# 10 The views of other parties

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## Introduction

10.1. Views were invited from Government departments, OFWAT's Southern CSC, the water industry, major shareholders in MKH, local authorities and other public bodies, business and consumer organizations, trade unions, businesses including major water users and other interested parties.

## Government departments

### *Department of the Environment*

10.2. The DoE submitted evidence on the regulatory framework for the water industry with particular reference to the mechanisms for securing water resources. The full text of this evidence is reproduced at Appendix 4.1.

## OFWAT's Southern Customer Service Committee

10.3. The Chairman of the Southern CSC, Professor Judith Rees, submitted evidence and attended a hearing.

10.4. The SCSC's principal statutory duties (contained in section 29 of the 1991 Act) included:

*(a)* keeping under review all matters appearing to affect the interests of customers of the four WoCs and one WaSC in the region;

*(b)* consulting these companies about those matters;

*(c)* making appropriate representations to the companies; and

*(d)* investigating complaints made or referred to the SCSC which relate to the carrying out by those companies of their functions.

10.5. On the issues raised by the variation of the reference (that is, whether there was a merger in being) the SCSC said that it had no evidence that GU and SAUR had made any attempts to influence MKW's decision-making in relation to customer services. Nor was it possible for the SCSC to say whether GU and SAUR had colluded and acted together at the MKH AGM. It was certainly conceivable that they had individually decided to vote in the way they had.

10.6. On the original reference, the SCSC said that it had consistently argued that in a relatively water-short area such as south-east England it was necessary to ensure the strategic development of resources to benefit customers in the region as a whole. The SCSC believed the EA had the power to use the licensing system to encourage strategic co-operation between companies, as on the 75:25 split arranged between SWS and MKW for the Medway Scheme. The SCSC's concern had been to avoid inefficient capacity development, with each company seeking independently to secure supplies rather than working together to promote the least-cost solution for the region. At the time of the Periodic Review, for example, the SCSC was dismayed to find that extremely high cost options including desalination plants were included in the proposed investment programmes of SEW and FDWS, rather than arranging BSTs with SWS. SEW's reluctance to enter such agreements was subsequently restated to the SCSC at its public meeting on 20 January 1995, when the Managing Director of the company clearly set out the SAUR Group's policy in this area. Great emphasis was placed on the ownership of resources and SAUR's unwillingness to be dependent on another company for supplies. On the GU side, only very recently, in response to the 1995/96 drought, was there evidence that discussions were taking place. One relatively small bulk supply had been arranged from MKW to FDWS.

10.7. It was the SCSC's belief that there could be no solution to the resource situation without the involvement of SWS; this company held most of the `available' reserves of water in the region. All the companies involved in the proposed arrangements were short of water resources at peak periods. Recent evidence of increased demand and higher ratios for peak to average use suggested that only very limited supply surpluses would actually be available. Further, potential urban and industrial development along the Thames corridor to the Channel Tunnel, the possible effects of climate change, and the fact that historically MKW had frequently needed to resort to hose-pipe restrictions in peak demand periods also led the SCSC to conclude that any surplus was likely to be small and short-lived. The SCSC had some concern that the proposed arrangements might actually exacerbate the problem because:

*(a)* SEW had consistently refused to enter into BST arrangements with SWS, though co-operation between them would be essential; and

(b) there might be a danger that GU and SAUR would in the short term merely strip MKW of its water resources which would not be to the advantage of MKW customers.

10.8. The proposal to split MKW appeared to be arbitrary. The SCSC had concerns about how the proposed JRC would actually operate. The existence of the JRC also raised questions concerning its position in the regulatory structure, reporting requirements and its relationship with the SCSC. The SCSC's view was that it was essential that any such company remained part of the core company, and that channels of communication and accountability between the JRC and customers (including the SCSC) were maintained.

10.9. Finally, the SCSC shared the view of the DGWS that any resource benefits which might conceivably follow the proposals could be achieved without the proposals, and were not linked in any way to such a structural change. The current imbalance in the present allocation of resources in the region could be overcome through the use of BSTs. Such arrangements would need to be complemented by a continued commitment to leakage reduction and demand management.

10.10. The SCSC would also regret the loss of an independent water company from the region. It had benefited from being able to use comparative information from the companies within the region and also outside it. This information had been particularly helpful in assessing the performance of the companies in a number of service areas, and these assessments had been vital in encouraging the companies to adopt best practice. For example, initially all the companies in the region were reluctant to allow the SCSC free access to their internal complaint files. However, MKW was the first company to invite the SCSC to its offices to undertake an audit of its complaint files. MKW's decision had prompted the other companies to follow suit.

10.11. MKW was the first company openly to offer its customers weekly instalment payment arrangements. It was also the first in its region to produce, in consultation with the SCSC, a leaflet that encouraged customers experiencing payment difficulties to contact the company and agree a mutually acceptable payment method. The company had also been very responsive to the SCSC's suggestions for improving its customer information literature. It had moved away from lengthy technical detail to plain English, with a focus on the customers' information needs. The company's billing literature had received a `crystal mark' from the Plain English Campaign. FDWS, on the other hand, had been slow to improve its material, and all the documentation for SEW was in the SAUR Group style. The SCSC was rarely involved in the development of such literature, except where consultation was a regulatory requirement.

10.12. The SCSC was convinced it was important that MKW was independent. Since MKW was not part of a group structure, it was not subject to outside influence. Group influence could have a significant impact on the SCSC's relationship with a water company, if group policy reduced the local company's freedom to negotiate with and respond to SCSC initiatives.

10.13. GU and SAUR claimed that the creation of two enlarged companies would provide two stronger companies for the purposes of comparison. However, the SCSC doubted this. The new companies would be part of diversified groups, with other subsidiaries undertaking construction, mains-laying and a host of other services for them. There would be a loss of transparency, greater potential for transfer pricing abuses and possible difficulties concerning accountability to customers.

10.14. Although GU and SAUR had stated that the proposals would improve the level of service to customers, no specific details were made available to the SCSC. It was worth noting that in terms of performance, all three companies had a somewhat patchy record. None of them could claim to be among the best performers in the country in levels of service (for example, pressure of mains water, response to billing queries), numbers of complaints, cost of water delivered and efficiency, and debt and disconnection. The SCSC remained sceptical of the ability of the proposals to produce improvements in service standards. It stressed that the improvements made by MKW in responding to billing enquiries and customer complaints were as a direct result of comparative competition. Moreover, the SCSC pointed out that the performances of SEW and FDWS had not (to date at least) markedly improved as a result of their ownership by larger groups.

10.15. If the proposed acquisition were to go ahead, the SCSC's belief was that safeguards would be particularly important in the following areas:

(a) The JRC should be seen as an integral part of the core businesses, and therefore subject to the same regulatory conditions and scrutiny as other parts of the two water companies. The SCSC would wish to have current access arrangements safeguarded.

*(b)* MKW customers allocated to the new western company should be safeguarded from price averaging, which would in effect result in them cross-subsidizing customers in the higher-priced SEW area.

*(c)* MKW customers should also be protected from bulk supplies being taken out of their area without the approval of the DGWS. There was no doubt that customers would react with hostility if resource transfers out of the Mid Kent area increased their vulnerability to supply restrictions in peak periods.

*(d)* GU and SAUR should be asked to make more concrete their claims about improved service standards, with explicit targets that would allow their progress to be monitored and taken into account in price reviews.

*(e)* The enlarged companies should be required to work co-operatively with SWS for the strategic development of resources in the region.

## The water industry

### *Southern Water Services Ltd*

10.16. SWS submitted information to the MMC and attended a hearing.

10.17. SWS said that, as a WaSC, it provided water services to 2.1 million customers in the south-east of England and sewerage services to these and, amongst others, the customers of MKW, FDWS and SEW (see Appendix 3.3). Its own projections of supply and demand showed that under average conditions demand would not exceed supply in its areas until after 2012, though it would be earlier under peak conditions. Currently SWS was thought to have surplus capacity of around 130 to 135 Ml/d, or 65 Ml/d under peak conditions. The bulk of this was in Hampshire and the Isle of Wight. Most of the shortages were in the east. The situation in Hastings had begun to improve as a result of the new Bewl-Darwell link.

