

19 September 2017

Decision to launch reviews of five water merger remedies

Introduction

1. The Competition and Markets Authority (CMA) committed in its Annual Plan in 2015/16 to commence a programme of work to review its existing remedies systematically to seek to remove measures that are no longer necessary. In 2016/17 the CMA has continued work in this area, and in its 2017/18 Annual Plan it committed to continue this work, launching further reviews either on its own initiative or in response to submissions from affected parties. As part of this ongoing commitment, the CMA is now launching reviews of five merger remedies originally put in place between 1990 and 2007 and which involved regulated water companies in England and Wales.

Jurisdiction

2. The CMA has a statutory duty, under Schedule 24 to the Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013, to keep under review undertakings and orders. From time to time, the CMA must consider whether, by reason of any change of circumstances:
 - (a) undertakings are no longer appropriate and need to be varied, superseded or released; or
 - (b) an order is no longer appropriate and needs to be varied or revoked.
3. The CMA carries out assessments of mergers concerning the water sector under a separate regime to other mergers across the rest of the UK. At present, these transactions are examined under the Water Act 2014, where the CMA's role requires it to consider whether the merger has or is likely to prejudice Ofwat's ability to make comparisons of costs and service standards between water enterprises. The CMA is the sole decision maker in phase 2 water merger cases and works closely with Ofwat.¹

¹ The [CMA's guidance on water mergers can be found here](#), while [Ofwat's guidance on its role in these investigations can be found here](#). Paragraph 1.2 of Ofwat's guidance covers details of its role in water mergers.

Remedies to be reviewed

4. The CMA has decided to launch reviews of the following 5 merger remedies in the water sector:
 - (a) **General Utilities plc/The Mid Kent Water Company, 1990:** The undertakings given to the Secretary of State by General Utilities plc dated 21 March 1991.
 - (b) **Lyonnaise des Eaux SA/Northumbrian Water Group plc:** The undertakings given to the Secretary of State by Lyonnaise Europe plc dated 23 April 1996.
 - (c) **General Utilities plc and SAUR Water Services plc/Mid Kent Holdings plc:** The undertakings given to the Secretary of State by General Utilities plc dated 21 April 1998 and SAUR Water Services plc dated 8 May 1998.
 - (d) **Vivendi Water UK plc/First Aqua (JVCo) Ltd, 2002:** The undertakings given to the Secretary of State by Vivendi Water UK plc and Southern Water Capital Limited 23 April 2003.
 - (e) **South East Water Ltd/Mid Kent Water Ltd:** The undertakings given by Utilities Trust of Australia and Hastings Diversified Utilities Fund, and by South East Water Ltd and Mid Kent Water Ltd, on 29 November 2007.
5. These 5 cases were selected from a total of 7 water merger remedies that are over or around 10 years old. The remaining 2 cases concerned mergers between water and sewerage companies. The Severn Trent Water Ltd/South West Water plc (1996) undertakings were the subject of a review in 2015 and were retained due to the lack of a relevant change of circumstances, while the other case, Wessex Water/South West Water (1996) has similarities with Severn Trent Water Ltd/South West Water plc, and therefore has not been selected for review, given the similarly low expectation of finding a relevant change of circumstances in this case.
6. The CMA considers there to be a realistic prospect of finding a change in circumstances relevant to the undertakings in each of these five cases. The changes that the CMA has identified include the following:

General Utilities plc/The Mid Kent Water Company, 1990

Original investigation and undertakings

7. In 1990 the Monopolies and Mergers Commission (MMC) investigated the transaction, finding that General Utilities plc had acquired the ability to

materially influence the policy of the Mid Kent Water Company. The MMC concluded that the transaction prejudiced the ability of the Director General of Water Services to make comparisons between different water enterprises.

8. On 21 March 1991, General Utilities plc gave undertakings to the then Secretary of State for Trade and Industry to reduce its holdings to not more than 19.5% of the voting share capital and not to make arrangements that might result in holdings by associated persons to take its shareholding over that level. On 30 June 1992, General Utilities plc reduced its holding in compliance with this obligation.

Changes identified

9. The CMA notes that the Mid Kent Water Company and the associated water company Mid Kent Holdings plc was bought by South East Water in 2007 and the two water companies are now fully integrated.
10. The CMA considers that this structure of ownership means that the concerns that arose from the 1990 investigation may not be relevant now, as the original target company, the Mid Kent Water Company, is now integrated as part of a larger water company and is no longer a distinct business. In this review, the CMA expects to focus on the nature of the corporate changes since the original transaction and the relevance of the undertakings to the current market structure.

Lyonnaise des Eaux SA/Northumbrian Water Group plc, 1995

Original investigation and undertakings

11. The MMC investigated this merger between a water and sewerage company (Northumbrian Water Group plc) and a water-only company North East Water plc, owned by Lyonnaise des Eaux SA. The MMC found the transaction to be against the public interest, but allowed it to proceed subject to behavioural undertakings being obtained.
12. The MMC recommended that the merged entity should be required to maintain or exceed the existing levels of customer service and deliver substantial price reductions. The negotiation of these price reductions was left to the Director General for Water Services.
13. The undertakings agreed specific revenue adjustments until 2002, provided for a price cap for North East Water customers until 1 April 2000, and provided service standard undertakings.

