



*Emerging Competition Issues in Regulated  
Network Industries: Alliances, Consortia and  
other Quasi-Mergers*

**Water and Sanitation: UK experience**

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# Emerging competition issues in water and sanitation – role of mergers and alliances

- **Assess the importance of mergers and alliances in UK industry**
  - Past 20 years – impact on regulation
  - Next 20 years – impact on liberalisation
- **Different ownership models**
  - England – private ownership – focus on capital market competition
  - Wales – not-for-profit corporation – procurement of services
  - Scotland and Northern Ireland – public procurement of investment projects

# UK industry (I)

- 12 companies in UK providing sewerage services
  - 9 companies in England plus Dŵr Cymru are regulated by Ofwat
  - Scottish Water regulated by WICS
  - Northern Ireland Water regulated by NIAUR
- Only change since 1990 has been the merger of 3 Scottish companies to form Scottish Water



## UK industry (II)

- 26 companies in UK providing sewerage services
  - 10 sewerage companies in England and Wales also provide water
  - 14 water only companies in England
  - Scottish Water and Northern Ireland Water



# Changes in ownership structure since 1989

- **England and Wales companies privatised and regulated in 1989**
- **Period of consolidation – 1990-1999**
  - Mergers of water only companies – number reduced from 29 to 16
  - Acquisitions by French water groups
  - Two attempted mergers of sewerage companies were blocked
- **Period of financial restructuring – 2000-**
  - Dwr Cymru became not-for-profit entity
  - Move to highly geared (c.80%) equity models
  - Emergence of private equity ownership
  - Further consolidation of water only companies

# Summary of current ownership

## ○ Current ownership structure

- 2 public sector companies (Scottish Water and Northern Ireland Water)
- 1 not-for-profit corporation (Dwr Cymru)
- 5 quoted companies (where the regulated utility forms a large part of the quoted holding company)
- 7 wholly owned subsidiaries (incl. 3 owned by Veolia, 1 by Agbar, 1 by Cascad)
- 8 owned by private equity investors