10.18. The effects of any merger on the public interest were likely to be adverse. SWS thought it was difficult to envisage the division of MKW between FDWS and SEW as providing any additional resources for customers of MKW. Whilst the proposals would, if implemented, lead to some reallocation of MKW's 25 per cent of the yield of Bewl Water reservoir to SEW's customers, this objective could be pursued in the absence of the acquisition proposals, through BST agreements; though SWS noted a reluctance on SEW's part to discuss BSTs. Any redistribution of MKW's current resources to the customers of other companies would inevitably hasten the day when a major new regional resource was needed. Water from such a resource might be expected to cost more than existing supplies, thus facing MKW customers with higher bills earlier than would otherwise have been the case. Commenting on the number and nature of BST and other supply agreements between SWS and MKW, SWS said that there was no expectation that a change of ownership of MKW, if that was agreed, would of itself disturb the operation of these agreements.

10.19. In the longer term SWS remained ready to take the interests of neighbouring water companies into account in developing strategy. The company had not ruled out Broad Oak or Darwell as sites for eventual major resource development, but currently it was looking to a possible increase in the capacity of the Bewl Water reservoir. In contrast to the present arrangement under which MKW had a 25 per cent share in Bewl, SWS did not have any obligation to provide 25 per cent of any increased capacity to MKW (or to any other company). However, SWS would be willing to discuss BSTs with adjoining companies and would expect the EA to have an input in this regard in view of the licensing implications. There was no fixed time-scale yet, but developing Bewl would allow resources to flow, via Weir Wood, to the Horsham and Crawley areas; take some of the pressure off SWS's Hardham works; and increase the supplies to the Hastings area via the new link to Darwell. SWS's plans also included looking at options for bringing water from the west into the Hardham or Sussex Coast parts of its area.

10.20. Wherever resources permitted SWS saw BSTs as a sensible approach which could have the effect of avoiding the redistribution of MKW's current resources thereby deferring for their customers the cost of funding expensive new reservoir schemes. BSTs were also preferable to transfers of abstraction licences.

Water undertakings necessarily worked to relatively short time horizons on water availability, and licence transfers of any short-term surpluses could well exacerbate longer-term capacity problems. For its part SWS would consider the prospect of selling some of its abstraction licences, and possibly placing its customers at risk, as an unattractive one. BSTs could, however, provide both short- and long-term solutions. It was not right to argue that there was an inherent lack of security in BSTs; the 60-year arrangement at Weir Wood with SEW could almost be classed as an in-perpetuity BST, and such long-term agreements were particularly feasible at the planning stage for new resources. Nor would SWS see its critical planning dates as limiting factors if, as the company was doing its planning, it was able to make due allowance for the BST needs of other companies. Despite any conditions attached to bulk supply agreements allowing a supplier to suspend delivery of water in specific circumstances, it was, in practice, most unlikely that supplies would be interrupted except in the event of some *force majeure*, for example a burst pipeline. SWS considered that it might well be cheaper for SEW and FDWS to use BSTs to solve resource problems in their areas rather than develop their own resources. SWS was currently completing internal consideration of a potable water link from its Turner's Hill service reservoir to Buchan Hill service reservoir to enable water from Weir Wood to be moved towards Crawley. This main would enable the company's longer-term objective of transferring additional resources from Weir Wood to the Crawley area to be achieved, ultimately using water transferred from an enlarged Bewl Water. When implemented there would seem to be an opportunity to make additional resources available from Weir Wood reservoir to SEW on a BST basis.

### *Cambridge Water PLC*

10.21. Cambridge Water PLC, which is an independent WoC, had concluded that a merger had not taken place. On the occasion of MKW's AGM in July, GU and SAUR had both raised important questions and voted against resolutions. In considering whether it might be taken to imply that GU and SAUR were acting together because both voted against resolutions, it was necessary to ask how a prudent shareholder who had expert knowledge of the water industry and its regulatory framework might have voted. Cambridge Water would have considered that MKH's increase of 90 per cent in dividend was exceptional, both in terms of the ability of a company to sustain such a dividend in future years and from the point of view of the DGWS, who was looking to see a fair balance between the benefits paid to shareholders and to a company's customers. For such reasons, the fact that GU and SAUR both voted against resolutions was inconclusive evidence that they were acting together to secure or exercise control over MKW.

10.22. In Cambridge Water's view, a small company, even if it was well run, might reach the limit of efficiency gains more rapidly than a large company. In these circumstances a small company could only achieve further gains, without the risk of losing shareholder support, if it was able to expand its business, for example through reorganizations in the industry which had the effect of spreading a company's overheads over a larger customer base. If such reorganizations could take place without loss of comparators, the DGWS's objectives might be advanced. In a regulated public service, the structure of the operating units rather than the issue of ownership should be the primary consideration. The MMC's decision in the MKH case should not be one which might prevent other reorganizations of operating units from being proposed.

### *Mid Southern Water plc*

10.23. Mid Southern is a subsidiary of SAUR. It said that a large amount of effort had been put in by both FDWS and SEW over recent years to try and break the deadlock over the misallocation of water resources between water companies. It could not be right that SWS, MKW and Portsmouth Water had surplus licences and water, whilst SEW and FDWS had a deficit. It considered it ludicrous that major resources such as Weir Wood, Bewl Water and Darwell were located within the boundary of SEW but were not available to SEW. Without adequate water resources under their own control SEW and FDWS would be unable to guarantee supplies, and it was difficult to see how they could compete with their neighbours.

10.24. In the company's view the imbalance of resources in the south-east of England could not be resolved by taking BSTs from the companies in surplus. BSTs had no place in the current competitive, privatized water industry. At times of peak demand of water shortages, the bulk supplier would always protect its own customers at the expense of the company receiving the BST.

10.25. Mid Southern was aware of various reports showing MKW's levels of service and other performance measures to be at the bottom of the league. The loss of MKW as a comparator would not, in its view, make any difference to the DGWS's ability to carry out comparisons between companies. An enlarged SEW and FDWS would be better and more significant comparators than they were now.

### *North Surrey Water Ltd*

10.26. North Surrey said that GU currently held 99 per cent of the company's voting share capital. It supported the proposed merger. GU had consistently emphasized the importance of local management and local circumstances and issues. So the development of North Surrey within the GU group had reflected its own particular circumstances. At the same time, benefit had accrued from being able to compare and contrast all the companies within the group. In addition, membership of the GU group had provided advantages through ready access to group expertise (for example, technical and scientific support) both in the UK and in France.

10.27. The company also submitted that ownership by GU had brought the following benefits:

*(a)* to management-by providing access to experts and the means to identify best practice through inter-group discussions;

*(b)* to customers-by improved service and better water quality, through responsive local management;

*(c)* to staff-through wider opportunities for career development; and

*(d)* to regulators-through ready, open access to good-quality information and an efficient comparator against which to measure others.

### *South Staffordshire Water Plc*

10.28. South Staffordshire Water Plc said that it had insufficient knowledge to determine whether there was a merger in being. As to the public interest of the proposed acquisition, the result of the MMC process should be one in which a sound, viable and transparent system of competition was able to operate.

### *Tendring Hundred Water Services Ltd*

10.29. Tendring Hundred said that it was acquired by GU following an agreed bid. It supported the proposed acquisition of MKW and emphasized the GU group's commitment to high standards. Since becoming part of the GU group, Tendring Hundred had continued to operate with a very high level of local autonomy. Group companies met regularly to report progress and discuss and exchange ideas and initiatives to improve performance in all areas of activity. This provided a stimulating and competitive environment and comparators were used extensively to help develop and improve performances by the group companies. For instance, customer service standards had been improved throughout the company. GU had made this a major issue and work was progressing throughout group companies to develop a comprehensive `customer charter'.

10.30. Tendring Hundred had a good record of achievements in leakage control and in persuading customers to use water wisely. On leakage it had consistently achieved about the best overall performance of all water companies in all the main leakage indicators in use, whilst further published data from OFWAT showed Tendring Hundred to have one of the lowest household per capita consumption figures. Together with the other GU group companies, it was in favour of water metering. As well as offering customers a heavily subsidized meter option, Tendring Hundred had recently decided to require all sprinkler users to be metered.

10.31. On the strength of this kind of local achievement, the company suggested that present customers of MKW would be assured of a well-focused and reliable water supply service were the proposed acquisition to proceed, and that the proposal would not be against the public interest.

### *Three Valleys Water PLC*

10.32. Three Valleys said that it was a wholly-owned subsidiary of GU and that it had been formed in 1990 by the merger of three former companies, Colne Valley Water, Lee Valley Water and Rickmansworth Water. The merger of these three companies had been extremely successful. Tangible benefits had been passed on to customers in the form of lower charges, improved customer service and improved water supply and distribution systems. At the time of the merger it had been anticipated that there would be greater self-sufficiency and flexibility in the use of water resources, including more efficient and effective use and the future development of an integrated distribution network. This had certainly been achieved with the bringing together of major sources of supply under common ownership and management. The following benefits had arisen:

*(a)* conjunctive use of major water resources;

*(b)* reduced reliance on BSTs;

*(c)* construction of major pipelines to transfer water to those parts of the new company area which had previously suffered from resource problems;

*(d)* ensuring that operations were as close as possible to the communities served; and

*(e)* creation of a water resources centre to manage and control the strategic movement of water around the enlarged area to ensure greater security of supply.