Changes identified

14. The CMA notes that most of the obligations in the undertakings appear to be time-limited and have now expired and the CMA intends to consider whether the remaining undertakings have any residual value.
15. Following the investigation and agreement of the undertakings, Lyonnaise des Eaux SA completed the acquisition, with Northumbrian Water being combined with North East Water into Northumbrian Water Limited (the largest subsidiary of Northumbrian Water Group plc). In 2003, Suez, a company that had acquired Lyonnaise des Eaux, sold 75% of Northumbrian Water Group to a consortium of private investors.²
16. The CMA's review of these undertakings expects to focus primarily on whether these undertakings have become time expired, and where relevant, also on the significance of these ownership changes in the control of the relevant businesses.

General Utilities plc and SAUR Water Services plc/Mid Kent Holdings plc, 1997

Original investigation and undertakings

17. The transaction was a joint venture between General Utilities plc and SAUR Water services plc seeking to obtain Mid Kent Holdings. Concerns arose from the transaction as General Utilities plc owned Folkestone and Dover Water company, while SAUR owned Southern Water, and Mid Kent Holdings owned the Mid Kent Water Company, with these three water companies being in adjoining areas of the UK.
18. The MMC concluded that the merger should be prohibited because of the loss of an important comparator. The Mid Kent Water Company was one of only 5 remaining independent water only companies of a size that the Director General of Water Services found useful for comparative purposes.
19. The undertakings agreed by General Utilities plc in 1998 covered the requirement not to give effect to any arrangement with SAUR Water Services plc with respect to Mid Kent Holdings plc or any of its subsidiaries that would give rise to a compulsory reference to the MMC from the relevant water merger legislation in operation at the time. SAUR Water Services plc agreed similar undertakings in 1997.

² The company was listed on the London Stock Exchange in September 2003.

Changes identified

20. The CMA notes that Mid Kent Holdings and the associated water company, the Mid Kent Water Company, were bought by South East Water in 2007 and the two water companies are now fully integrated.
21. General Utilities plc, more recently Vivendi Water UK plc, was part of Compagnie Générale des Eaux. In 2003 it changed its name to Veolia Water UK Limited. The UK water companies branded as Veolia Water were sold on 28 June 2012 to Rift Acquisitions.³ Veolia Environment retained a 10% stake in the new business, Affinity Water, and this stake was sold in May 2017.
22. The target company from the transaction, Mid Kent Holdings, is now integrated as part of a larger water company and is no longer a distinct business (as noted in paragraph 9 and due to the transaction discussed in paragraphs 30 to 32), and the CMA notes that there have been several other changes to this sector since the time of the original investigation. Consequently, the CMA considers that the concerns which arose in considering the original transaction may no longer be relevant to the current market conditions.
23. The CMA expects the review of these undertakings to focus on the changes in corporate ownership and the implications of these for the structure of the market and the ongoing relevance of the undertakings.

Vivendi Water UK plc/First Aqua (JVCo) Limited, 2002

Original investigation and undertakings

24. Vivendi Water UK Ltd, (previously General Utilities plc) had an interest in four water-only companies, while First Aqua Limited owned Southern Water Services Limited, a water and sewerage company. Following investigation by the Competition Commission (CC), it concluded that the merger should be allowed subject to the divestment of Vivendi's 31.4% interest in South Staffordshire Water. The Competition Minister ruled that this remedy was not appropriate. Vivendi subsequently joined forces with the Royal Bank of Scotland in re-structuring the transaction.
25. In the revised form, Vivendi would acquire a 19.9% interest in Southern Water Services Limited through a holding company, Southern Water Investments

³ An entity established by Morgan Stanley and M&G Investments.

Limited. The Royal Bank of Scotland would initially own the remaining 80.1% through a second holding company, Southern Water Capital Limited.

26. In 2003, Vivendi agreed a set of undertakings concerning limitations of its voting rights, and ability to appoint directors in Southern Water Services Limited and other companies within the holding company group, as well as a limitation in the interest in Southern Water Services Limited which was not to exceed 25%. Southern Water Capital Ltd also gave undertakings concerning its role in the transaction.

Changes identified

27. Vivendi Water UK was part of Compagnie Générale des Eaux.
28. In 2003 it changed its name to Veolia Water UK Limited. The UK water companies branded as Veolia Water were sold on 28 June 2012 to Rift Acquisitions.⁴ Veolia Environment retained a 10% stake in the new business, Affinity Water, and this stake was sold in May 2017.
29. The CMA expects to focus in this review on the changes in ownership and the implications of these for the relevance of the undertakings to the current market.

