

# 3 The principal parties to the proposed merger

3.1. This chapter describes the companies principally involved in the proposed merger. At the core of the proposal are three statutory water companies: Colne, Lee and Rickmansworth, which propose to merge their activities under a holding company called Three Valleys Water Services PLC (Three Valleys). Lee is 99 per cent owned by GU, the United Kingdom water investment subsidiary of the French water supply company, CGE. The terms of reference for our inquiry refer us to the proposed merger of Colne and Rickmansworth with 'water enterprises under the control of General Utilities PLC'. This reflects the fact that, in addition to Lee, GU owns a controlling interest in three other statutory water companies and has substantial minority interests in several others, including both Colne and Rickmansworth. If the proposed merger proceeds, GU, and thus CGE, would own a majority interest in Three Valleys.

3.2. In addition to describing the three water companies, GU and CGE, this chapter also looks at the Three Valleys Committee, a co-operative joint venture between Colne, Lee and Rickmansworth, which has operated a large water treatment works at Iver in Buckinghamshire since 1971.

3.3. Set out below are descriptions of each of the three SWCs involved in this merger. Appendices 3.1 to 3.5 contain further financial and other information on each of the companies described in this chapter and include maps which show the individual supply areas of the three SWCs principally involved.

## Colne

3.4. Colne is based at Watford, supplying a present population of some 766,000 with an average daily flow of 207 megalitres, by way of over 300,000 water connections.<sup>1</sup>

3.5. Colne was established by Act of Parliament in 1873, serving a small initial population in South-West Hertfordshire and what is now London. By 1911 the company was serving a population of over 100,000, as a result of mergers with neighbouring undertakers as well as the growth of the London suburbs it served. In 1956 the Government adopted a policy of encouraging the water industry to regroup into larger and more viable groups. Colne followed this policy with a series of acquisitions over the following years. In 1973 Colne reached its present size with the acquisition of the Watford Corporation's water undertaking.

3.6. The company has participated with Lee and Rickmansworth in the Three Valleys Committee since its inception in 1970. At present, the company draws about 77 per cent of its water needs from underground sources; the remainder comes from the Iver Treatment Works, operated by the Three Valleys Committee, which treats water drawn from the River Thames. Colne contributes three-sevenths of the capital costs associated with the Iver works. Colne is actively involved in research and development, both independently and in relation to other bodies such as the Water Research Centre. Some of this research involves investigating the main aquifers in its area; other research is into geographic information systems, the replacement of the operational control system, and computer modelling of the main water distribution network.

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<sup>1</sup>A megalitre is 1,000,000 litres (220,000 gallons), equivalent to 1,000 metric tonnes. A megalitre of water would fill a domestic bath over 6,500 times.

3.7. Unaccounted-for water, principally leakage, amounts to 27 per cent of the company's average daily supply. The company has an active leakage detection programme and plans future improvements. The company expects total demand to rise by about 13 per cent over the next ten years but believes that the improved leakage detection and control programme could produce savings which would result in a net increase in demand of only about 2 per cent.

### *Future development*

3.8. Between 1989/90 and 2004/05 Colne has capital expenditure plans of some £170 million. The company told us that these plans related to proposed expenditure in three areas: underground assets, overground assets, and the expansion of, and introduction of ozone treatment at, the Three Valleys works at Iver.

3.9. Colne told us that some 11 per cent of its capital expenditure plans reflected the need to deal with emerging water quality problems. The company told us that there was evidence that the quality of its underground water supplies was slowly deteriorating. The main problems were the persistent presence of pesticides in virtually all the company's sources. Tackling these problems could involve the use of granular activated carbon filters. The company also told us that there was evidence of rising nitrate levels throughout the area; while most sources were well below the maximum level prescribed by the water quality regulations, two of the company's sources in urban areas were approaching that limit.

3.10. The company also told us that a large part of its capital expenditure plans was to replace some of its older small-diameter pipes, and to embark on a programme of relining or renewing some of its cast iron mains which had internal coal-tar linings. In the area supplied with water from Iver the gradual breakdown of these linings had caused traces of polycyclic aromatic hydrocarbons to appear. Refurbishment will absorb over half of Colne's planned capital expenditure to 2004/05.