10.33. In its view none of these benefits would have been achieved successfully if the companies had remained separate. Three Valleys, although part of GU, did retain considerable local autonomy and was, therefore, an important comparator for the DGWS. The Three Valleys merger, together with the benefits of the support from GU, had also resulted in improved efficiency with unit operating costs falling from 44 p/m$^3$ in 1991/92 to just 38 p/m$^3$ in 1994/95. This was against an increase in the industry unit operating cost from 42 p/m$^3$ in 1991/92 to 44 p/m$^3$ in 1994/95. (Source: OFWAT's 1994/95 Report on The Cost of Water Delivered and Sewage Collected.)

10.34. Another major benefit of the merger and of being part of an international group was the ability to access the considerable research facilities of CGE world-wide. During the last five years since the merger, the company had reduced the leakage rate on its own mains by about one-third and it was still working to reduce it even further. Three Valleys did not believe this would have been possible to the same extent had the three former companies remained separate.

## Major shareholders in MKH

### *Morgan Grenfell*

10.35. Morgan Grenfell, whose Investment Banking Division was a financial adviser to GU, gave the following information to the MMC about its own role in MKH matters:

*(a)* *Structured Finance and Investment Banking Divisions*. Structured Finance Division (SFD) was the banking division of Morgan Grenfell. It carried on all the activities of general commercial banking including export credit, leveraged buy-outs, leasing and tax-based lending. The MMC would appreciate the distinction between these activities and the corporate finance activities of the Investment Banking Division (IBD) of Morgan Grenfell. Strict Chinese walls were in operation between SFD and IBD; in particular, IBD operated from its own segregated and secure area and the divisions had separate reporting lines. Officers and staff of the two divisions operated independently of each other and did not share information unless permitted under proper compliance procedures. The procedures for maintaining the Chinese walls were set out in the compliance manual and relevant officers and staff were required to undertake to comply with the manual.

*(b)* *9.4 per cent holding*. In 1991 GU undertook to the Secretary of State for Trade and Industry to reduce its shareholding in MKH to a level of not more than 19.5 per cent (the `undertaking'). Following the

undertaking, on 30 June 1992, SFD purchased 2,256,000 10 per cent redeemable cumulative preference shares of £1 each in MKH (the shares) from GU (see Appendix 3.7). This holding represented almost 9.4 per cent of the voting rights in the share capital of MKH. Under the purchase agreement for the shares (the Agreement) there were provisions for payment of deferred compensation by GU to Morgan Grenfell in certain circumstances to maintain an agreed return to Morgan Grenfell as a result of the purchase. There were no constraints imposed on Morgan Grenfell's voting rights or rights of disposal (although the compensation payments might be affected under certain circumstances). Morgan Grenfell received legal advice that it was not `associated' with GU or CGE or any of its subsidiaries under section 77(4) of the FTA by virtue of the Agreement and confirmed this to OFWAT before completion of the Agreement. Morgan Grenfell understood that GU was similarly advised that it and Morgan Grenfell would not be associated under the Agreement and that the Agreement did not confer upon GU any interest in the shares. Morgan Grenfell further understood that there were discussions over the terms of the Agreement involving GU or its advisers, the DTI, the OFT and OFWAT before the Agreement was entered into. On 30 June 1992 Morgan Grenfell notified MKH of the acquisition in accordance with section 198 of the Companies Act.

*(c)* *Financial adviser*. After the acquisition of the shares, SFD had been solely responsible for managing the holding. It had not consulted IBD on the holding as regards voting rights attached to the shares or otherwise. Similarly, SFD had not been involved in IBD's role as financial adviser to GU. IBD accepted its appointment as financial adviser to GU in connection with MKH on 15 December 1995 and following independent legal advice. In the light of legal advice received, IBD concluded that Morgan Grenfell's procedures for segregation of roles described above would mean that SFD would not be acting with GU to secure control of MKH and that its holding of the shares would not be relevant for this purpose. Further, IBD was aware that any change in control would be subject to investigation by the MMC and a bid by GU would require it to be released from the undertaking. As such, IBD could not in any meaningful sense act with GU to acquire control until such time (if ever) as following the MMC report the undertaking was relaxed.

10.36. Morgan Grenfell voted by proxy against resolution 6 (authority to purchase own shares) proposed at the AGM of MKH held on 18 July 1996 and against the extraordinary resolution proposed at the separate general meeting of the holders of 10 per cent redeemable cumulative preference shares 1997 on the same date (see Appendix 6.3). It did not vote in relation to any other resolutions proposed at those meetings.

10.37. The decision on how to vote/abstain at the meetings was taken by SFD without reference to IBD. The SFD personnel concerned concluded that it was in the commercial interests of SFD to vote against the two resolutions referred to above and that the other proposed resolutions were immaterial to its interests. In particular:

*(a)* SFD concluded that the passing of the proposed resolutions could not be to its advantage as preference shareholder (irrespective of the Agreement).

*(b)* SFD had received legal advice that voting in favour of or abstaining from voting on any resolution which could affect the value of the preference shares might affect compensation rights under the Agreement and that, therefore, the cautious approach, to avoid any doubt, would be to vote against any such resolution. SFD had followed this advice.

*(c)* SFD considered that the passing of the resolutions might be part of a defensive strategy by MKH to discourage bids (by any person, not just GU/SAUR) for the company which might prevent SFD from maximizing its value in the shares should a successful bid at an appropriate price otherwise be made (and cleared by the MMC).

### *The Equitable Life Assurance Society*

10.38. The Equitable Life Assurance Society (Equitable Life) said that it was not aware of the existence of a formal agreement between GU and SAUR to act together although that did not mean that one did not informally exist.

10.39. It did seem possible that, in the event that a bid did not take place, GU and SAUR could exercise creeping control of MKH, perhaps by installing friendly directors on the Board. It was difficult to gauge whether this would operate in the public interest or not. Whichever parties were in control, they would be regulated by OFWAT. The consumer would therefore be protected against higher than necessary price rises, deterioration in the quality of service and reductions in capital expenditure. Hence, Equitable Life did not believe that the universe of water enterprises would be so significantly affected by such a merger as to prejudice the DGWS's ability to set bench-marks and make comparisons.

10.40. However, it had been suggested that the main motivation behind GU's and SAUR's intention to bid was to secure access to MKW's supply of water. If this was the case, then it might be said that a take-over of MKW could be operating against the public good-at least as far as MKW's customers were concerned. Ultimately, it was in the interest of Equitable Life's policyholders (as indirect shareholders in MKH) that there should be more clarity in the situation. Either both companies should be disallowed from bidding (and either or both companies should have to reduce their holdings in MKH), or they should be allowed to put a formal offer on the table. What was unacceptable was for GU and SAUR to exercise control without paying a premium to other shareholders for that control.

### *The Prudential Assurance Company Limited*

10.41. The Prudential Assurance Company Limited (the Prudential), which owns 1,681,900 ordinary shares and 1,375,900 preference shares in MKH, said that it was unable to provide the MMC with any evidence which might indicate that GU and SAUR had been acting together to secure or exercise control of MKH. The Prudential had not communicated with either GU or SAUR or with their advisers. However, the statement made by these companies on 21 December 1995 which indicated that any discussion with the Board of MKH about the proposed offer would be subject to mandatory reference to the MMC might be taken as an indication that GU and SAUR would not act to secure or exercise control of MKH until MMC clearance had been obtained.

10.42. With the prospect of a bid being made for MKH in the foreseeable future it was not surprising that some shareholders in MKH might come to the conclusion that it would not be in their interests for either the share repurchase proposal or the management incentive scheme to be approved. Shareholders in listed companies generally had a very wide range of views on matters which might affect their economic interests. In the particular situation of MKH the fact that GU and SAUR voted as they did at the meetings on 18 July 1996 could not be taken as evidence that they were acting together to secure or exercise control of MKH.

10.43. Although the Prudential did not support the contention that the public interest would be adversely affected if there were an existing merger, it did not at this time believe there was or might be an existing merger. However, if it were to be found that there was a merger in being, the Prudential did not believe it would prejudice the ability of the DGWS to make comparisons between different water enterprises.

