

**COMPLETED ACQUISITION OF MACQUARIE LUXEMBOURG WATER SARL
(NOW HASTINGS LUXEMBOURG WATER SARL) BY HASTINGS DIVERSIFIED
UTILITIES FUND AND UTILITIES TRUST OF AUSTRALIA**

Statement of Issues

The Competition Commission (CC) intends to consider the following:

Jurisdiction

1. On 2 October 2006, Hastings Fund Management Limited made a public announcement that Hastings Diversified Utilities Fund (HDF) and Utilities Trust of Australia (UTA) had acquired South East Water Limited (South East Water). Given that HDF and UTA already owned Mid Kent Water Limited (Mid Kent Water), the inquiry group's (the Group's) view, with which the merging parties agree, is that a water merger has taken place within the meaning of the Water Industry Act 1991 (as amended by the Enterprise Act 2002). The UK turnover of both South East Water and Mid Kent Water exceeds £10 million.
2. The completed merger was referred to the CC on 16 November 2006. Accordingly, the merger was referred to the CC within four months of the date on which it took place.

Issues

3. The Group will consider whether the merger has prejudiced, or may be expected to prejudice, the Water Services Regulation Authority's (OFWAT's) ability to make comparisons between different water enterprises for the purposes of assessing performance and setting price controls. In determining this, the Group will consider:
 - (a) the current performance of South East Water and Mid Kent Water in terms of operating expenditure, capital expenditure, water resources, quality issues, or any other relevant measure;
 - (b) whether South East Water and/or Mid Kent Water are currently among the most efficient comparators;
 - (c) any particular similarities between South East Water and Mid Kent Water (for example in terms of water resources, management style or financial structure);
 - (d) potential developments in South East Water and Mid Kent Water's performance in the absence of the merger, and, in particular, the likelihood of South East Water or Mid Kent Water becoming among the most efficient comparators in the absence of the merger either under the existing comparative competition framework or any likely alternative model;
 - (e) the number and characteristics of companies required for the effective operation of the existing comparative competition framework and, in particular:
 - (i) any similarity or dissimilarity in the costs or controls of South East Water and Mid Kent Water and the information required to enable them to be appropriately and effectively compared:

- the extent to which, before the merger, the costs of either or both of South East Water and Mid Kent Water were not independent of the costs of other water companies;
 - the likely extent of common control of South East Water and Mid Kent Water after the merger; and
 - any other factors suggesting that South East Water and Mid Kent Water might remain to some extent under independent management after the merger, including whether they would retain distinct policies and management cultures;
- (ii) the type of analysis currently used for price-setting and related data requirements, in particular:
- the number and quality of remaining independent comparators following the merger; and
 - the quantitative and qualitative effect on the comparative analysis of cost and quality performance of losing a comparator;
- (iii) the number and characteristics of companies required to make effective comparisons for other purposes, such as monitoring service levels, adherence to quality standards, compliance with regulatory accounting guidelines, or comparisons of capital structures or other financial comparisons; and
- (iv) the availability of alternative sources of information and/or data for such comparisons;
- (f) what might be the prejudice to OFWAT in making comparisons between water companies if OFWAT were to use alternative methods of comparison;
- (g) whether the merger might reduce the reliance OFWAT could place on efficiency comparisons in setting price caps and/or lead it to set higher price caps for all companies than would otherwise be the case;
- (h) to the extent that OFWAT can place lesser reliance on efficiency comparisons, whether that might result in price controls being based to a greater extent on factors relating to the companies' own costs, and to a lesser extent on factors independent of their own costs, so reducing the incentives on water companies to achieve cost savings;
- (i) whether, and if so to what extent, the merger might give rise currently or in the future to a lessening of competition in relation to the provision of water services;
- (j) whether the merged company might be a better comparator than either of the individual companies prior to the merger; and
- (k) whether, taking account of all of the above, and any other relevant issues, the merger may be expected to result in a prejudice to OFWAT's ability to make comparisons between different water enterprises.

Remedies

4. Should the Group conclude that the merger has resulted or may be expected to result in a prejudice to OFWAT's ability to make comparisons between different water enterprises, it will consider whether remedies might be appropriate and, if so, what such remedies might be, and will issue a further statement at a later date.
5. In considering possible remedies, the Group will explore whether any relevant customer benefits might be expected to arise as a result of the merger and, if so, what these benefits are likely to be, which customers would benefit and how. These might include, in particular, water resource benefits.