘Complaint Submitted under the Competition Act 1998 by the Federation of Wholesale Distributors 5 April 2002’.

³¹ Paragraphs 3(1) and 3(3) of Schedule 8 Competition Act 1998. [**See chapter X detail, editor to insert**]

³² *Freeserve v Director General of Telecommunications* [2003] CAT 5, para 107.

In supervising the performance of the authorities, the CAT has demanded that Authorities provide greater detail in their decisions to reject complains.³³ Running slightly counter to this, it has been suggested that the Tribunal is eager to see Authorities resolve cases quickly, especially when the complainant is a small operator.³⁴ In one instance, having decided that the authority's rejection of a complaint was wrong, it required the authority (Ofcom) to reach a conclusion (either a finding of no infringement, or a decision to issue a statement of objections) within five months.³⁵ However, the Court of Appeal considered that the Tribunal had gone too far: while it was entitled to 'express its own view as to how urgently the case should be dealt with', it is not 'able to give directions to the regulator in relation to the conduct of the further investigation.'³⁶ This is helpful for Authorities as they are entitled to prioritise work as they see fit, taking into account the resources at their disposal (although a failure to re-investigate may be susceptible to judicial review).

In aiding the development of the law, the CAT in one case, in addition to dismissing an appeal against an Ofcom finding that there was no infringement of competition law, went on to set aside other parts of Ofcom's decision even when this was not necessary to determine the appeal. Thus Ofcom was worried that its success in front of the Tribunal would turn out to be a Pyrrhic victory as the parts of the decision that were set aside risked undermining Ofcom's policy in the relevant markets. Therefore it appealed against those parts of the CAT's judgment setting aside its decision even if that did not affect the outcome of the present dispute. The Court of Appeal hesitated in hearing an appeal of this nature because it should give priority to appeals of real significance to the parties, but in the end agreed with Ofcom's concerns and issued a general warning to Tribunals to desist from ruling on points that are unnecessary for deciding the appeal: '[d]eciding no more than is necessary may be described as an unimaginative, unadventurous, inactive, conservative or restrictive approach to the judicial function, but the lessons of practical experience are that unnecessary opinions and findings of courts are fraught with danger.'³⁷ The main danger is that the opinions may be wrong because the Tribunal did not have full representation on the issues, and may be damaging when relied upon by others.³⁸

3. Government Reports

Two reports have investigated concurrency and the relationship between competition law and sector-specific regulation. The DTI/Treasury *Report on concurrent competition powers in sectoral regulation* in 2006 and the House of Lords Select Committee on Regulators' report, *UK Economic Regulators* in 2007.³⁹ Three points

³³ E.g. *ibid.*, para 131 (requiring more detailed analysis of market definition) and 212 (criticising the lack of detail on the reasons for dismissing the predatory pricing complaint).

³⁴ R. Whish "Appeals to the Competition Appeal Tribunal under the Competition Act 1998 and the Enterprise Act 2002" in P. Vaas (ed) *Regulatory Review 2006/2007* (University of Bath, 2007).

³⁵ *Floe Telecom Limited (in liquidation) v Office of Communications* Order of the Tribunal 1 December 2004..

³⁶ *Office of Communications & Anor v Floe Telecom Ltd* [2006] EWCA Civ 768 para 35.

³⁷ *Office of Communications T-Mobile (UK) Ltd v Floe Telecom Ltd* [2009] EWCA Civ 47, para 20.

³⁸ On the merits, the Court of Appeal agreed with Ofcom that the Tribunal's interpretation of the relevant legal issues was incorrect and ordered that the portion of the CAT's order setting aside a part of Ofcom's decision should in turn be set aside.

³⁹ Above n 14; House of Lords, Select Committee on Regulators 1st Report of Session 2006–07 *UK Economic Regulators* (HL Paper 189-I) <http://www.publications.parliament.uk/pa/ld200607/ldselect/ldgrltrs/189/18902.htm>

emerge from these reports: the working of case allocation provisions; the use of CA98 by the Authorities, and the interaction between sector-specific regulation and CA98.

As noted in the section above, the DTI/Treasury considered that the processes for allocating cases had worked well; however it also encouraged further coordination measures, which the OFT and the Authorities have now implemented. The Select Committee echoed this sentiment, indicating that there appeared to be a good working relationship between the authorities and the OFT, while noting some instances where the regulated undertakings reported poor coordination among the OFT, Competition Commission, and the Authorities.⁴⁰

Regarding the use of CA98, the Select Committee was concerned that a sector regulator might not be ‘assiduous enough in investigating competition issues.’⁴¹ Two entrants in the water industry market (Albion Water and Aquavitae) and a consumer group (Energywatch) were not satisfied with the authorities’ responses to their complaints.⁴² The Committee was not specific as to why the Authorities might under-enforce CA98, although both it and the DTI/Treasury reported the views of some commentators that this might be a deliberate policy to avoid conflict with the industries they regulate,⁴³ and it recommended that complainants should be given the option of requesting the OFT to take the lead in investigating complaints. This is not a helpful suggestion because it risks harming the working relationship between OFT and the Authorities: the OFT taking a case is evidence that it does not trust the authority. What is needed instead is a better understanding of why CA98 might be under-utilised by some Authorities, a question we pursue below.

Regarding the relationship between competition law and regulatory powers, both reports subscribe to the well established view that regulatory powers are necessary to create the conditions for competition, but that economic regulation should recede in time, leaving the need to apply only competition law.⁴⁴ This is at odds with what is happening: the number of staff employed by Authorities had increased by 9.14% between the financial years 2004/05 and 2006/07;⁴⁵ and regulatory intervention is not abating. Nor is this view sustainable in light of the remaining natural monopoly segments of all utility networks, nor with the broader duties that have been imposed on regulators.⁴⁶ Furthermore, the statutes themselves do not foresee the end of sector specific regulation: while the Authority’s primary objective in the regulated sectors is ‘to protect the interests of consumers... wherever appropriate by promoting effective competition’,⁴⁷ this wording acknowledges that it may not always be appropriate to protect consumers by competition; nor does it assume that promoting competition will necessarily require the relaxation of regulatory controls, for instance imposing on a dominant firm the duty to share facilities

⁴⁰ UK Economic Regulators *ibid.*, paras 6.17-6.26

⁴¹ *Ibid.*, para 6.34, echoing the views of an earlier report Better Regulation Task Force ‘Economic Regulators’ (July 2001)

⁴² *Ibid.*, paras 6.34, 6.35

⁴³ DTI/Treasury above n 14, para 4.8.