### *The Royal London Mutual Insurance Society Limited*

10.44. The Royal London Mutual Insurance Society Limited (Royal London) said that it did not have any reason to believe there had been collusive behaviour by GU and SAUR via their large shareholdings in MKH. Indeed, Royal London had traditionally viewed the two companies as rivals for influence over the company. The fact that both companies voted against the controversial performance share plan was unsurprising given the nature of the plan. Royal London's final decision was to abstain, although it could understand why other shareholders should have taken a more adverse view.

## Local authorities

### *Kent County Council (County Planning Department)*

10.45. As the strategic authority for Kent, Kent County Council (KCC) was not directly concerned with issues of monopoly and competitiveness. But it was concerned with their consequences upon present and future residents, the economy and the environment. KCC said that it had received very diverse evidence about the efficiency and effectiveness of SEW, FDWS and MKW. KCC sought an organization for, and pattern of, water supply and re-use in the county which provided secure, high-quality and equitable provision for the future. It was aware that in parts of the county, notably east Kent, the level of future supply was such as to place at risk the needs of residents and the local economy. East and north Kent were priority areas for economic development under KCC's structure plan and in terms of Government regional policy.

10.46. KCC considered that major initiatives on water conservation and water transfer within Kent were needed before expensive water storage schemes were considered. It understood that the DGWS and the EA could require co-operation or co-ordination between suppliers, with or without company reorganization and merger. It believed that the need for co-operation and co-ordination was clear; the means to achieve the necessary high level of integration of supply was a matter for the DGWS and the EA.

10.47. The improvement of supplies remained the prime requirement. And in the event that the primary objective of securing sustainable and long-term water supplies could be achieved without company merger, then this would provide an *a priori* case for ensuring a basis of competitive water supply in the county.

### *Ashford Borough Council*

10.48. Ashford Borough Council (ABC) said that it was concerned by the attempted hostile take-over of MKW by two multinationals, GU and SAUR. This appeared to breach the MMC recommendation of 1990 and the undertakings given by GU to the Secretary of State at that time. ABC therefore opposed the proposed acquisition and urged protection for the interests of the water consumers of the borough.

10.49. ABC, whose concerns were also conveyed by Sir Keith Speed MP (Ashford), believed that the DGWS's use of comparators between water companies as a basis for price controls would be eroded if MKW disappeared.

### *Maidstone Borough Council*

10.50. Maidstone Borough Council said that its Policy and Resources Committee considered that there was no objection to the proposed acquisition, subject to the water market in the south-east of England still having sufficient diversity of ownership for comparisons to be drawn between the performance of water companies, and the DGWS being satisfied that the protection of customers' interests was not prejudiced.

### *Shepway District Council*

10.51. Shepway District Council (SDC) said that FDWS served the majority of the Shepway area. Only a small part of the SDC area was served by MKW. SDC's main concern was to ensure that, whatever the outcome of company ownership, residents within the existing MKW area continued to receive supplies of high-quality water and associated services at an acceptable price. Given the restrictions of water supplies over the last two years as a result of drought conditions, it might be that a larger company covering a wider catchment area had the ability to ensure a continuing supply of water throughout the whole of the area.

### *Swale Borough Council*

10.52. Swale Borough Council (SBC) had noted the developments concerning MKW with some alarm. What was a well-managed water provider appeared to be threatened with the aim of supplying its water to other areas, where management did not appear to be as good, to the detriment of the community in the MKW area. SBC was, therefore, concerned that the proposed merger was not in the interests of the public presently served by MKW. Both the potential purchasers' subsidiaries were experiencing difficulties in meeting demand. The intention, as SBC understood it, was to optimize water resources over a larger area. SBC did not find this argument convincing. Spreading scarce resources over a wider area might well lead to a deterioration of service, and a levelling down rather than a levelling up.

10.53. The management and operational performance of MKW had been good and SBC would not wish to see any deterioration of service to customers. There was a significant risk that the loss of MKW's independence would not be in the public interest. SBC would oppose the proposed take-over.

### *Tonbridge & Malling Borough Council*

10.54. Tonbridge & Malling Borough Council (TMBC) did not feel it was in a position to comment on whether GU and SAUR had been acting together to secure or exercise control of MKW. If the MMC found that there was an existing merger then TMBC believed this might give rise to concerns that it would not operate in the public interest. The essence of these concerns was the same as TMBC had for the proposed merger. This was that a reduction in the number of independent water enterprises would lessen the ability of the public to effect comparisons of performance. This could result in a reduction of pressure to secure infrastructure improvements which were needed to preserve and safeguard the quality and adequacy of water supplies.

10.55. It followed, therefore, that TMBC considered that the ability of the DGWS to make comparisons between different water enterprises would be prejudiced. It was difficult to see what remedy might be available to prevent that prejudice other than disallowing the proposed merger, whether through enforcement of GU's 1991 legally binding undertakings or through the exercise of such statutory powers as were available under relevant enactments. TMBC asked the MMC to consider very carefully the interests of water consumers during the course of their investigations.

10.56. Other particular concerns were:

*(a)* The existence of independent suppliers in various areas, whilst not directly providing choice and competition for consumers, did provide the opportunity for bench-marking of performance and price. This could facilitate informed debate and lead to improvements in performance.

*(b)* If the take-over were permitted, a virtual monopoly would be created in the area. Customers would not easily be able to judge performance and the new body would have less incentive to manage its resources effectively.

*(c)* MKW had managed its supplies effectively in the difficult climatic conditions that had prevailed; for example, it currently did not have a hose-pipe ban in place. It was understood that such bans were in force in nearby areas served by GU and SAUR. If the take-over were allowed, then water resources from the Mid Kent area could be piped to other areas to alleviate supply difficulties. TMBC's concern was not that it was wrong that water resources should be pooled for the benefit of the overall population. Rather, it was that the possibility of imposing a hose-pipe ban in Mid Kent and transferring the resources saved to other areas might be a more attractive proposition than addressing fundamental issues such as leakage levels and capital expenditure on infrastructure improvements.

### *Tunbridge Wells Borough Council*

10.57. Tunbridge Wells Borough Council expressed concern that a merger of this kind could result in the formation of very large companies and a consequential reduction in competition.

### *Addington Parish Council*

10.58. Addington Parish Council said that it did not wish the proposed take-over of MKH to take place. The general feeling among residents was satisfaction with the service given by MKW, which had achieved this success by taking BSTs and by having invested more than twice as much per head in water resources in the period 1990 to 1995 as had FDWS or SEW.

### *Bethersden Parish Council*

10.59. Bethersden Parish Council expressed its concern at the proposed acquisition of MKH, and said that there was no real justification for losing this valuable independent water company which had served Mid Kent successfully.

### *Birling Parish Council*

10.60. Birling Parish Council said that the proposed take-over was not necessary and was not needed to achieve improved water supplies or service standards; and it would eliminate an independent comparator, making it harder for the DGWS to set stringent price controls and service standards. MKW had had no hose-pipe bans in 1996, unlike FDWS and SEW, because it took BSTs and had effective resource management policies, investing more than twice as much per head on water resources between 1990 and 1995 as FDWS or SEW.

### *Borough Green Parish Council*

10.61. Borough Green Parish Council said that it was most disturbed to hear about the proposed take-over of MKH and wished to register support for the continuance of an independent MKW. There was particular concern about the reduction in competition that would result from a take-over, and about the ability of a different water supplier to make the necessary investment in, and commit the required levels of maintenance to, the infrastructure.

### *Boughton Monchelsea Parish Council*

10.62. The Boughton Monchelsea Parish Council (BMPC) strongly objected to the proposed take-over of MKW by GU and SAUR. Local residents had always enjoyed a very reliable service from MKW. MKW, unlike other water companies, had not had a hose-pipe ban in 1996. By exercising effective resource management it had managed to maintain an uninterrupted water supply. BMPC very much doubted whether GU and SAUR had the same concern over Kent's environment as MKW. The need for profits would, in BMPC's view, undoubtedly lead to higher water bills for Kent's residents.

### *Brenchley Parish Council*

10.63. Brenchley Parish Council was totally opposed to a take-over by GU and SAUR and urged that the MMC recommend that the bid be prohibited.

### *Broomfield & Kingswood Parish Council*

10.64. Broomfield & Kingswood Parish Council (BKPC) considered that service from MKW had been, and still was, more than satisfactory. There had been no hose-pipe bans in the area, although neighbouring supply companies had had such bans in force. BKPC fully approved of MKW's operational policies, including its investment plans and environmental approach. BKPC, therefore, felt strongly that the proposed take-over should be refused.