South East Water Ltd/Mid Kent Water Ltd, 2007

Original investigation and undertakings

30. The transaction concerned the owners of Mid Kent Water Ltd, Hastings Diversified Utilities Fund and Utilities Trust of Australia, seeking to purchase South East Water Ltd. The intention was to merge the two water-only companies and the parties claimed this would deliver benefits that could not be realised absent the integration.
31. The CC found the merger likely to have an adverse impact on Ofwat's ability to make comparisons between water companies. The CC had regard to the customer benefits it found in the investigation in mitigating the adverse effects that it found. The CC concluded that a price reduction would be effective in mitigating the adverse effects of the merger and was the most reasonable and proportionate remedy in the circumstances. The undertakings took the following form:

⁴ An entity established by Morgan Stanley and M&G Investments.

- (a) a price reduction should be given by a one-off lump sum transfer from Mid Kent Water Ltd and South East Water Ltd to their customers through bills for 2008/09;
- (b) the price reduction should have a total value of £4 million distributed equitably across all customers of Mid Kent Water Ltd and South East Water Ltd; and
- (c) the price reduction should be accompanied by a requirement for Mid Kent Water Ltd and South East Water Ltd to accept a price determination in the Price Review 2009 that reflects £3.1 million annual operating expenditure savings.

Changes identified

- 32. The CMA expects to focus in this review on determining whether these undertakings have time expired.

Liaison with Ofwat

- 33. The CMA intends to liaise with Ofwat during these reviews to seek its views and evidence relevant to these undertakings and changes in the regulated water sector.

Assessment against the CMA's prioritisation principles

- 34. To make best use of its resources, the CMA needs to ensure that it makes appropriate decisions about which projects and programmes of work are undertaken across all areas of responsibility. The CMA has assessed the information available in relation to its current merger remedies that concern the regulated water sector and selected the above remedies for review based on the reasoning set out above and the assessment of these reviews against its published prioritisation principles⁵ as discussed below.

Impact

- 35. Concerning the impact of reviewing these merger remedies in the water sector, the removal of remedies that are no longer appropriate allows the CMA to focus its resources on monitoring and enforcing remedies that continue to generate benefit for consumers and the UK economy. Moreover, the CMA expects its wider programme of remedy reviews to deliver reductions

⁵ The CMA's [prioritisation principles](#) can be found on its website.

in regulatory burdens generating indirect benefits for consumer welfare from the release of remedies that are no longer necessary.

Strategic significance

36. The CMA considers these merger remedy reviews concerning the water sector represent a strategic priority, as this work not only reflects the CMA's statutory duty to keep under review orders and undertakings, but also the CMA's published priorities in the current financial year to continue its systematic work to review its existing remedies to identify those that are no longer needed. The CMA also notes that this work arose out of an Annual Plan commitment in 2016/17 to carry out internal work on remedies in the regulated sectors.

Risk

37. In relation to risk, the CMA notes that the remedies being considered vary in age from nine to 26 years old, with four of the five remedies being over 14 years old. Given the age of these older remedies, there is a significant likelihood that at least some of them may no longer be appropriate given the market and other developments that have taken place in the intervening years. In relation to the youngest undertakings from November 2007, we consider the risk of failing to find a change of circumstances in this case to be limited, given the time-limited nature of the undertakings. Consequently, the CMA considers there to be a realistic prospect of finding a relevant change of circumstances in relation to each of the five reviews selected.

Resources

38. Regarding the resources involved in these reviews, the CMA considers that conducting a package of five merger remedy reviews concerning the water sector represents an appropriate use of our limited resources, given the synergies from performing legal and economic analysis of five remedies in the same sector, and where several remedies have overlapping parties involved. The CMA considers that these reviews will involve a modest commitment of resource, consistent with the commitment in the 2017/18 Annual Plan to continue work in this area and the CMA's broader priorities.

Decision to launch reviews

39. The CMA has reached a decision to launch reviews of the remedies arising from the five transactions described above. In reaching this decision, the CMA has obtained sufficient evidence to have established a realistic prospect of

finding a change of circumstances in each of the remedies to be reviewed. Moreover, the CMA has assessed the reviews of these remedies against its published prioritisation principles and found their launch to be consistent with the principles.

40. Given the age of the remedies and the relatively straight-forward nature of the potential changes in circumstance identified, and to ensure its resources are used most effectively, the CMA has decided, in these cases, to proceed directly to carrying out these reviews without issuing an invitation to comment on whether to carry out these reviews.

Stakeholder views

41. The CMA is seeking views from interested parties as to whether there is a case for removing or varying any of these undertakings.
42. Those responding should provide their views, supported with relevant evidence where possible, in writing to the CMA either by email or by post as set out below.

Peter Hill
Competition and Markets Authority
Victoria House (6th floor)
37 Southampton Row
London WC1B 4AD

remedies.reviews@cma.gsi.gov.uk

43. Responses should be received by the CMA by **5pm on 9 October 2017**.