⁴⁴ *Ibid.*, para 1.4.

⁴⁵ *Ibid.*, para 7.38.

⁴⁶ For a critique, see P. Larouche ‘A Closer Look at Some Assumptions Underlying EC Regulation of Electronic Communications’ (2002) 3 *Journal of Network Industries* 129.

⁴⁷ E.g. s.3(1)(b) Communications Act 2003, s.4AA(1) Gas Act 1986, s.2(2B) Water Industries Act 1991.

with competitors may protect consumers by enhancing competition, but if the dominant firm has a natural monopoly, continued regulatory intervention will be required to ensure the market remains competitive.⁴⁸

That said, the DTI/Treasury Report provides a reasoned argument in favour of greater reliance on competition law powers by suggesting that regulators are risk averse when they prefer to apply sector-specific regulation in that they feel more confident in applying these rules because companies prefer rule-based regulation. However, the DTI/Treasury suggest that if significant efforts were made to apply competition law (which may include decisions being lost on appeal to the CAT), this could create a valuable set of precedent that would guide Authorities and deter undertakings more effectively than the continued application of sector-specific rules. This suggests that a period of costly transition away from rule-based regulation to principle-based regulation is necessary before greater use can be made of CA98. Further, according to the DTI/Treasury, the costs outweigh the benefits: (1) rule-based regulation can have unanticipated anticompetitive effects; (2) rules may stifle the development of competitive pressures that would improve market outcomes; (3) compliance with general principles can be more flexible and stimulates innovation; (4) competition law sets a higher hurdle for intervention and prevents over regulation; (5) CA98 affords greater third party scrutiny of regulatory decisions; (6) competition law principles deter all anticompetitive conduct while rule-based regulations only prevent specific forms of conduct.⁴⁹ However, this might be too idealistic a scenario: first regulators have to pursue other public policy objectives than competition, second EU directives (e.g. in electronic communications) may require the imposition or regulatory remedies in certain circumstances (e.g. when an undertaking holds significant market power); third even in the most competitive of the regulated sectors (electronic communications) there is continued use of regulatory tools; fourth regulators might find they have better tools to tackle market failures through the use of regulatory powers.⁵⁰ Thus, a more realistic objective is to examine how to achieve the best mix between regulation and competition law.

Finally, it is worth noting the Select Committee's views about the success of deregulation: some sectors (electronic communications and energy) are more competitive than others (water, where 'competition had barely made an appearance at all'),⁵¹ with a mixed picture in airports and rail.⁵² This roughly tallies with the use of CA98: Ofcom and Ofgem have been significantly more active in considering the application of CA98, while the other regulators have lagged behind. It demonstrates that creating the conditions for competition also creates incentives for incumbents to defend their established position and the need for competition law enforcement.

4. Ofcom

4.1 The application of competition law by the regulator

⁴⁸ Contra DTI/Treasury above n 14, paras 2.24-2.27.

⁴⁹ Ibid., para 4.11

⁵⁰ On this point see Ofgem's response to the DTI/HMT Report (12 December 2006) (available at www.ofg.gov.uk)

⁵¹ Above n 39, para 7.6. Further analysis relating to the lack of competition in the water sector leads to the conclusion that Ofwat should apply the regulatory powers to improve competition (paras 7.16-7.23)

⁵² Ibid., paras 7.3-7.3

Of the utility regulators, Ofcom (and its predecessor Oftel)⁵³ has been the most active in applying CA98 (between 2004 and early 2007 it opened 200 inquiries, 60 of which could have been considered using competition law, and opened 10 CA98 investigations),⁵⁴ although it has yet to find an infringement. As may be expected, the bulk of its investigations have concerned exclusionary abuses, and the main target of complaints and investigations has been BT. On the whole, the approach taken by Ofcom in interpreting the concepts of dominance and abuse is in line with that of the OFT.

Procedurally, Ofcom is able to draw on previous work it has undertaken in the sector to help with defining markets and assessing dominance, which allows it to address these questions more efficiently than would a generalised competition authority, thus justifying giving sector regulators competition powers. That said, the CAT has imposed a requirement that, in cases where a non-infringement decision is reached, the authority has to indicate ‘at least briefly’ what the relevant markets are and whether or not any assumption of dominance has been made.⁵⁵ There is a risk that this lengthens proceedings in instances where there are no anticompetitive effects so that even outlining possible relevant markets seems superfluous.⁵⁶ It also runs against the CAT’s concerns about the length of time competition authorities take in resolving disputes, discussed above.

Ofcom has addressed a number of methodological questions arising from its investigations into price squeeze and predatory pricing claims. In predatory pricing cases, Ofcom’s view is that recovering losses post-predation is a relevant consideration, but this runs counter to the ECJ’s position;⁵⁷ it has also taken the view that an average variable cost floor is not suitable because of the high levels of capital costs involved in network industries and so it has used long run incremental cost (LRIC) as the floor below which pricing will be deemed predatory, which is in line with the Commission’s practice.⁵⁸ In price squeeze investigations Ofcom uses an ‘equally efficient operator’ test, considering ‘whether the dominant undertaking would be profitable in the downstream market if it had to pay the same input prices as its competitors.’⁵⁹ In one decision, it considered whether a ‘reasonably efficient entrant’ test should be applied but took the view that this might be a ‘more relevant test if there were an objective to promote competition under sectoral powers.’⁶⁰ This is consistent with the regulators’ duties not to use competition law in a regulatory manner.

⁵³ The functions of Oftel were transferred to Ofcom by the Communications Act 2003.

⁵⁴ Ofcom response to DTI/HMT Review on Concurrent Competition Powers in Sectoral Regulation (12 January 2007) (available at www.ofcom.gov.uk).

⁵⁵ *Freeserve* above n 33, para 131

⁵⁶ E.g. Oftel *BT 118500 directory enquiries number* (31 December 2003); Ofcom *Vodafone/O2/Orange/T-Mobile* (26 May 2004).

⁵⁷ OFT/OFTTEL *Application in the telecommunications sector* (OFT417) para 7.14 (note that these guidelines were published before 2003, so they may not represent current thinking). The ECJ has recently confirmed that recoupment is not an element that must be proven to establish predatory pricing: Case C-202/07 P *France Télécom v Commission* judgment of 2 April 2009.