### *Doddington Parish Council*

10.65. Doddington Parish Council (DPC) urged rejection of the proposed take-over bid. MKW had served customers in its area well. There had been no hose-pipe ban in 1996. DPC understood that MKW's investment in water resources would enable this state of affairs to continue. This was particularly important to local strawberry growers who had irrigation systems in place. DPC was also worried that if the proposed take-over were successful, water would be taken to improve the situation in other areas leaving MKW customers with shortages.

### *Ditton Parish Council*

10.66. Ditton Parish Council expressed concern regarding the proposal for the take-over of MKH by GU and SAUR. It had always been totally satisfied with the services provided by MKW and could not understand the necessity for any take-over.

### *Egerton Parish Council*

10.67. Egerton Parish Council had considered a submission to it from MKH and supported MKH's contention that the proposed take-over should not and need not happen. As an independent company, MKH had demonstrated success in maintaining water resources and supplies and in achieving high standards of service. It made no sense to eliminate this company or to merge it with companies which had not matched MKW's achievement in avoiding supply shortages this year.

### *Parish Council of Farningham*

10.68. The Parish Council of Farningham (PCF) wrote to express its concerns at the proposed take-over. PCF supported MKH's reasoning in objecting to the proposals. It further stated its concern about companies taking over and exploiting facilities which were an integral part of MKW's infrastructure, with the possibility that these facilities would be run down as a result of a gradual reduction in the necessary investment.

### *Great Chart with Singleton Parish Council*

10.69. The Great Chart with Singleton Parish Council (GCSPC) believed there was no need for the proposed take-over. It would eliminate an independent comparator, making it harder for the DGWS to set stringent price controls and service standards. In GCSPC's view the proposed take-over was not required to achieve improved water supplies or service standards. This was achieved by taking bulk supplies, as MKW had done, and by effective resource management. GCSPC also made the point that MKW had invested more than twice as much per head on water resources as FDWS or SEW between 1990 and 1995.

### *Lenham Parish Council*

10.70. Lenham Parish Council considered that MKW should continue to remain under the ownership of MKH. The Council urged that the proposals be looked at very closely as the present situation was of benefit to the people of Kent.

### *Plaxtol Parish Council*

10.71. Plaxtol Parish Council (PPC) urged that the proposed acquisition of MKH be disallowed. It was concerned that:

*(a)* the continued supply of water during dry summers would be prejudiced if the two adjoining areas took too much water from the MKW area following a take-over;

*(b)* the village community needed to be reassured that they would not be called upon to subsidize the improvements which the bidders would need to make in their areas; and

*(c)* value for money and efficiency would suffer. In recent years MKW had substantially improved its efficiency and customer service and had reduced leakage from the system.

### *River Parish Council*

10.72. River Parish Council (RPC) had considered the possible effect of the take-over bid and did not feel that the break-up of MKW would be in the best interests of the people of Kent or of the natural environment. There was no doubt, in RPC's view, that the Broad Oak reservoir scheme which was considered in the 1980s should have gone ahead to ensure adequate supplies overall for the county; it was discontinued because of the fragmentation of the water companies even before privatization. RPC could not agree with MKW's view that the additional reservoir capacity would not be needed until 2010. But in any event what was needed most in the interests of the county as a whole was to avoid the distraction of take-over bids and wasteful competition between the various water bodies, and to encourage greater co-operation and working together.

### *Rolvenden Parish Council*

10.73. Rolvenden Parish Council said that it agreed with the case against the proposed acquisition presented by MKH, and thus opposed the take-over proposed by GU and SAUR.

### *Sholden Parish Council*

10.74. Sholden Parish Council supported MKH's wish to remain an independent company, and felt that the proposed take-over bid was not in the best interests of the county as a whole. Whilst other water companies in the area had imposed hose-pipe bans, MKW appeared, with the help of supplies of surplus water purchased from SWS, to have managed its own resources more successfully.

### *Smeeth Parish Council*

10.75. Smeeth Parish Council objected to the proposed take-over because MKW was giving an excellent service, particularly in respect of the amount being put back into resources to improve their management. A take-over was not needed to improve water supplies or service standards. Indeed, it would eliminate an independent comparator, making it more difficult for the DGWS to set stringent price controls and service standards.

### *Westbere Parish Council*

10.76. The hostile take-over of MKH by GU and SAUR was of great concern to Westbere Parish Council (WPC) and its parishioners. The services enjoyed in Westbere over recent years from MKH had been of a high standard and at reasonable cost; and more particularly, through quality management and investment in the infrastructure, rationing by way of hose-pipe bans had been avoided unlike in neighbouring companies' areas. The proposed merger was designed to dissipate well-managed resources to areas with inferior facilities and could only be to the disadvantage of the customers of MKW.

## Other public bodies

### *English Nature*

10.77. English Nature said that the proposed merger did not raise any particular concerns, provided that the new owner of MKW carried out its function of managing land and water resources with due regard to the general principles of sustainability and with full regard to its duty to further nature conservation as required by the Water Resources Act 1991. As an owner of land designated as sites of special scientific interest, MKH had a statutory responsibility to consult the local authority, the Secretary of State for the Environment and English Nature if proposing to carry out any operation which was potentially damaging on that land. English Nature felt it was important that this statutory obligation should be brought to the attention of any prospective owner of such land.

### *East Kent Health Authority*

10.78. East Kent Health Authority considered it important to draw the MMC's attention to the need to ensure that the health authority and its officers, in particular the Consultant in Communicable Disease Control (CCDC) who was also appointed as `proper' officer to the local authorities in East Kent, continued to have the active co-operation of the water companies on issues of public health. It was a statutory requirement for regular liaison meetings to be held between the water companies and the CCDC.

10.79. Recent examples where it had been important to have full co-operation were:

- investigation of cases of cryptosporidium;
- safety of effluent from rendering plant;
- discharge of sewage into the sea;
- monitoring nitrate levels;
- protection of renal dialysis patients; and
- water contamination with sewage.

### *Brighton Health Care NHS Trust*

10.80. Brighton Health Care NHS Trust, while not as yet directly affected by the proposed merger, felt that the trend towards combination of water companies must be of concern to clients because it affected the number of alternative pricing regimes available, and influenced the water supply strategy for the future. Combinations must inevitably alter the relationship of power between the DGWS, the customer and the companies. On balance, it was in the interest of the customer, and therefore of the Trust, to maintain the balance in favour of the DGWS. The Trust would not encourage a combination of water or utility companies.

### *Eastbourne & County Healthcare*

10.81. Eastbourne & County Healthcare, an NHS Trust, said that it had no objection to the proposed merger and would rely on the current regulatory bodies and market forces to ensure that consumer services and associated costs were not adversely affected.

### *South Kent Hospitals NHS Trust*

10.82. South Kent Hospitals NHS Trust said that while it did not wish to comment on whether the proposed acquisition of MKW by GU and SAUR was against the public interest, it noted that the services of a number of local water companies varied in quality and cost. It did not regard all services provided by MKW as being outstanding value for money, and would welcome a new management structure which might reduce existing prices and introduce a more competitive pricing regime.

## Business and consumer organizations

### *The Water Group, Canterbury Friends of the Earth*

10.83. The Water Group, Canterbury Friends of the Earth (the Water Group), wrote to the MMC and attended a hearing.

10.84. The Water Group was a sub-committee of the Canterbury Friends of the Earth. It was originally set up to consider a proposal from the Southern Water Authority and the then Mid Kent Water Company to build a reservoir at Broad Oak. The Water Group successfully opposed this and had subsequently kept a watch on water-related matters in the area.

10.85. The Water Group had a number of reasons for rejecting the proposed merger. MKW was primarily a Kent company, most of whose customers, employees and shareholders lived in Kent. MKW had very close local connections. This `intimacy' would be lost if the proposed acquisition were successful. In this respect the proposal was against the public interest. The acquiring companies' headquarters were outside this country, remote from the concerns and interests of the local customers and employees.

10.86. MKH had improved its environmental record significantly. It had won acclaim for restoring Chilham Mill, and there were other areas where it had made environmental improvements. It was to be doubted whether a larger combined organization that would result from the take-over would take so much interest in such concerns.

10.87. The Water Group believed that SEW and FDWS had not co-operated with other water companies in sharing water resources. MKW had substantial partnership on water resources matters and developments, such as at Bewl, with SWS. If MKW were taken over, the legal relationship between the new companies and SWS would be in jeopardy, to the detriment of both SWS and MKW customers. MKW had come from being the company with the highest standing charges in England to being among the lowest. That was a significant and major step and was particularly important when the EA was trying to ensure the efficient use of water. Low standing charges ensured that the cost of water reflected actual use and hence encouraged economy.