## ○ Approach to mergers has been governed by need to retain system of comparative competition

# Mergers and comparative competition

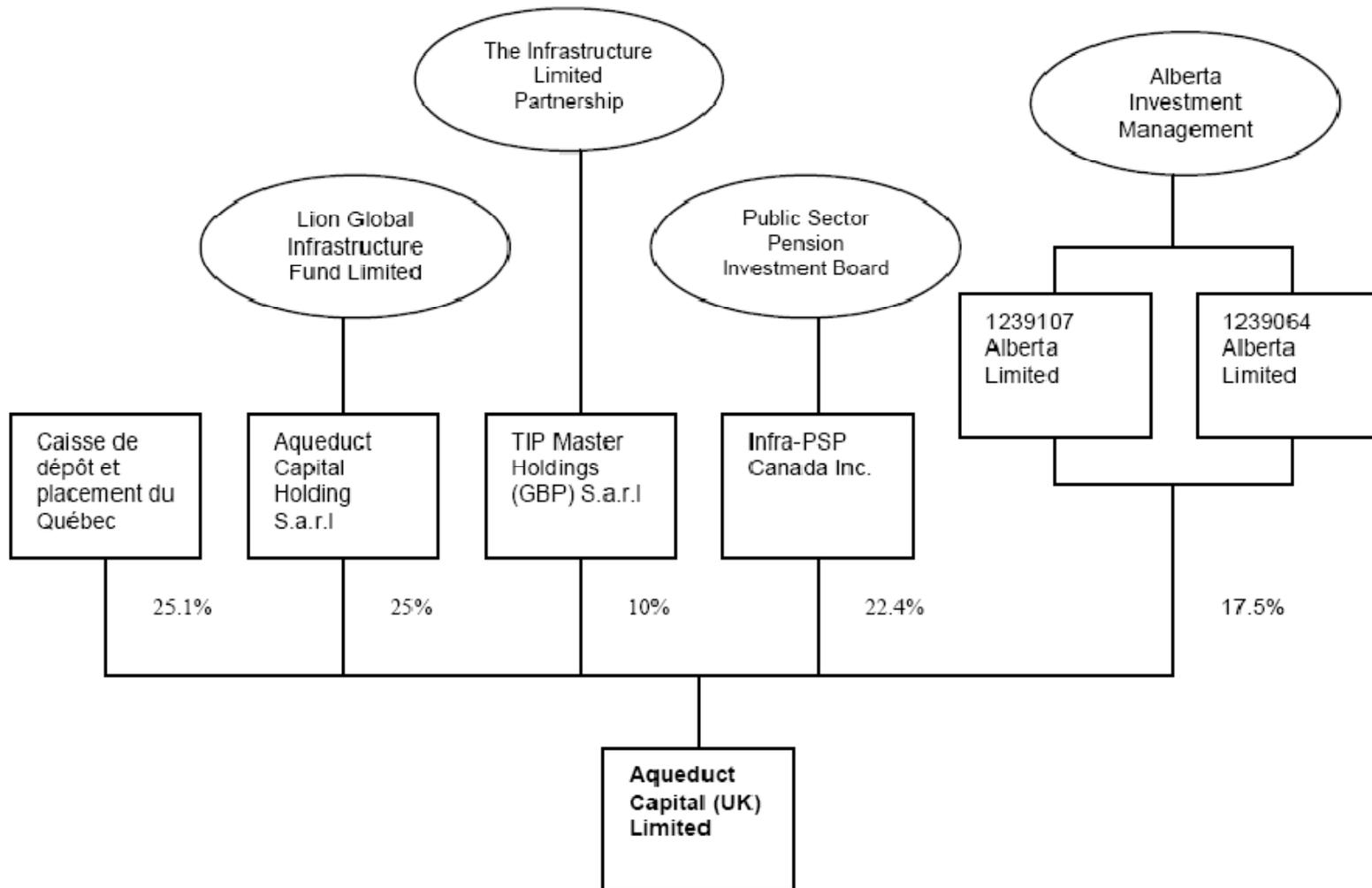
- Regulation of natural monopolies built on system of comparative competition (efficiency models, league tables etc)
- Mergers between water only companies have been allowed – subject to compensation to customers
- Mergers between sewerage companies have been blocked
- Common ownership of water only companies was also permitted but the authorities were aware of the possible loss of control from cross-shareholdings

# Common ownership and cross-shareholdings

- During the 1990s nine water only companies were acquired by three French groups (Generales des Eaux, Lyonnaise and SAUR)
- Ofwat considered that the loss of independent ownership damaged comparative competition
- Authorities intervened when Generales des Eaux acquired a 29.9% stake in Mid Kent Water
  - Generales des Eaux forced to reduce stake to 19.9%
  - Not able to appoint any director to the Board
- Ofwat are now monitoring cross-shareholdings in the private equity structures – though this could be difficult to monitor going forward