⁵⁸ See OFT417 *ibid.*, para 7.15; e.g. Ofcom BT 0845 and 0870 retail price change (19 August 2004); Ofcom BT Wholesale Calls (16 June 2005).

⁵⁹ OFT 417 *ibid.*, para 7.26, and OFTEL *BT UK-SPN calls service* (22 May 2003); Ofcom *Vodafone/O2/Orange/T-Mobile* (26 May 2004).

⁶⁰ OFTEL *BT Openworld* (20 November 2003) paras 3.22 to 3.26.

Finally, a long-running dispute has led to discussion on whether an anticipated illegal use of a facility can justify a dominant undertaking's refusal to supply. The issue arose in 2003 when VIP complained about a termination of a 'GSM gateway service' by T-Mobile and Floe made a similar complaint with respect to Vodafone. In brief, both T-Mobile and Vodafone are dominant in the market for wholesale voice call termination on their network; their termination charges for calls that originate from a fixed handset are regulated, but remain high enough to spur the search for alternative, cheaper ways of calling mobile phones. The GSM gateway is a means of avoiding the termination charge whereby a call that originates from a fixed handset is made to appear like a call originating from the same network as that of the person receiving the call. When the calling party and the called party are on the same mobile network, termination charges are lower than in a fixed-to-mobile call. T-Mobile and Vodafone originally afforded VIP and Floe with access to their GSM gateways but this was later withdrawn. The Director General of Telecommunications (the Director) found that the use that VIP and Floe made of the gateway was unlawful and concluded that 'a dominant undertaking would be objectively justified in refusing to supply a customer where the products or services to be provided were to be used in an unlawful manner.'⁶¹ The CAT found that the analysis of the legality of the use of the GSM gateway by the Director was flawed. Therefore the issue of the defence did not require examination but the Tribunal addressed it, giving the following indications: 'where the relevant authorities have pronounced that an activity is illegal, competition law cannot and does not require the dominant undertaking to participate in the furtherance of an illegal act.'⁶² However, 'where there may be doubt as to the legality of an activity or where the relevant authority has announced that it is not for the time being taking enforcement action.... We do not consider that the dominant undertaking can necessarily rely... on its own interpretation of the illegality of the activity objectively to justify conduct that would otherwise be an abuse of a dominant position.'⁶³ This very restrictive approach is arguably in line with that of the CFI in *Hilti*,⁶⁴ but when Ofcom re-investigated the issue, and again came to the conclusion that the use of the GSM gateway is unlawful, it provided a more generous approach for justifying the refusal to supply. Its principal finding was that T-Mobile and Vodafone 'would potentially have been committing a criminal offence' by continuing to supply VIP and Floe. This triggered the application of paragraph 5(2) of Schedule 3 CA98 so that the refusal to supply was carried out 'in order to comply with a legal requirement', which in this case was the duty to desist from criminal conduct. The policy behind this conclusion was that '[i]t would defeat the purpose of the competition rules if they were to act to promote competition in a particular economic activity which is itself unlawful.'⁶⁵ If this approach was not accepted, Ofcom ruled, relying on *United Brands*, that 'a dominant undertaking is objectively justified in refusing to supply a customer if it does so as a means of protecting its legitimate commercial interests and [its actions] are reasonable and proportionate.'⁶⁶ In examining the legitimate commercial interests of T-Mobile and Vodafone, Ofcom said that had these firms supplied VIP and Floe

⁶¹ Ofcom *Vodafone re-investigation* (29 June 2005) para 38, Ofcom *T-Mobile re-investigation* (29 June 2005) para 35.

⁶² *Floe Telecom Ltd v Ofcom* [2004] CAT 18 Para 333

⁶³ *Ibid.*

⁶⁴ Case T-30/89 *Hilti v Commission* [1991] ECR II-1439, where the CFI held that the dominant undertaking could not refuse to supply goods when it feared there was a safety risk in their use by the undertaking requesting them. There were laws prohibiting the sale of dangerous products and enforcement bodies with powers to enforce these rules.

⁶⁵ *T-Mobile re-investigation* above n 61, para 194

⁶⁶ *Ibid.*, para 243, citing Case 27/76 *United Brands v Commission* [1978] ECR 207

respectively, they themselves ‘would have faced a genuine risk of committing a criminal offence’⁶⁷ and so were justified in wishing to avoid prosecution and the resulting commercial damage. The termination was proportionate and there was no need for the undertakings to refer the matter to the regulator because even without enforcement action, the activity in question remained unlawful and therefore it was legitimate to cease those illegal commercial transactions.⁶⁸ Ofcom’s broader defence is to be welcomed given the uncertainties that face regulated industries.

There has been little examination of whether dominant undertakings are exploiting their dominant position. Two decisions touched on this issue and offer useful insights. One was a complaint against BT regarding the wholesale access to DSL broadband products where purchasers complained that some contract terms were unreasonable and the levels of service poor.⁶⁹ Regarding the quality of service, it was noted that inefficiency could amount to an abuse but that there was insufficient evidence of an effect on competition or consumers. That said, it noted that BT had undertaken to improve this service by introducing Service Level Agreements and Service Level Guarantees, but it found that BT had been ‘cautious’ and ‘unambitious’ in this regard, and accordingly the Authority would monitor how BT reassessed its contractual relations.⁷⁰ A similar preference for self-regulation can be seen in an investigation into the prices charged for making calls to hospital patients was closed after Ofcom decided that a better way forward would be to encourage co-operation between the Department of Health and the service providers with a view to developing a new pricing structure.⁷¹ The solutions in these two cases are of interest because they show that beyond competition and regulation, a potentially fruitful enforcement strategy to ensure compliance with competition law is to encourage self-regulation. This is especially the case given the difficulties that competition authorities face when regulating excessive pricing or detailed contractual arrangements in high technology markets.

4.2 The interface between competition law and sector regulation

In relation to broadcasting markets, section 317(2) of the Communications Act 2003 stipulates that ‘[b]efore exercising any of their Broadcasting Act powers for a competition purpose, Ofcom must consider whether a more appropriate way of proceeding in relation to some or all of the matters in question would be under the Competition Act 1998.’ If Ofcom decide to use CA98 then they may not use the Broadcasting Act powers in relation to the same issue. Ofcom stated that it will follow the same approach in markets for electronic

⁶⁷ Ibid., para 245.