10.88. The cost of the take-over would have to be recouped from somewhere. This cost was likely to come from the customers or staff, and hence was likely to be against the public interest. There would also be the incentive to sell more water (to generate more income) to help recoup the costs, and this would also be an undesirable effect. It was likely that, if the companies remained as they were, a Broad Oak reservoir would only be developed when essential, because the companies would not co-operate unless they had to. One large company would be in a more powerful position and able to push a development through sooner. The customers would have to pay the extra costs involved. The Water Group's major concern about this proposed merger was that the present separate arrangement was fairly straightforward for the DGWS and the EA to manage. With one large organization it would become much more difficult, and this would be significantly damaging to the public interest.

10.89. Accordingly, the Water Group considered the proposed acquisition to be against the public interest. Were it allowed to proceed, this should only be on condition that various offsetting public interest improvements were made, especially on the environmental side (for example, reductions in abstractions, re-using water, improving water quality and reliability of water supply). While a price reduction would be beneficial economically for customers, it might be detrimental environmentally, if reduced costs reduced the incentive to save water. On the other hand, the Water Group emphasized the need for any conditions attached to agreement to the merger to include making leakage reductions the top priority, and making sure that demand management did not just mean `more metering' and nothing else.

### *The Chartered Institution of Water and Environmental Management*

10.90. The Chartered Institution of Water and Environmental Management said that it wished to express its concern that the high level of professionalism in the science, engineering and management of MKW's service to customers was maintained.

### *Kent Chamber of Commerce & Industry*

10.91. The Kent Chamber of Commerce & Industry (KCCI) said that it had taken written evidence from both FDWS and MKW.

10.92. The fundamental case advanced by FDWS was that an unequal distribution of natural resources as between the companies could and should be addressed through a corporate take-over. KCCI accepted that there was an unequal distribution of natural resources. However, it believed that the shortage of water resources in the Folkestone and Dover area could satisfactorily be met by a BST agreement with MKW, particularly from the Barham source (close to the border between the two areas). The price charged (if an issue) could be arbitrated upon by the regulator. Penalties could be attached to any failure to honour agreements to supply. On this basis, the stated objectives of FDWS could be met without the need for a take-over. KCCI had offered to arrange a meeting between FDWS and MKW to discuss a suitable BST arrangement and to act as an `honest broker' at any stage, if that were thought to be helpful and if both parties agreed.

10.93. MKW appeared to the business community to be an increasingly well-managed, locally-directed company, which had shown great commitment over a number of years to the local community, perhaps particularly the business community. Its independent presence also enabled better comparisons of performance between companies in the region. A take-over would put this comparator role at risk. In saying this, KCCI did not in any way wish to detract from the undoubted quality of FDWS's operation within its own area, and there were a wide range of issues that it was not in a position to weigh.

### *Maidstone and Mid-Kent Chamber of Commerce and Industry*

10.94. Maidstone and Mid-Kent Chamber of Commerce and Industry (MMKCCI) said that it would find it astonishing if the proposed merger received the blessing of the MMC. Not only was MKW one of the few truly independent water companies still existing but one of the few successful ones. It had an excellent record of supply to Mid Kent and a good image in the eye of the consumer.

### *Shepway Chamber of Commerce & Industry*

10.95. Shepway Chamber of Commerce & Industry (SCCI) wrote to give its full support for the proposed acquisition of MKH. In coming to this conclusion SCCI had taken many issues into account:

*(a)* The proposals appeared to include the guarantee of a grid system from within the existing price limits to provide relief from existing and future water shortages. Both the grid system and the jobs generated by the investment would benefit the Kent customer.

*(b)* The MKH suggestions that bulk supplies might be available from area to area did not seem to offer the grid system which would be needed to transfer the bulk supplies.

*(c)* MKH had circulated a number of letters and articles which were, at best, misleading. The anti-French comments made were very damaging to the image and economic interests of Kent.

*(d)* The problems of water supply in the south of Kent were real and acute. GU and SAUR had a proven record of investment and were world leaders in water resource management.

*(e)* The commitment of GU to Kent and to east Kent in particular was genuine and to be welcomed.

*(f)* Four water supply companies currently served the region and the system was undoubtedly fragmented. This arrangement was in sharp contrast to much of Great Britain where water supply was provided by one company on a regional basis, enabling strategic management of the resources available. It was hard to see how the water supply arrangements in Kent could be optimized without some merging of the fragments.

*(g)* GU and SAUR provided the only viable, long-term solution to developing a sustainable water supply. Their plans also fitted well with the EA's wish to see greater co-operation to solve Kent's supply problems.

*(h)* The acquisition would defer the need for the construction of any additional surface reservoirs, would enable long-term planning of resources and would ensure a sustainable water supply now and in the future.

### *Business Link (Kent) Limited*

10.96. Business Link (Kent) Limited (Business Link) felt that if there was a merger in being, such a merger would reduce competition in the water supply industry and would make it much more difficult for the DGWS to make comparisons. Secondly, the take-over of a company with a comparatively good track record in resource management by organizations with a less comparatively good track record seemed to Business Link to defy logic. For these reasons, the consumer would not be well served.

10.97. Business Link pointed out that it shared the same Chairman as MKH. However, the Chairman had not solicited, or contributed to, Business Link's views in any way.

10.98. As far as the proposed merger was concerned, it was the view of Business Link executive officers that the bid was not in the public interest. Business Link's catchment area consisted largely of the territories of all three companies. It believed the take-over would have a negative impact on the economic development of the sub-region. Major local investment decisions of the near future could well rest on availability and cost of water.

10.99. The bidding consortium had explicitly stated that they did not intend to undertake major investment in the foreseeable future, whereas MKW had invested consistently over the last few years. This had resulted in a small surplus of resources and no hose-pipe or other user constraints. This had not been the case in the neighbouring authorities.

10.100. It was clear that the consortium was looking to acquire MKH as a means at least to defer, if not avoid, major investment in their respective areas at the expense of users in the Mid Kent catchment. MKW prices were lower than those in Folkestone and its surrounds by approximately 20 per cent. It seemed inevitable that the consortium's comparative water shortage and consequential high prices could cause MKW prices to rise if the take-over proceeded.

10.101. It was Business Link's understanding that, should such a take-over take place, there was no expectation that the industry would become more efficient or that there would be more effective additional investment.

### *The Kent Dimension*

10.102. The Kent Dimension is a local purchasing initiative, supported by KCC and Business Link. It said that MKW was one of the first major buyers in Kent to join this initiative and had continually worked with The Kent Dimension to ensure maximum sourcing in Kent. It said that MKW's participation in the programme had undoubtedly had a significant favourable impact on the local economy in creating local business and jobs and The Kent Dimension was concerned that this local benefit could well be lost through GU's and SAUR's centralized buying policies, if the proposed merger was allowed.

### *Kent County Agricultural Society*

10.103. Kent County Agricultural Society (KCAS) was opposed to the proposed acquisition as it felt that the excellent standard of service offered at present by MKW would deteriorate. Through MKW's good management of its resources there was not a hose-pipe ban in operation. The two GU and SAUR companies on either side of MKW were unable to satisfy customers' needs. MKW had invested heavily in resources. Leakage had been brought down substantially and there was an ongoing programme to reduce this further.

10.104. KCAS felt that if the proposed take-over went ahead the forward planning and investment made by MKW would be halted and resources poured into neighbouring areas. As there was no direct competition in the water and sewerage industry, it was essential that there was a diversity of water suppliers to provide comparative prices for the DGWS.

### *Stour Fishery Association*

10.105. Stour Fishery Association (SFA) wished to submit the strongest possible representation against the proposed acquisition of MKH. The proposed take-over was a threat to the ability to make comparison between various companies. It would eliminate, to a large extent, any comparison between companies, making it harder for the DGWS to set price controls and service standards. The proposed take-over would also detract from improvements in water supplies, with which a very high proportion of MKW customers were satisfied. MKW had invested more than twice as much per head on water resources as FDWS and SEW.

10.106. MKW had been providing fresh water supplies of the highest quality since at least the turn of the century. By its careful husbanding of resources and by planning well ahead, despite the almost continual drought for the last five years except for the winter of 1994/95, MKW did not have a hose-pipe ban. Each year MKH channelled its profits back into the water company to increase efficiency, reduce leakage, improve the supply of water to the many towns within its area and improve the pipelines supplying these towns. Unlike some other companies, it had not simply handed out profits to shareholders and its senior management.

10.107. Further, MKW was doing all it possibly could to increase metering. As a result of the efficient retention of supplies, it had been able to offer BSTs to two companies in the region. SFA was particularly worried at the suggestion that MKW's water resources would go to adjacent water companies. It would create considerable strain in the present MKW area. The Kentish Stour, the last surviving chalk stream in south-east England, was already abstracted to the absolute limit.