## **Rickmansworth**

3.11. Rickmansworth is the smallest in terms of population of the three SWCs principally involved in this inquiry. It supplies a population of 556,000 with an average of 198 megalitres of water per day. Rickmansworth was established by Act of Parliament in 1884. It has grown steadily through the acquisition of adjacent undertakings, especially in the period after 1945, when Government policy encouraged the amalgamation of small undertakings to produce more viable units. The most recent acquisition was the water undertaking of the Chesham Urban District Council, which was transferred to Rickmansworth in 1973.

3.12. Rickmansworth draws over 70 per cent of its water from borehole sources; the balance is provided from the Three Valleys treatment works at Iver. The company's ground water sources are already being fully exploited. Consequently growth in demand is expected to have to be met by increased supplies from Iver. Rickmansworth expects demand from consumers to increase by 23 per cent over the next ten years; the company expects to be able to meet 9 per cent of this by improved leakage control. At present, the company estimates that it loses 30 to 35 per cent of its water through leakage, and substantial resources have therefore been devoted to leakage detection in recent years.

3.13. The company told us that it faced some water quality problems which would require investment. In particular, one source has become infected with cryptosporidia (chlorine-resistant protozoa), and has consequently had to be withdrawn from use until a satisfactory method of treatment is developed. Another source has become contaminated with an organic solvent, and some

evidence has emerged that polycyclic aromatic hydrocarbons, derived from old coal-tar-lined mains, may be a problem. Pesticides, above the EC drinking water maximum admissible concentration levels, are present in five of the company's 22 borehole sources.

### *Future development*

3.14. Rickmansworth has capital expenditure plans totalling £108 million over the period 1989/90 to 2004/05. The company told us that this expenditure would include a significant contribution to the expansion of the Iver Treatment Works, where the company has paid three-sevenths of the capital cost of development, as well as investment in the laying of new mains, the development of one major new reservoir, and the refurbishment of old mains and pumping systems. The challenge which faced the company, we were told, was in coping with the gradual shift in the focus of demand from the South and East of the company's area to the North and West, as growth occurred in the towns on the urban periphery. These areas of new demand were away from the Iver source in the south, and generally at a higher ground level, necessitating greater investment in pumping, and in the development of a more secure network of trunk mains and reservoirs.

### **Lee**

3.15. Lee provides over 300 megalitres of water per day to a population of 1.021 million, dispersed over a relatively wide area of sub- and peri-urban communities north of London. It owed its origin to the policy of the Government in 1958 of regrouping water undertakings into larger bodies. The result of this policy was that the two major undertakers in the upper Lee Valley, the Barnet District Water Company and the Herts and Essex Water Company, jointly promoted a bill to merge their activities as Lee from the beginning of 1960, and at the same time took over the activities of 14 smaller undertakings in the upper Lee Valley. Further amalgamations took place in 1963, and in 1973 Lee reached its present size when it amalgamated with the Luton Water Company.

3.16. Lee obtains 83 per cent of its water needs from its own borehole sources; the bulk of the remainder is obtained from the Grafham Water scheme, in which Lee has participated since 1961, and which is operated by Anglian Water. Some additional bulk water is obtained from Thames Water, in the south of Lee's area, and a small amount is obtained from Colne. Lee has contributed one-seventh of the capital costs of the Three Valleys Committee's treatment works at Iver since 1970, but has not taken water from this source. The company has, however, announced its intention of taking water from Iver from 1991.

3.17. Lee told us that the cost of treated surface water from other undertakers was about twice that of its own borehole water; the company was, however, abstracting as much water as its aquifers would permit. The company told us that it was continuing capital investment in the development of new mains to improve security of supply, meet growing demand and, in some cases, to connect communities which had hitherto had small, isolated systems into the company's principal distribution system. These small, isolated systems were often those established by small undertakings before the company's formation in 1960. The company's trunk mains, pumping and reservoir systems were, the company considered, generally in good condition as a result of a continuing programme of renovation and replacement.

3.18. In common with other water undertakers in the area, Lee faces a pesticide pollution problem, which will require attention. In addition, aquifers at Dunstable and Luton are affected by significant pollution by chlorinated solvents. In general, however, the company's water quality problems were not acute.