⁶⁸ Ibid., para 256.

⁶⁹ This complaint could be characterised both as an exploitative abuse (BT taking advantage of its dominance to harm firms downstream) or exclusionary (BT harming downstream rivals, since BT was also competing with the complainants on the retail market).

⁷⁰ *Oftel Complaint Submitted under the Competition Act 1998 by the XDSL Wholesale Products Industry Group* (January 2002) paras 23-26. In 2004 however, the market for wholesale broadband access was subjected to more detailed regulation under the Communications Act 2003 to ensure the development of competition (*Ofcom Review of the wholesale local access market* (16 December 2004)).

⁷¹ *Ofcom’s Investigations Programme: Report on activity between 1 October 2005 and 31 March 2006*, p.20; *Ofcom own-initiative investigation into the price of making telephone calls to hospital patients* (18 January 2006)

communications networks and services.⁷² The discretion it has cannot be fettered in advance and a case-by-case determination of which powers are more appropriate must be carried out.⁷³ However, in its decisions there is little substantive discussion to explain why CA98 is more appropriate.⁷⁴ Accordingly the only guidance on why Ofcom prefers CA98 is found in its public statements, and these identify a general policy of minimising the application of regulatory powers, and identify a number of advantages that obtain when applying CA98. For instance a now superseded document suggested that CA98 was more advantageous when tackling anticompetitive conduct because it afforded greater powers of investigation, effective powers to issue interim measures, the power to apply financial penalties, and it would ‘make it easier for operators to develop compliance systems and cultures by replicating successful examples from other sectors.’⁷⁵ In contrast, regulatory powers were best used residually when the authority had to fulfil its sector-specific duties.

While Ofcom is comfortable in applying CA98, there remains scope for applying regulatory powers. The major reason for this is that some forms of conduct are hard to pin down as abuses of dominance and the authority finds that sector specific rules are applied with more ease. Two examples illustrate this. One is broadband migration: Ofcom has introduced a new regulation requiring all broadband providers to follow a set of rules to ensure customers can switch easily from one provider to another. Switching costs had the effect of limiting competition, and reducing incentives for providers to ensure they provided customers with the best service. It would be tricky to handle this issue using competition law because each provider (whether dominant or a new entrant) would have an incentive to try and keep its subscribers, so the only way to tackle this would be to bring a case alleging all providers had abused a collective dominant position. However the law on this point is uncertain.⁷⁶ Furthermore, the regulatory approach allowed Ofcom to impose a more effective remedy to guarantee customers could switch.⁷⁷ The second example is the consultation on termination rates for calls to mobile phones. This entails the regulation of prices to a market where each mobile phone operator is dominant (because if A wants to call B on B’s mobile phone he cannot avoid having the call routed through B’s phone network) but Ofcom is reluctant to deregulate and merely enforce CA98 if charges are too high, for the following reasons: (1) competition law does not provide for ‘ready-made solutions’ to problems found in telecoms markets; (2) competition law provides less certainty for regulated players than do price controls; (3) competition law enforcement is not likely to cause an increase in competition in a market where there is no effective competition

⁷² Ofcom *Draft Enforcement Guidelines* (2006) para 10.09. Absent a final version, they ‘reflect how Ofcom now conducts its investigations, including our approach to prioritisation.’ *Ofcom’s Investigations Programme: Report on activity between 1 April and 30 September 2008*.

⁷³ This is in contrast with the view Oftel took in its *Competition Act Strategy* (2002) where it indicated that when considering behaviour that could contravene both CA98 and the sectoral regime, it would carry out an investigation under CA98 from the start.

⁷⁴ E.g. Oftel *Disconnection of Floe Telecom Ltd’s services by Vodafone Ltd* (3 November 2003) para 17; Ofcom *T-Mobile: disconnection of VIP Communications Limited’s services* (31 December 2003) para 15.

⁷⁵ Oftel *Competition Act Strategy* (2002).

⁷⁶ G. Monti “The Scope of Collective Dominance Under Article 82 EC” [2001] 38 CMLRev 131

⁷⁷ Ofcom *Enforcement Report* (12 May 2009) pp.16-18.

yet; (4) finally, deregulation would entail operators negotiating with each other and disagreements would have to be resolved by Ofcom.⁷⁸

These two examples illustrate the general point made by one commentator: ‘Ofcom may make claims to be a competition authority, with special expertise in telecommunications. In reality it is much more than that; it is a regulatory agency with powers to manage the market going way beyond those of a normal competition body.’⁷⁹

5. GEMA

5.1 The application of competition law by the regulator

Allegations of exclusionary abuse have formed the bulk of GEMA’s work, which is in line with its enforcement strategy.⁸⁰ Between 2000 and 2004 it received 44 complaints, but most were not followed up, mainly due to lack of evidence.⁸¹ In five cases that were investigated more fully, it found no infringement of the Chapter 2 prohibition, but in the one decision where it found an infringement (*National Grid*), it imposed a significant fine of £41.6 million, which was (at the time of writing) the second highest fine by a competition authority in the UK.⁸² To date, a combination of its decisions and the OFT’s guideline, *Application in the Energy Sector*,⁸³ indicate that there are some distinguishing features to the application of competition law in this sector, which we review first before turning to look more closely at the *National Grid* case and what lessons it holds for the application of competition law in regulated industries.

The guideline notes a number of instances where specific features of energy markets warrant distinct approaches. For example, when issues of market definition are under scrutiny, certain market features may require a modified approach: wholesale price movements may be greater than 5-10% (which is the usual benchmark for the hypothetical monopolist test) therefore an alternative approach may be required; and since electricity (and to some extent gas) cannot be stored easily there is the possibility of market power being present for brief periods, unlike other markets. In terms of dominance, a situation of inelastic supply and demand conditions (e.g. in wholesale markets) might indicate that a relatively small player may have sufficient market power to be found dominant below the normal thresholds.⁸⁴ These difficulties are exemplified by GEMA closing its CA98 investigation into Scottish Power and Scottish Southern Energy in the wholesale electricity market. The suspected abuse concerned a four week period during which the two firms held a dominant position because of transmission constraints between England and Scotland and when prices charged by these two firms were much greater than those charged by comparable generators. The Authority determined that the likelihood of finding an

⁷⁸ Ofcom *Wholesale mobile voice call termination: Preliminary consultation on future regulation* 20 May 2009, paras 6.89-6.94.