## Trade unions

### *UNISON*

10.108. UNISON, the principal trade union in the water industry with approximately 30,000 members, said that some 500 of its members had a direct interest in the proposed merger. It was represented on both European Works Councils established by CGE and SAUR. And within the UK water subsidiaries of these two companies, the union enjoyed robust and effective industrial relations. However, the position in MKH was different in that the company had decided not to recognize trade unions with effect from 1994.

10.109. UNISON's reaction to the present take-over proposal was conditioned by the policies it had developed on the future of the water industry. In 1996 UNISON had published a report, *Plan for Water*, which presented a number of options for the future. The union said that fundamental to UNISON's approach was the fact that water was a natural monopoly vital to the nation's health and its environment. Therefore it should not be subjected to the turbulence of unbridled market forces. This was recognized to a limited extent by the putting in place of various regulatory/supervisory bodies.

10.110. UNISON believed that the regulatory bodies including the DGWS and the MMC should strike a better balance of interest between the various stakeholders in the industry, employees, consumers and shareholders. In the regulated water industry, apart from market pressures, there were also the price pressures emanating from the DGWS. Taken together these put pressure on a company to achieve greater levels of efficiency. All too often this manifested itself in an attack on jobs. UNISON said that it was particularly concerned about potential job losses because it understood that MKH would be broken up and absorbed into FDWS and SEW. It urged the MMC to make it a condition of any agreed take-over that the new company must fully discuss any restructuring proposals with UNISON with a view to reaching an agreement.

10.111. The MKH derecognition of unions had, in UNISON's view, marked a wide-ranging attack on employees' contracts of employment. The company had unilaterally imposed a job evaluation scheme and pay system, and the provisions for hours of work, sickness benefits and redundancy terms were rewritten. And the company had given further indications of its anti-trade union stance which, in UNISON's view, was totally without justification.

10.112. Hence, in the event of the proposed take-over being approved by the MMC, it should be on condition that the new company or companies should recognize the appropriate trade unions (including UNISON) for the purposes of collective bargaining and should negotiate with these trade unions on the establishment of relevant and suitable provisions and mechanisms for joint negotiating and consultation.

## Businesses (including major water users)

### *Ashworth Frazer (Home Counties) Ltd*

10.113. Ashworth Frazer (Home Counties) Ltd said that it had been a supplier to MKW for 12 years during which time it had built up a close working relationship. It asked that the MMC consider the possible adverse consequences to its business should the proposed merger be allowed.

### *Aylesford Newsprint Ltd*

10.114. Aylesford Newsprint Ltd (AN) said that the company did not support the proposed take-over. MKW, although within one of the driest parts of the UK, had achieved something in the past 12 months that very few other water companies had been able to. It had secured sufficient volume of water to meet immediate needs and had lifted its hose-pipe ban. This had been achieved through good management and planning. The company was convinced that it would be a retrograde step for MKH to lose its independence.

10.115. AN was a major industrial water user employing 450 people. It was considering expanding the capacity of its newspaper recycling plant. It said that it relied on having an uninterrupted supply of water and was most anxious about losing MKW as its water supplier. AN noted that MKW management had achieved some notable successes over the past years to the benefit of its customers. This had included a high rate of investment, for example £34.3 per head of population in resources, and substantial reductions in leakage. These successes, together with a good business performance and the avoidance of hose-pipe bans in 1996, indicated a company that was performing well.

10.116. MKW's husbandry of resources had allowed it to offer bulk water supplies to the other two companies in the region. This, therefore, indicated that the GU and SAUR bid was much more to do with acquiring resources than with improved service and efficiencies for MKW's customers.

### *Babtie Group Ltd*

10.117. Babtie Group Ltd, which had been retained by MKW as its independent engineering adviser with respect to the proposed GU and SAUR acquisition, submitted a statement recommending BSTs as an alternative to the proposed merger.

### *Belmont International Limited*

10.118. Belmont International Limited (BI) said that the company and the majority of its 28 employees benefited from the superior services of MKW both at work and at home. The take-over bid should be rejected. MKW had been exemplary in its management of water resources. The performance of the GU and SAUR companies had fallen well short of those of MKW. With the continuance of MKH as an independent company the DGWS would be better placed to control price and services standards for the benefit of all water users.

### *Brettel Bros*

10.119. Brettell Bros said that it was a small family business which currently had a framework agreement with MKW to manufacture and supply steel manhole covers and frames. It saw the business it did with MKW, which constituted a major part of its annual turnover, as essential to its survival, and that of its suppliers and workforce, as it believed that neither GU nor SAUR, both large companies, would deal with small firms such as itself.

### *P J Burke (Kent) Ltd*

10.120. P J Burke (Kent) Ltd said that it was a small family firm employing local labour. Half its annual turnover was work carried out for MKW. It was very concerned for the future of its company and employees should the take-over go ahead. A larger utility could well use large national companies for laying mains, and small local firms would not have the opportunity to tender for the work.

### *Eternit UK Ltd (Pipes Division)*

10.121. Eternit UK Ltd (Pipes Division) (Eternit) told us that it was principally a supplier of asbestos-cement pipes and fittings but also supplied leak noise correlation equipment and services. Its customer base consisted mainly of water utilities. On the proposed acquisition of MKH, Eternit felt that the bigger the client organization, the less likely it was that it would be considered as a supplier.

10.122. Eternit said it believed that, in the case of mergers, the economies came from job losses in the subsumed company. A merger in this case would create financial difficulties, job losses and even closures in small suppliers such as itself. It did not believe it was alone in this view. A great deal of nervousness prevailed amongst other small supply companies. Eternit believed that if the proposed merger were allowed to proceed it would constitute a signal for other predatory bids against the remainder of its client base. The very existence of such bids was harmful to businesses such as itself where cash flow and profitability had been very difficult in the years since privatization of the water industry.

### *Eurotunnel*

10.123. Eurotunnel said that it was a substantial industrial and transport enterprise in east Kent. Although it had no premises in MKW's territory it was concerned and knowledgeable about the subject of water supply in Kent. It said that it had been in discussion with FDWS concerning a proposal to bring water from the Continent to Kent through the tunnel cooling system, a scheme taken into consideration during the design and construction of the tunnel.

10.124. Eurotunnel said it had little doubt that water supply within the Kent region would be inadequate in the future. It was pessimistic about the long-term outlook and felt that the MMC should attempt to arrive at an answer that would improve water resource prospects for the whole of Kent and East Sussex.

### *Fleet Cost Management*

10.125. Fleet Cost Management said that it had been a supplier of a wide range of vehicle-related services to MKH since 1990. The introduction of a new parent company would lead to a review of all suppliers bringing into jeopardy a long-standing relationship.

### *Ford Motor Company Limited*

10.126. The Ford Motor Company Limited (Ford) business centre at West Byfleet told the MMC that it understood that, potentially, its established link with MKH could disappear were the proposed bid from GU and SAUR to proceed. Ford could lose approximately £375,000 a year should the merger occur and this would have an impact on its business within Kent.

10.127. Ford thrived in a very competitive market-place and believed that the competitive element should be in place in all industries. The merging of the three companies would, therefore, not seem appropriate.

### *Hays Chemical Distribution Ltd*

10.128. Hays Chemical Distribution Ltd (Hays) told the MMC that it had had an excellent working relationship with MKW for a number of years and this had recently grown significantly both in terms of the strength of the supplier/customer relationship and in its financial importance to Hays. It viewed with disappointment the prospect of years of hard work and relationship-building being wasted and having to start again with new organizations with different views and principles.

### *Invicta Trucks Ltd*

10.129. Invicta Trucks Ltd (Invicta), a supplier of vans and heavy commercial vehicles, said that there had been a trend towards company mergers with the result that purchasing was conducted centrally on a larger scale. This had adversely affected Invicta. It was opposed to the proposed merger for this reason. Invicta felt that reciprocal business within local areas promoted many of the qualities that were missing in business today, such as loyalty, trust and quality. MKW was one of the few remaining utilities in Kent to which Invicta had been able to supply vehicles and associated services. The loss of this trade would be detrimental to its business in many ways. Invicta believed there could be significant reductions in work levels which would contribute to job losses.