### *Future development*

3.19. Overall, the company plans to invest £333 million over the period 1989/90 to 2004/05. Of this amount, about a third will be spent on new capacity (including a contribution to the expansion of

the Iver Treatment Works), another third on the refurbishment of existing assets, and the remaining third on water quality, new distribution and other projects. The company has had a ten-year leakage reduction strategy in operation since 1984, which has aimed to reduce losses from 13.0 litres per property per hour to 6.8 litres per property per hour, a level which Lee considers economically acceptable, by 1994.

### **Existing co-operation between the three companies**

3.20. Colne, Lee and Rickmansworth have co-operated in the Three Valleys Committee since 1970. The committee, and the Iver Treatment Works it operates, were established as a result of the recognition by Colne and Rickmansworth in the early 1960s that the aquifer resources which both relied on would not meet projected growth in demand. Consequently a scheme was developed to draw water from the River Thames. Lee decided at the outset to join this scheme as part of its long-term planning for potential increases in demand, although it was not then in need of a further source of supply. The three companies jointly obtained the right to abstract water from the River Thames, and, through the Three Valleys Water Order 1970, obtained the powers to build a treatment works. The Order established the Three Valleys Committee to supervise the works, and apportioned the capital costs. Each company has two nominees on the committee, with one vote each; Lee contributes one-seventh of the capital costs, while Colne and Rickmansworth pay three-sevenths each. Operational costs are apportioned as follows:

#### *Water abstraction charges*

Actual amounts payable by the three companies in accordance with the agreed schedule of requirements which apportion the total quantities licensed for abstraction.

#### *Working charges*

Costs of electricity, chemicals, plant attendants and water taken from Thames Water through the relief tunnel are apportioned quarterly between the companies according to quantities taken.

#### *Other costs*

All other operating costs are apportioned between the companies as follows:

Colne	3/7ths
Lee	1/7th
Rickmansworth	3/7ths

3.21. The treatment works at Iver was constructed between 1970 and 1974, at an original cost of £7 million. Since that time a further £16 million has been invested in the works, which are able to treat up to 159 megalitres per day. The investment in Iver represents 16 per cent of the three companies' gross fixed assets as at 31 March 1989. At present the output is used entirely by Colne and Rickmansworth. It is, however, intended that the works be substantially expanded to provide water for Lee from 1991, as well as to meet further demand from Colne and Rickmansworth. In addition, the companies plan to invest in the development of ozone treatment of water at Iver, in order to improve water quality and to reduce the use of chlorine, and the associated hazard created by the bulk storage of large amounts of chlorine. The cost of planned work at Iver is estimated at £33 million.

3.22. The Three Valleys Committee presently employs 32 staff. In addition there are staff within the three companies whose duties encompass support of the Iver Works. In addition to the development and operation of the Iver Works, the companies have co-operated in staff training.

3.23. In addition to their involvement with the Three Valleys Committee, Colne and Rickmansworth entered into an agreement in November 1988 to provide for closer co-operation between their two companies. The agreement provided for the appointment of the Managing Director

of Rickmansworth to be also Managing Director of Colne. Rickmansworth appointed a further director from Colne to join its Board of Directors; the two Boards now have three directors in common. In addition, one member of the Colne Board is also a member of the Lee Board.

## Major shareholders in the three companies

3.24. Table 3.1 lists the major holders of voting stock in Colne, Lee and Rickmansworth.

TABLE 3.1 Major holders of voting stock in Colne, Lee and Rickmansworth

	%
Lee	
GU owns 99 per cent of the voting stock.	
Colne*	
GU	28.2
SAUR	25.2
Bank of Scotland Nominees	11.1
GRE Nominees/Metropolitan Trust	10.1
Rickmansworth	
SAUR	29.9
GU	16.1
GRE Nominees 27930751	13.1
Schroder Nominees (WCA)	9.9
Pearl	5.9
Metropolitan Trust	5.5
Phoenix	3.5
DSB Nominees	3.5

Source: Colne, Lee and Rickmansworth.

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\*The statutes of Colne impose restrictions on the number of votes which may be cast by any one shareholder. However, these restrictions may possibly be circumvented by any shareholder by splitting its shareholding into a number of nominee holdings. There is no discretion for the directors of Colne to decline to register such transfers.