⁷⁹ E. Pitt ‘Competition Law in Telecommunications’ in I. Walden and J Angel (eds) *Telecommunications Law and Regulation* 2nd ed (Oxford: Oxford University Press, 2005) p.330

⁸⁰ OFT ‘Application in the Energy Sector’ 2005 (OFT 428) para 3.3 noting the need for particular vigilance towards incumbents.

⁸¹ ‘Complaints considered by Ofgem under the Competition Act 1998’. Unfortunately Ofgem has not made available any comparable data for later years.

⁸² GEMA *National Grid Competition Act Decision* 21 February 2008.

⁸³ OFT 428 above n 80.

⁸⁴ *Ibid.*, para 3.21. In these settings risks of exploitative abuse arise, para 3.25

infringement of CA98 was low and that a regulatory approach would be preferable to address this manifestation of market power.⁸⁵ A follow-on report on market power in the electricity wholesale sector indicated specific concerns about the appropriateness of CA98 as a tool to address possible abuses, in particular the complexity in applying the dominance test when market power is intermittent and limitations in addressing remedying exploitative abuses.⁸⁶

The *National Grid* decision concerned an abuse in the market for the provision and maintenance of domestic gas meters that took place as soon this market was opened to competition in 2004. All customers who are supplied with gas must receive it through a meter.⁸⁷ National Grid is the dominant meter operator and its business model was to retain ownership of the meters it made available to gas suppliers and an annual rental charge was used to recover the cost of supplying the meter. To facilitate competition the regulator decided to encourage gas suppliers to look for new meter operators by allowing them to replace National Grid meters at short notice without a penalty charge. Substantial entry would eliminate the rental income stream that National Grid anticipated, since the meters have little value once removed. As a result National Grid renegotiated the contracts with gas suppliers (beginning with its largest customer, British Gas) and two models were drawn up: (1) for meters installed before 2004 (legacy meters) the gas supplier would gradually reduce the number of meters it bought from National Grid and pay a charge if the number of meters rented fell below that which was agreed; (2) for meters installed after that date, there would also be a charge if meters were replaced prematurely. The regulator found that these contracts excluded competitors contrary to the Chapter 2 prohibition and Article 82 EC.

In relation to dominance, National Grid had high market shares in the market for gas meters (no distinction was drawn between legacy and new meters): 98% in 2002 and 89% in 2007. However the CAT expressed caution as to whether one might conclude there is dominance from such high market shares (as the case law of the ECJ suggests) because after the lifting of a statutory monopoly, even vigorous entry may not cause a substantial dent in the incumbent's market share, but 'such market entry may well mean that the incumbent has little effective market power and is destined to lose market share rapidly in future.'⁸⁸ Therefore in this kind of circumstance market shares raise no presumption of dominance. Nonetheless, the CAT confirmed dominance by finding high entry barriers and weak buyer power. One factor that dented buyer power was that both parties believed that the authority would be opposed to large scale switching of meters from National Grid to new entrants and this weakened the suppliers' hand while strengthening National Grid's bargaining position.⁸⁹ In considering whether the contracts were abusive the question asked was akin to that in other industries: whether the contracts went 'too far in protecting National Grid from the consequences of competition and whether the agreement's foreclosing effect is too severe to be justified by National Grid's desire to protect the revenue stream generated by its

⁸⁵ 'Ofgem closes Competition Act 1998 case against Scottish Power and Scottish Southern Energy' Information Note R/4 (19 January 2009)

⁸⁶ *Ofgem Market Power Concerns in the Electricity Wholesale Sector* (March 2009)

⁸⁷ Schedule 2B para 2, Gas Act 1986

⁸⁸ *National Grid v Gas and Electricity Market Authority* [2009] CAT 14, para 51

⁸⁹ *Ibid.*, para 70

meters.⁹⁰ The CAT agreed that these contracts were capable and did foreclose entry to the detriment of consumers, but disagreed with the Authority that the contracts stifled the roll out of so-called 'smart meters' (which transmit information about each customer's use directly to the supplier without requiring a personal visit as do contemporary meters) attributing this to other reasons, not least the role of government in managing what would be a major project.⁹¹

Perhaps the key issue for the application of competition law in regulated industries is found in the CAT's decision to reduce the fine from £41.6 million to £30 million because it found that the Authority had been closely involved in discussions about the new contracts, and although they did not provide formal approval, the CAT understood National Grid's 'surprise and dismay' by the decision and the fine.⁹² Two lessons can be drawn from this: first it appears that utilities regulators have an obligation, when opening new markets and when it is closely involved with the incumbent in discussing the latter's plans, to offer some assistance. The Tribunal noted:

'We are surprised that the Authority did not consider that it was part of its role either as an industry regulator or as a competition law enforcement agency to steer the industry participants away from making private arrangements which risked jeopardising the competitive process to a serious degree.'⁹³

However, the second lesson is that even if the regulator fails to do this, it does not provide the dominant firm with a complete defence, only a reduction in the fine. However these two findings appear to be in conflict with each other: surely if the regulator becomes involved and gives the impression of approving a scheme it later defines as abusive, the undertaking merits stronger protection.⁹⁴

5.2 The interface between competition law and sector-specific regulation

In common with other authorities, GEMA should consider applying CA98 first before using its powers under the energy legislation.⁹⁵ In a letter responding to the DTI/Treasury Report, it gave an insight into the six major factors that influence its choice between apply CA98 or regulatory powers: (1) the complainant's wishes; (2) the speed of intervention; (3) the efficiency with which a given enforcement route would address the issues; (4) the resource implications; (5) the deterrent effect; (6) the availability of damages. The Authority considered that while the choice would be made on a case by case basis, making these criteria public would 'promote consistency and a structured approach.'⁹⁶ These general criteria conflict with the government's desire to phase out regulation but instead suggest that on a case by case basis the authority determines the most effective enforcement strategy.

⁹⁰ Ibid., para 93

⁹¹ See now Department of Energy and Climate Change *A consultation for Smart metering for Electricity and Gas* (May 2009)

⁹² Above n 88 para 209

⁹³ Ibid., para 208

⁹⁴ See the arguments developed in G. Monti 'Managing the Intersection of Utilities Regulation and EC Competition Law' (2008) 4(2) *Competition Law Review* 123.

⁹⁵ Above n 80.

⁹⁶ Ofgem response to DTI/Treasury Report 12 December 2006 (available from www.ofg.gov.uk).

