



EUROPEAN COMMISSION

Brussels, 29.03.1995

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 21(3) DECISION

To the United Kingdom Government

Dear Sir,

Regulation (EEC) 4064/89 : Application by the United Kingdom of 6.3.95 for the recognition of a legitimate interest under Article 21(3) re certain provisions of the Water Industry Act 1991 (as amended by the Competition and Services (Utilities) Act 1992)

1. On 6 March 1995, the United Kingdom made an application for the recognition of a legitimate interest under Article 21(3) of Regulation (EEC) 4064/89 ("the Merger Regulation"). This application was in relation to sections 32 to 34 of the Water Industry Act 1991 as amended by the Competition and Services (Utilities) Act 1992 (together "the UK regulatory legislation").
2. The purpose of the UK regulatory legislation is to safeguard the provision of a vital service and to protect the consumer. The UK regulatory legislation is operated in the context that established water suppliers enjoy a strong natural monopoly in the provision of services in their areas, though limited competition might be possible along the boundaries between water suppliers. The Director General of Water Services in the UK has a need to maintain an adequate number of comparators (i.e water suppliers who are independently controlled) inter alia to sustain the effectiveness of the regulatory regime. The ability of the Director General of Water Services to compare the costs and performance of an adequate number of companies is important to setting price parameters which enable the undertakings properly to carry out their functions and at the same time protect the interests of customers by setting prices no higher than is necessary.

3. The UK regulatory legislation provides that the Secretary of State for Trade and Industry ("the Secretary of State") must make a reference to the Monopolies and Mergers Commission (MMC) where a merger takes place between two water enterprises (section 32 of the Water Industry Act 1991) which fulfil certain thresholds in terms of assets. The MMC must determine, in deciding whether a merger could be expected to operate against the public interest, whether the ability of the Director General of Water Services to make comparisons between different water enterprises is prejudiced and shall have regard to any other purposes only as far as they do not conflict with the ability of the Director General of Water Services to make comparisons or where the achievement of that other purpose is of substantially greater significance in relation to the public interest and cannot be brought about except in a manner which conflicts with that principle (section 34 (3) of the Water Industry Act 1991 as amended by the Competition and Services (Utilities) Act 1992). These provisions were originally contained in the Water Act 1989 which predated the adoption of the Merger Regulation.
4. Article 21(2) of the Merger Regulation states that no Member State shall apply its national legislation on competition to any concentration that has a Community dimension. Article 21(3) allows for Member States to take appropriate measures to protect legitimate interests other than those taken into consideration by the Regulation and compatible with the general principles and other provisions of Community law. These other legitimate interests must however be recognized by the Commission after an assessment of their compatibility with the general principles and other provisions of Community law before the appropriate measures may be taken.
5. The UK regulatory legislation is based on the assumption that water companies operating in the private sector in strong natural monopoly positions require specific regulation to ensure that they do not abuse their monopoly position. To this effect the control exercised by the United Kingdom authorities is aimed at ensuring that the number of independently controlled water companies is sufficient to allow the Director General of Water Services to exercise his regulatory functions. The interest pursued by the UK regulatory legislation is not one of those specifically referred to in Article 21(3) second subparagraph of the Merger Regulation. In order not to go beyond the interest pursued by the UK regulatory legislation other issues in relation to mergers between water companies can only be taken into account to the extent that they affect the control regime as set out above. These other issues would principally include the allocation of cost savings arising from the merger or the effect of the merger on the level of water charges and which would be used in the calculation of the pricing formula for the merged company. By contrast, the UK authorities are not entitled to consider other matters which the Commission must take into account in assessing concentrations that have a Community dimension and which do not directly relate to the operation of the regulatory regime. Under Article 21(1) and 21(2) of the Merger Regulation these matters are the responsibility of the Commission and would be considered in the context of any notification under the Merger Regulation.
6. Furthermore, the UK regulatory legislation does not appear incompatible with the general principles and other provisions of Community law. In particular, it does not constitute as such either a form of arbitrary discrimination, as the thresholds have been determined in an objective manner, or a disguised restriction in trade between Member States. Also, the implementation of this legislation must not be carried out in a discriminatory manner. The minimum number of independent water companies should therefore not be higher than necessary to ensure the effective operation of the regulatory regime in order to be

appropriate and proportional to the objective in question. In any event, the Commission has taken note that the United Kingdom authorities undertake to apply the UK regulatory legislation in a way that is consistent with the United Kingdom's obligations under Community law. In this connection, the United Kingdom authorities shall communicate in each case in which the UK regulatory legislation is applied the measures envisaged in order to enable the Commission to verify that these measures are appropriate, proportional and non-discriminatory.

7. Consequently, the Commission recognises the legitimate interest of the United Kingdom in applying the above mentioned provisions of the Water Industry Act 1991 as amended by the Competition and Services (Utilities) Act 1992 subject to the specific provisions contained in paragraphs 5 and 6 above. This recognition only applies to the current legislation. A new application would be necessary should any amendment be made to the UK regulatory legislation. This decision is adopted in application of Article 21(3) of Council Regulation no 4064/89.

For the Commission,