

## Competition Commission response to the consultation on Water Merger References: Competition Commission Guidelines

1. In July 2003 the Competition Commission (CC) issued a consultation document *Water Merger References: Competition Commission Guidelines*. Its purpose was to seek views on the draft guidance that the CC proposed to issue on its approach to assessing water merger references referred to it by the Office of Fair Trading (OFT) under the Water Industry Act 1991 as amended by the Enterprise Act 2002 and the Water Act 2003.
2. We received 20 responses from regulators, water companies, consumer organizations, law firms and others. We are grateful for the care and thought all respondents have put in. The responses are available in the CC's Information Centre [info@competition-commission.gsi.gov.uk](mailto:info@competition-commission.gsi.gov.uk) except where confidentiality has been requested.
3. Although there were a number of varied comments and suggested improvements, we were pleased that the responses generally welcomed the guidance and felt that it achieved clarity and transparency.
4. The comments related to five major issues:
  - the use of comparators, in particular the weight to be given to the number of comparators at the disposal of the Director General of Water Services (DGWS);
  - how the CC might approach the DGWS's economic and modelling methodology where this was relevant to the water merger questions;
  - evidence of consumer benefits;
  - remedies; and
  - the European Decision.
5. Initially, we make four general points.
6. First, it is the law that requires the test of whether the merger will prejudice the ability of the DGWS to make comparisons to be applied and also requires any prejudice to be remedied unless benefits flowing from the merger are substantially more important than the prejudice. Some comments, mainly from water companies, amounted to redefining the test which the CC plainly cannot do. Likewise, the qualifying threshold for a mandatory reference of £10 million depends on the law.
7. Second, some respondents seek more detail in the guidance than is realistic on particular matters. One is more information on how the CC will consider the effects of the merger on the value of the DGWS's comparisons than is set out in paragraphs 2.15 to 2.23. Another is how precisely we expect to deal with mixed mergers between water enterprises and other enterprises. In such cases we would follow the most efficient procedure within the terms of the legislation. However, this guidance cannot anticipate how every issue that might arise will be treated nor how every piece of evidence from third parties will be handled.

8. Third, there have been minor developments in the wording of the secondary legislation, which has been reflected in the text.
9. Fourth, the CC has published another piece of guidance, *CC8: Application of Divestiture Remedies in Merger Inquiries*, and some changes to paragraphs 3.20 to 3.25 reflect that guidance.

### **The use of comparators and the weight to be given to the number of comparators**

10. It is evident that there remain differences of view between the industry and consumer bodies on the one hand and the regulator on the other over the use of comparators. Our guidelines cannot resolve this difference of view. Our approach will be, as we indicate in paragraph 2.23, that we will take an overview of the value of the prejudice to the DGWS's comparisons in the circumstances of each case.
11. A number of respondents suggest that the last sentence of paragraph 2.2 of the draft guidelines "... the Commission considers that companies under common ownership may be expected to behave in similar ways and hence that a water merger will affect the value of comparisons made by the DGWS" implies that the loss of an independent comparator inevitably gives rise to prejudice. That is not the case—see the first sentence of paragraph 2.3 and paragraph 2.16 which make clear that each case is to be considered on its merits and in the light of a variety of factors. Some respondents suggest that the concept of the DGWS's ability to make comparisons should not be limited to or constrained by his current practice. We do recognize that this is one of the factors that may need to be considered—see the last sentence of paragraph 2.15 which specifically recognizes the possible need for DGWS to consider alternative comparisons.

### **How the CC might review the DGWS's methodology where this is relevant to the water merger questions**

12. One respondent complains that there is no critical analysis of the DGWS's methodology, but that is not the purpose of our guidelines on the loss of a comparator.

### **Evidence of consumer benefits**

13. Paragraph 3.34 deals with the weight attributed to immediate price cuts as evidence of customer benefits. The companies have argued that the benefits should not be passed on immediately because that would deter mergers delivering long-term benefits. (Under the existing regulatory system cost savings would be passed on automatically after five years.) It is not unknown for mergers to fail to deliver the cost savings that management expect and, in the light of this, we continue of the opinion that more weight can be attached to anticipated cost savings which are supported by immediate proposed amendments to companies' price caps. However, each case will be considered on its merits and we would note that there is nothing in paragraph 3.34 that suggests that all the savings have to be transferred immediately to customers—thus some incentive for the companies could and probably would remain, subject to the consumer benefits being substantially more important than the prejudice to the DGWS's comparisons.

## **Remedies**

14. Some respondents regarded the terms of paragraph 3.34 as over-prescriptive in discounting certain future cost savings and not giving weight to other potential savings in addition. The redrafted paragraph addresses these points.

## **The European decision**

15. Some respondents have questioned the applicability of the European decision. The guidance reflects our current understanding of the decision.

Competition Commission  
December 2004

Responses were received from:

Dieter Helm  
Indepen Consulting Ltd  
WaterVoice  
European Commission Competition DG  
Addleshaw Goddard  
Clifford Chance  
Simmons and Simmons  
Office of the Director General of Water Services  
Ofgem  
Chartered Institute of Purchasing and Supply  
Unison  
Anglian Water Services Limited  
Mid Kent water plc  
Northumbrian Water Ltd  
Severn Trent Water Ltd  
Thames Water Utilities Ltd  
Veolia Water