## General Utilities

3.25. As Table 3.1 shows, Lee is virtually wholly owned by GU, which also has substantial minority shareholdings in Colne and Rickmansworth. GU is a United Kingdom-registered, wholly-owned subsidiary of CGE, a major French company with a long involvement in the French water industry. CGE established GU in 1987 principally to act as the holding company for CGE's interests in the United Kingdom water industry. Through GU, CGE has made substantial investments in a number of SWCs in the United Kingdom. Table 3.2 shows GU's holdings in SWCs as at 29 January 1990.

TABLE 3.2 GU's holdings in SWCs

<i>Name of company</i>	<i>Percentage of voting capital %</i>
Lee	99.3
North Surrey	98.6
Tendring Hundred	79.2
Folkestone and District	72.6
Bristol	29.9
South Staffordshire	29.9
Mid Kent	29.8
Colne	28.2
Rickmansworth	16.1

Source: GU.

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Note: Holding in Mid Kent is via a stake in Mid Kent Holdings PLC, which owns the issued share capital of The Mid Kent Water Co.

3.26. CGE told us that its decision to establish a separate United Kingdom holding company reflected a commitment to long-term investment in the water industry. CGE said that GU's role would include general oversight of water industry subsidiaries, including the monitoring of financial performance. GU would encourage technical co-operation, and assist its subsidiaries in the negotiation of financing arrangements. GU would also be able to provide advice on possible areas for diversification outside core water supply activities, drawing on the experience available within the CGE group. To achieve these goals, a management team was being established within GU.

## **CGE**

3.27. CGE is a multinational services and construction group. It specialises in the provision of water and other utility and technical services, mainly in France, but also in other European countries, North America, Asia, Africa and Latin America.

3.28. CGE was established in 1853, to provide water for Paris. Over the following century it grew steadily, obtaining contracts in a large number of cities in France. The company went through periods of substantial growth and diversification in the 1950s and in the 1980s. As well as its involvement in the provision of water and sewerage services, CGE has diversified into other service areas, including collective heating, solid waste collection and treatment, public transport, cable television and leisure parks. CGE also has major construction interests.

3.29. CGE told us that the provision of water in France was the responsibility of the local authority, but that many local authorities chose to delegate these functions to private undertakings. Typically these arrangements would take one of three forms:

- (a) a long-term concession under which the private contractor assumed all responsibility for the provision of water, including the necessary capital investment, for a period of 25 to 30 years;
- (b) a medium-term 'franchise', normally for 12 years, under which the private contractor assumed full responsibility for operations and maintenance (including, in general, replacement), while capital assets (and responsibility for capital expenditure) remained vested in the local authority; and
- (c) subcontracting arrangements whereby the local authority remained responsible for water provision, but subcontracted specific tasks to a private contractor.

3.30. CGE told us that under the first two types of arrangement, the private contractor was identified to customers, and thus answerable to customers for quality and service. The prices charged were fixed by contract following negotiation between the local authority and the undertaking, and would normally remain unchanged in real terms for a number of years. CGE told us that it was unusual for a franchisee to be replaced as undertaker by another private contractor or by a local authority, but this possibility was available to local authorities and enabled them to obtain better terms. CGE also told us that this organisation of water undertakings had contributed to its decentralised corporate structure, and its sense of the importance of local identity and accountability in its operations. CGE allowed its local subsidiaries a considerable degree of independence, although major investment decisions were taken in consultation with CGE senior management, as were decisions involving business strategy.

3.31. CGE also has interests in the United Kingdom outside the water industry. These include:

- energy management, the maintenance of boilers, cooling plant and freezers;
- technical maintenance services;
- collection and processing of solid and liquid waste;
- construction and construction project management;
- joint ventures in the design, construction and installation of water and waste water treatment plant; and
- cable television and a 10 per cent stake in TVS.

CGE told us that its most significant investments outside the water industry were in energy management, in which it had been involved since the late 1960s through Associated Heat Services plc, and construction, where it had a controlling interest in Norwest Holst.

3.32. CGE undertakes research and development in the field of water treatment and supply, among other areas. The company told us that it had particular expertise in the use of ozone to treat water and in the use of biological processes for the denitrification of drinking water and the removal of phosphates from waste water and that a major research programme relating to elimination of pesticides was in progress.