It seems that in addressing harm to final consumers GEMA has preferred to rely on its regulatory powers. At the time of writing, it is consulting on a series of proposals that are designed to further enhance the benefits that consumers may reap from competitive markets. Its strategy is to amend the suppliers' obligations in two ways: first by placing further controls on retailers to improve the information available to consumers and to make it easy for a consumer to switch from one energy provider to another.⁹⁷ These measures are designed to address two concerns: that a significant portion of consumers have yet to switch supplier, and that most people who switch do not find the cheapest supplier, indeed a significant number pay more after switching.⁹⁸ The second part of the strategy is to impose two licence conditions on suppliers to avoid discrimination: 'a requirement for any difference in the terms and conditions offered in respect of different payment methods to be cost reflective; and a prohibition (limited to three years) of undue discrimination in any terms and conditions offered to customers.'⁹⁹ The latter is of interest from a competition law perspective, because the concern it addresses is that the six energy suppliers tend to offer cheaper contracts in areas where they are new entrants and keep higher prices in those areas where they formerly held monopolies. Thus, price discrimination might be addressed under CA98 but given that the authority has identified an industry-wide practice it seemed more practical to address it by way of regulation. A further advantage of regulation is that the Authority has consulted widely on these proposals, whereas action under CA98 does not afford the same possibilities for participation. Nonetheless, one might question the wisdom of the proposal by reference to a well known judgment of the ECJ, *United Brands*,¹⁰⁰ which prohibited price discrimination by the dominant undertaking selling bananas in various EU countries. As one critic noted at the time, the upshot was that while before bananas were sold at lower prices in poorer countries and higher prices in wealthier ones, the judgment would lead to higher prices.¹⁰¹ Likewise in this case, banning price discrimination reduces the incentives to sell energy at low prices. Indeed, the Authority's study revealed that the impact of this measure on competition was 'ambiguous.'¹⁰² However, the study concluded that the impact on vulnerable consumers would be positive, and the Authority concluded by placing more weight on the protection of this group in recommending these measures. This is in line with the wider statutory duties that are imposed on it, and facilitates the achievement of objectives that cannot be obtained with competition law enforcement. Accordingly those that have criticised this policy option on grounds that it is anticompetitive have failed to consider the broader regulatory objectives that the authority is obliged to consider.¹⁰³

6. Ofwat

6.1 The application of competition law by the regulator

⁹⁷ Ofgem *Energy Supply Probe - proposed retail market remedies* (15 May 2009)

⁹⁸ House of Commons Business and Enterprise Committee Energy prices, fuel poverty and Ofgem Eleventh Report of Session 2007–08 (HC 293-I) pp.53-4.

⁹⁹ Ofgem *Addressing undue discrimination - final proposals* 15 April 2009, para 1.7

¹⁰⁰ Above n 66.

¹⁰¹ W. Bishop "Price Discrimination under Article 86: Political Economy in the European Court" (1981) 44 MLR 282

¹⁰² Above n 99 para 5.67

¹⁰³ 'Ofgem regulator resigns over 'anti-competitive' pricing proposals' *The Times* 13 June 2009; R. Milne 'Ofgem's attempt to end 'unfair pricing' could severely impede the competitive market' *Utility Weekly* 12 June 2009.

Ofwat is in charge of regulating a number of regional monopolies. Plans to increase contestability are under consideration but at present the agency plays a significant role in regulating the economic performance of 21 monopolies in England and Wales.¹⁰⁴

Once competition is stimulated however, the dominant incumbent will have incentives to thwart new entry. To date there have been two unsuccessful complaints (one by a water company accusing another of predatory pricing, one by a waste collector complaining that a water company was diverting such business to its waste collection subsidiary¹⁰⁵) and one finding of abuse: a price squeeze practiced by Dwr Cymru to damage Albion. Albion had secured a contract to supply one firm (Shotton) with water. Albion bought the water from Dwr Cymru who in turn obtained it from United Utilities. The dispute began when Albion sought to change its purchasing strategy: buying the water directly from United Utilities and paying Dwr Cymru for transporting the water through its network, a 'common carriage' agreement. Albion complained that the price that Dwr Cymru was offering to charge for this was so high that it made it unprofitable for Albion to resell the water to Shotton. The regulator ruled that there was no price squeeze but on appeal the CAT exercised its powers to carry out further investigations and ruled that there had been a price squeeze. The CAT was particularly concerned that Dwr Cymru's actions threatened the existence of the only new entrant in the market at that time, and was critical of the regulator's apparent reluctance to recognise the value of the new entrant's services to consumers and for competition.¹⁰⁶ The Court of Appeal confirmed both the finding of a price squeeze and the CAT's power to make a decision of abuse where it has the evidence that allows it to reach such a finding.¹⁰⁷ However, it remains to be seen how far this case sets a precedent for future disputes between new entrants and incumbents. We consider this in the following section.

6.2 The interface between competition law and sector-specific regulation

Since December 2005 the Water Industry Act 1991 (WIA91, as amended) provides for an access regime which gives new entrants a right to access an incumbent's infrastructure to deliver water services. If terms and conditions between the new supplier and the incumbent cannot be agreed, Ofwat is empowered to make a determination of what these terms and conditions should be.¹⁰⁸ The question to be explored is how far this affects the application of CA98. A convenient place to begin is the first price determination made by Ofwat under WIA91 in the dispute between Anglian Water Services and Aquavita. Aquavita complained about the access price offered by Anglian Water both under WIA91 and CA98. Ofwat took the view that it was more appropriate to apply WIA91 for the following reasons: WIA91 provided a bespoke approach to the dispute, it would allow for a speedier resolution (given that no questions of dominance and abuse would have to be assessed), Ofwat could decide a definitive access price, it would not be an efficient use of resources to proceed under CA98 as

¹⁰⁴ M. Cave *Independent Review of Competition and Innovation in Water Markets: Final Report* (April 2009).

¹⁰⁵ Ofwat *Thames Water Utilities Ltd/Bath House and Albion Yard* (30 March 2003); *Southern Water Services Limited: provision of new infrastructure in East Kent* (2 August 2004).