# Example of private equity model – where does the control lie?

## Ownership structure



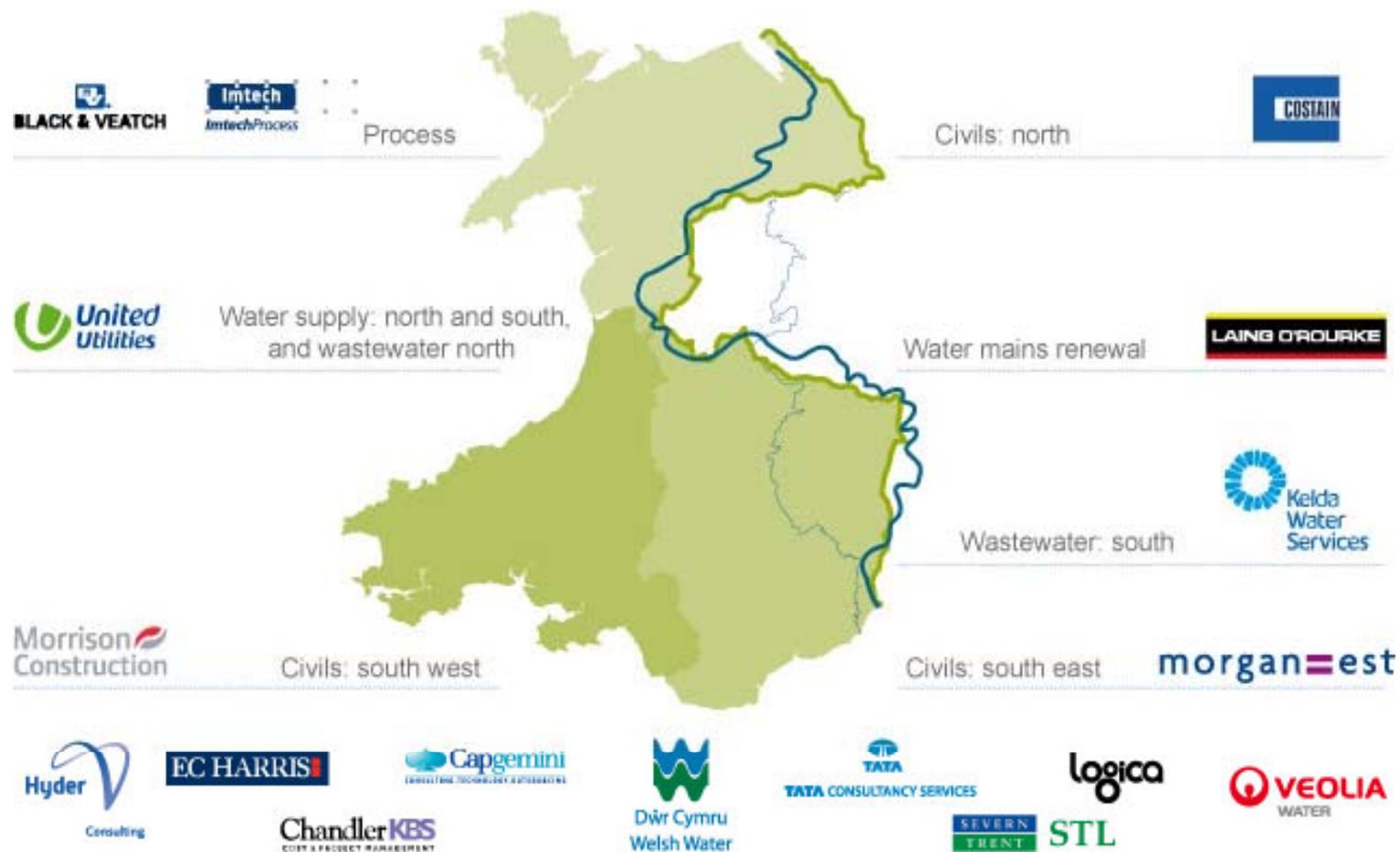
# Procurement and large investment projects (I)

- Regulation in England and Wales has focused on retaining number of comparators in the ownership of utilities
- However, the much of the operations and the majority of capital expenditure is subject to out-sourcing, tendering or concession contracts ...
- ... this is subject to much less regulatory oversight
- In 2000 Dwr Cymru became a not-for-profit corporation and outsourced all its asset operations on a long-term contract to United Utilities ...
- ... effectively losing an independent sewerage operator

# Procurement and large investment projects (II)

- In Scotland and Northern Ireland large capital projects have been funded using Public-Private Partnerships (PPP) – long-term contracts (30 years) to build and run treatment works
- A review of PPP contracts in Scotland (covering water and sanitation and other sectors) showed number of bidders varied between two and nine – *though the report concluded that three bidders should be enough to ensure value for money*
- Ofwat requires Dwr Cymru to report on the procurement of its services – the report explains how competition is encouraged through
  - Splitting service into component lots
  - Allow sufficient time in process – to encourage entrants
  - Provide feedback to all unsuccessful bidders
- How well can a regulator monitor this performance?

# Dwr Cymru: procurement of operations and capital expenditure



# The next 20 years: liberalisation and separation

- Government review of competition in water and sanitation in progress
- One option is 'single buyer' model for water and wastewater treatment – starting with new projects
- Long-term contractual relationships become more important – regulation becomes less important
- Key questions
  - How would industry structure evolve? Companies split between network operators and service providers?
  - How much competition for treatment services?
  - What would be the role of the regulator in encouraging this competition?

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