¹⁰⁶ See e.g. *Albion Water Ltd v Water Services Regulation Authority* [2006] CAT 23 paras 893-895

¹⁰⁷ For discussion of the CAT's analysis of price squeeze see F. Parker 'When is a Pipe not Just a Pipe?' [2005/2006] 4 Utilities Law review 151

¹⁰⁸ S.66 Water Industry Act 1991

well, and the regime in WIA91 was specifically designed to tackle the dispute at hand.¹⁰⁹ However, in making its determination under the statute Ofwat complained that the formula for calculating the access price was unsatisfactory because it did not allow the regulator to give access to competitors so that they were able to undercut the incumbent, and urged reform.¹¹⁰ Given this conclusion, should Ofwat not have considered applying CA98 and examined whether the access price offered by Anglian could have been characterised as an abuse of dominance? Then, unbound by the perceived defects in WIA91, Ofwat would have been able to tailor an effective remedy the introduced competition. According to the CAT in *Albion Water*, this route remained open because the WIA91 did not disapply the Chapter 2 prohibition.¹¹¹ However the Court of Appeal took the view that it was unlikely that CA98 would bite, because it is not applicable when the conduct in question is in compliance with a legal requirement, making reference to paragraph 5(2) of schedule 3 CA98.¹¹² Accordingly, once Ofwat determines the price, the dominant undertaking has no duty to offer a better price. If the CAT is right, it seems that there would be two routes to applying CA98: one would be private litigation, the other would be to try and force Ofwat to apply CA98, but this would seem to require Aquavita to challenge Ofwat's decision not to proceed under CA98, and this might be difficult to achieve given the discretion the Ofwat has and the reasons it has provided seem reasonable. If the Court of Appeal is right and the undertaking is immune from CA98, one commentator has suggested an interesting alternative means by which to challenge Ofwat's finding, based on Article 86(1) EC. This provides that in relation to holders of special or exclusive rights, a member State may not enact or maintain in force any measure contrary to EC competition law. An undertaking such as Anglian has a special right to supply water, and if the application of WIA91 leads to it retaining its dominance, it may be that Ofwat is in breach of Article 86(1) read jointly with Article 82. To avoid this result, Ofwat may be required to interpret WIA91 in a manner that is compliant with competition law, lest it be found in breach of EC Law and potentially subject to damages claims by injured parties.¹¹³ These legal difficulties suggest more attention must be paid to devising a clearer relationship between CA98 and utilities regulation.

Given the absence of competition, consumers' economic interests must be safeguarded by regulation: pricing for instance is regulated at regular intervals, and other aspects of each firm's performance are regulated by the Guaranteed Standards Scheme Regulations (GSS Regulations),¹¹⁴ which include requirements that firms respond promptly to complaints and queries from customers, give notice about interruptions of supply, maintain a minimum amount of water pressure, and make payments to customers when in breach of any service standard. Failure to achieve these standards could also constitute exploitative abuses, prohibited by s.18 CA98. The overlap between the application of regulatory powers and CA98 is managed by in section 22A(13) WIA91 (as amended by the s.48 of the Water Act 2003):

¹⁰⁹ Ofwat *Final determination by the Water Services Regulation Authority determining terms for wholesale access prices offered by Anglian Water Services Ltd to Aquavita (UK) to four customers* (28 March 2008) para 4.6

¹¹⁰ Ofwat 'Case highlights the need for change water competition rules' Press release PN08/08 (28 March 2008)

¹¹¹ *Albion Water* above n 106, para 978

¹¹² *Dwr Cymru* above n 23, para 23

¹¹³ F. Parker 'Applying the Cost Principle: Ofwat's First Wholesale Access Price Determination' [2006/2007] 16 *Utilities Law Review* 214, 216.

¹¹⁴ The current version is: Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008, SI 2008 No. 594, with effect from 1 April 2008.

An enforcement authority shall not impose a penalty under this section where it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998.

Prima facie it is not clear what might make CA98 more appropriate when the allegation is a breach of a service standard as the level of monetary fine is likely to be identical (no penalty may exceed 10% of the company's turnover under both statutes):¹¹⁵ when calculating the fine imposed on Severn Trent Water Ofwat relied in part on the fining policy of the OFT and even the EC Commission in competition cases. In this decision, as in others, there is but a perfunctory statement explaining why the penalty was not imposed under CA98: that the infringement is a breach of the GSS Regulations, therefore CA98 is inappropriate.¹¹⁶ This is unsatisfactory because the reason s.22 penalties are under consideration is precisely because there has been a failure of regulatory standards, and in this context WIA91 demands that consideration should be given to applying CA98 in lieu. There is a pragmatic reason why Ofwat prefers to fine a company under WIA91: the basis of the infringement in Thames Water was in fact over 11,000 separate infringements (including missed appointments, interruptions of water supply, and failures to deal with sewers). In an action under CA98, Ofwat would have to explain why each of these failures constituted abuse, and while it is well established that sloth is an abuse of dominance the precise parameters of exploitative abuse are not well determined. But expediency is not the same as appropriateness. It may be that action under CA98 would be most appropriate when Ofwat takes the view that consumers should have a right to seek damages for pecuniary and non-pecuniary losses suffered. On the other hand, consumers' interests may be better served by applying sector specific rules as in some cases (e.g. Thames Water) the firm undertook to make missed payments.¹¹⁷ Earlier, voluntary payment of a lower sum is preferable to later, court ordered payment of a higher sum. So possibility of compensation afforded by CA98 does not make a compelling case why action should be taken under that statute. The best reason to explain why applying WIA91 is more appropriate than CA98 is that Ofwat is testing a firm's compliance with industry standards, and its decision offers guidance to all regulated firms on how to comply with these standards, while a determination that failures amount to an abuse of dominance is not as helpful an interpretation of the relevant regulatory obligations. Thus, ensuring adequate behaviour by all regulated firms is best served by enforcement of sector-specific rules. Accordingly, as with the broad guidelines suggested by Ofgem, it appears appropriate that an Authority should weigh up the relative merits of applying competition law and regulation in an explicit manner to provide clear guidance on what action it considers to be best suited for different types of case.

7. Conclusion

This survey of the application of CA98 by regulators reveals a paradox: while considerable effort has been made to ensure that concurrency does not lead to inconsistency and duplication, there has been relatively little application of CA98 by the Authorities. There is no evidence that this is the result of regulatory capture, as revealed by frequent interventions by the Authorities using sector specific powers. Perhaps the DTI/Treasury's suggestion that the preference for regulation is caused by path dependence, with Authorities unwilling to

¹¹⁵ S.22A(11) WIA 1991 (as amended).

¹¹⁶ Notice of Ofwat's imposition of a penalty on Thames Water Utilities Limited (16 April 2008), Annex 1, page 54.

¹¹⁷ *Ibid.*, para 51

experiment with CA98 when they feel comfortable using regulatory powers, is accurate. On the other hand, it may be argued that the kinds of cases that Authorities should be considering under CA98 (exclusionary abuses by incumbents) are very difficult ones and even general competition authorities are slow to bring these cases, for both practical reasons (the significant amount of evidence and expert economic analysis required, the likelihood of a successful appeal by the defendant, and as noted above in the review of Ofcom and GEMA's practice, specific market conditions require a slightly different approach to applying competition law concepts, making enforcement more demanding), and also because the line between lawful and unlawful exclusion is so blurred that there is a fear they will over-enforce competition law and thus harm competition in the long run. Furthermore, as evidenced in Ofwat's approach, it seems reasonable to favour the application of sector-specific rules when these appear to be tailor made to tackle the dispute.

When CA98 has been applied, the resolution of the dispute had often hinged on the relevant regulatory framework: in *Floe*, the regulatory scheme rendering the use of GSM gateways unlawful was the basis on which Ofcom considered there would be a defence to any abuse, in *National Grid* the fine was reduced when it was found that the regulator had been aware of the defendant's plans, and in *Albion Water* subsequent regulation in the sector meant that future price squeeze cases would likely be controlled by means other than CA98. Furthermore, in many instances when CA98 has not been applied and sector specific regulation has been used instead, it might have been possible to intervene with competition law: in regulating the price of gas, in monitoring the performance of water supply companies, and in regulating mobile termination rates and migration to other internet service providers. All these matters can fall within the scope of the Chapter 2 prohibition but in each case there was good reason not to apply CA98: the pursuit of non-competition objectives in the gas sector and the practical benefits of using regulatory powers in the water and telecoms sector. Taken cumulatively, these examples suggest that more is required to explain the relationship between competition law and regulation so that an appropriate enforcement mix is achieved. This task must start by denying the government's view that regulation must give way to competition law, and this can be achieved by establishing a legitimate space for sector specific regulation and for competition law. Harlow and Rawlings suggest five models of regulatory legitimacy, which some take to operate cumulatively.¹¹⁸ The first source of legitimacy is the presence of a legislative mandate: while competition law has a single mandate, sector regulation embodies a wider range of potentially conflicting goals, and the risk is that 'the more discretion there is the less a statutory mandate can be used to justify actions and policies.'¹¹⁹ On the other hand, it is has been argued that it is precisely the nature of public law to require decisions based on multiple factors, and the task of public lawyers to develop approaches that help the decision-makers do so in ways that are not arbitrary.¹²⁰ Second, expertise legitimates action: here both OFT and sector regulators score highly. Third, the efficiency and effectiveness of the regulator can be used to legitimise its activity, although this is a difficult, if not impossible attribute to measure. For instance, the mere fact that the authorities do not enforce competition law significantly is not necessarily a measure of their ineffectiveness, but may be because firms comply or because there are better regulatory tools to address market

¹¹⁸ C. Harlow and R. Rawlings *Law and Administration* 2nd ed (London: Butterworths, 1997) pp.309-315.

¹¹⁹ *Ibid* p.310.

¹²⁰ T. Prosser, "Privatization, Public Ownership and Public Services" (1994) 1 *Juridical Review* 3

failures. Fourth is oversight and here competition law scores more highly because the process of judicial oversight is much more intensive thanks to the CAT's role, while judicial review of regulatory decisions is less thorough. A final model of legitimacy is the presence of fair administrative procedures. Here both score highly: competition law enforcement can be triggered by complaints, however the final decision is that of the authority, while regulators consult widely also at the stage of imposing remedies. In sum, while taken cumulatively it may be argued that competition law enforcement benefits from greater legitimacy, there are sufficient indicators that render regulatory intervention equally legitimate.

Having established the legitimacy of both forms of intervention, three conclusions follow: first that a regulator should be free to select between using competition law and regulation, but that a coherent policy mix must be designed. Here the framework suggested by Ofgem discussed in section 5.2 above marks a helpful starting point, and it is also echoed by the Office Rail Regulation whose overriding principle in determining whether to use CA98 or regulation is 'to use the most effective, efficient and expeditious solution.'¹²¹ While it may be overly ambitious to design a detailed scheme to explain when CA98 will be used and when regulation will apply, the Concurrence Working Party seems an ideal forum for the discussion and publication of a framework to explore criteria to determine the relative merits of competition law and regulation. The difficulties noted in section 6.2 regarding what rules to apply to fix access prices to new entrants in the water sector shows that this is not an easy task, but that it is a necessary one. Second, that an Authority using its regulatory powers is free to reach decisions that are based on non-competition considerations set out in the statutes even at the expense of creating more competitive markets. This is not affected by EC Law: while Community Law imposes an obligation on a Member State to disapply national law when this authorises or facilitates an infringement of EC competition law,¹²² the Court has also recognised that restrictions of competition may be justified.¹²³ The regulator's legitimacy cannot be challenged merely because it avoids a pro-competitive solution, but only when it fails to offer good reasons based on public policy to restrict competition. Third, undertakings subject to sector specific regulation need more certainty as to the application of CA98 when there has been regulatory intervention. It seems that regulated undertakings merit protection from the application of CA98 not only when national law requires them to act in anticompetitive ways (as CA98 provides) but also when regulation makes the undertaking's conduct reasonable. This can be supported from Ofcom's analysis in *Floe*, which suggested an objective justification arose when the dominant firm's refusal to deal stemmed from its perception of a risk that dealing with the rival would be a criminal offence. One might consider whether the same result should obtain when the undertaking places reasonable reliance on the regulator, as did the defendants in the *National Grid* decision: merely reducing the fine may not be sufficient to reflect the undertaking's reliance placed on the Authority, even in the absence of a formal decision.

¹²¹ *ORR Competition Act Guideline: Application to Services Relating to Railways* (August 2005) Para 3.23.

¹²² Case C-198/01 *Consorzio Industrie Fiammiferi v Autorità Garante della Concorrenza e del Mercato* [2003] ECR I-8055.

¹²³ Case C-309/99 *Wouters v Algemene Raad van de Nederlandse Orde van Advocaten* [2002] ECR I-1577.