### *JKN Polymers Ltd*

10.130. JKN Polymers Ltd (JKN) said that MKW had become the largest user of its products in the UK, although it had since supplied many other water companies. Being adopted as a supplier and having its innovative product used by MKW afforded JKN high status in terms of the quality standards necessary to be acceptable as a supplier to the water industry. This had been achieved through close consultation with MKW. It felt it had made these achievements as a result of MKW affording small and concept companies like JKN the opportunity to supply and service a need with a truly environmentally-aware attitude. It considered SAUR's approach to choosing suppliers to be very different. The assistance and visionary encouragement of MKW had not been afforded to JKN by the larger merged water companies with the exception of Thames Water and Lyonnaise. Due to their size, the larger companies generally lacked the focus on long-term priorities at which MKW excelled.

10.131. JKN said that MKW was not just a water supply company or another commercially-motivated company. Although it was good at both, it was more importantly perceived locally as a company that put back more than it took out. It felt this benefit would be lost should the merger go ahead.

### *Kentec Tool Hire (Medway Handling Engineers Ltd)*

10.132. Kentec Tool Hire (Medway Handling Engineers Ltd) (Kentec) said that it had taken some 13 years to develop and maintain the successful business it had now become. It had reinvested profits so as to give the company a solid foundation from which to expand. During that time it had worked very closely with some of its more important clients among which MKW and its subsidiaries ranked highly.

10.133. Kentec said that MKH was probably one of the largest buying powers in the area. If MKH were lost, there would be redundancies and the closing down of several small businesses. More importantly, Kent would lose one of the institutions which had done so much for the economic development of Kent businesses as well as spearheading many worthwhile local charity events. Kentec doubted whether GU or SAUR would do this.

### *Kent Technical & Draughting Services*

10.134. Kent Technical & Draughting Services (KTDS) said that it had for some considerable time been providing technical assistance to MKW, and now Halcrow Engineering. Its close association with MKW and the reasonably constant flow of orders had helped it to expand its company and to invest several thousand pounds in up-to-date technology and equipment. This had permitted KTDS to continue to maintain the high quality of service it provided.

10.135. If the merger were to proceed it would be inevitable that MKW's technical services would be relocated elsewhere, leading to redundancies in KTDS. It would also similarly affect small businesses all over the south-east of England.

### *MCS Cleaning Contractors Ltd*

10.136. MCS Cleaning Contractors Ltd (MCS) said that it had provided quality services for MKW since 1972 and feared that the loss of such a customer could result in job losses. Becoming and remaining a quality supplier to MKW had taken much time and effort. MCS believed MKW had been very active in the economic development of Kent and that businesses would suffer if MKW ceased to exist.

## *Medway Travel Limited*

10.137. Medway Travel Limited (Medway) said that MKH had played an important role in supporting local industry and in placing business in an area which had a high level of unemployment. It understood that in an earlier inquiry the MMC had concluded that if MKW were absorbed by a larger water company it would become less useful as an independent comparator and that this would have an adverse impact on the public interest-a view which Medway supported. Medway believed that competition resulted in diversity of approach and the development of new concepts in technology and service. The merging of the three companies under consideration would negate this advantage in the Kent area.

## *Sabre Security*

10.138. Sabre Security (Sabre) said that it was a regional security company based in Whitstable and provided the security requirements of MKW at its Paddock Wood, Ashford and Snodland depots.

10.139. MKW was one of Sabre's main customers, and the loss, or potential loss, of its business would have a significantly adverse effect on Sabre. Sabre had spent many years building up a close relationship, and felt that the proposed acquisition would undermine its hard efforts. Sabre was, therefore, of the opinion that the benefits of competition within the water industry would be clearly damaged should the merger proceed. There would also be a loss of a comparator.

## *Safeway Stores plc (Directorate of Engineering)*

10.140. Safeway Stores plc (Safeway) said that its Directorate of Engineering considered that the proposed acquisition would constitute a monopoly of the water supply covering the area of the present three companies, and that the merger could be expected to operate against the public interest. Such a merger would clearly prejudice the ability of the DGWS to make comparisons between different water enterprises as these would have merged into a monopolistic supply.

10.141. Safeway added that if the merger took place, it would clearly be prudent for the company to budget for additional water charges for the area, as without competition there could be price pressure on the consumer. It believed such a take-over would be detrimental to the public interest.

## *SCA Packaging Limited*

10.142. SCA Packaging Limited (SCA) said that it was a major industrial water user in Aylesford employing 485 people in the manufacture of corrugated cases and paper from recycled material. It relied on having an uninterrupted supply of water in order to conduct its business efficiently. SCA said that it would be most anxious about losing MKW as its supplier of water, especially as it was the only one of the three companies involved in the merger discussions not to have imposed any water restrictions on its customers.

10.143. SCA also said that it was important for it to be able to enjoy the benefits yielded by competition in the water industry. By losing MKW as an independent business, the number of water companies serving Kent would be reduced with, consequently, less competition in the region.

## *Sensus Metering Limited*

10.144. Sensus Metering Limited (Sensus) said that it was a world-leading water metering equipment and system supplier. MKW was one of Sensus' principal UK customers, purchasing water meters, electronic reading systems and software. It made the following main points:

*(a)* Sensus' experience of working with MKW had shown it to be one of the leading water utilities in the UK in the implementation of new and innovative ways of optimizing operating methods, both in the supply and distribution of water.

(b) MKW operated fair but thorough selection of suppliers, making its choice on life cost, value, quality, availability and many other aspects. Conversely, the GU and SAUR companies did not appear to operate in this way.

(c) Sensus was under no illusion that the acquisition of MKH would in all probability result in cessation of contracts with the company. There was a significant risk of its investment being wasted.

(d) Allowing the acquisition of MKH by two utilities which currently controlled a significant proportion of the UK and French water industries did not appear to be in concert with the aim of increasing market competition.

### *Shepherd Neame*

10.145. Shepherd Neame believed that the proposed acquisition of MKH would not produce economies of scale in relation to the production of water. It was particularly concerned at the proposals because the company relied on the quality of well water for the production of beer. The company was the only brewery remaining in Kent. Shepherd Neame believed that if there was a considerable increase in the extraction of water this could lead to an imbalance in the constituents of its water supply; it was particularly reliant on a fine balance of mineral salts. The company also thought that if the water companies were now to be grouped together, the water from local sources could easily be transferred elsewhere, and that this could restrict the availability of water within the area. That in turn could lead to a slowing down in any potential development in east Kent.

### *G Stow PLC*

10.146. G Stow PLC (Stow) said that it was a principal waterworks contractor for MKW which it believed to be efficient and well managed while having some of the most difficult water resource problems of any area of the UK.

10.147. Stow was opposed to the proposed merger. MKW had operated a very efficient in-house geological and hydrogeological unit and carried out its own water resources work. Unlike many other water undertakings, it had always had an ongoing repair and renewal programme.

### *Swale Business Supplies*

10.148. Swale Business Supplies said that it had been a preferred supplier to MKW for some 16 years. Should it lose MKW as a much-valued customer there was a very real likelihood of job losses.

### *T M Products Ltd*

10.149. T M Products Ltd (TMP) viewed with concern the increasing monopolization of the water industry by large operators. It considered the proposed merger as disadvantageous for the following reasons:

(a) One of the intentions of privatizing the pre-1989 water authorities was to increase competition and customer focus in the former public sector bodies. The proposed merger would erode the diversity of the market. It would place control of key enterprises in the market outside the UK. It would also reduce local accountability of a highly visible service to the public.

(b) TMP was specifically concerned by the bid because where SAUR had taken control of other small water companies TMP had generally lost business to foreign competitors providing a technically inferior product at marginally lower cost. Because of the fixed size of the UK water market TMP had not been able to replace this business.

(c) MKW had generally been more discerning in expectations of performance from its suppliers than most of the water industry.

(d) Previous MMC investigations in 1991 had noted the value of MKW as an independent comparator. Further take-overs since then had surely strengthened the case.

### *T N Printers Ltd*

10.150. T N Printers Ltd (TNP) said that it had spent the last six years supplying MKH and its subsidiaries with most of its business stationery. To lose this important customer could present extreme difficulties for the company. There was very little opportunity to replace such an account. The result would be a downward trend in business and inevitable redundancies.

### *Truck Crane Services Ltd*

10.151. Truck Crane Services Ltd (TCS) said that it was a small business which had become a quality supplier to MKW after expending much time and effort to meet demands and maintain the service it required. The loss of MKW as a customer could well result in job losses within TCS since finding business opportunities in such a competitive area was very difficult. MKW had been very active in the economic development of Kent; and TCS and many other small businesses would suffer were MKW to be taken out of the market-place. It considered that there should be competition in all industries, not least the water industry, and it did not wish the merger to proceed.

### *Uponor Ltd*

10.152. Uponor Ltd (Uponor) said that it was the major supplier of distribution pipeline materials to MKW. It felt its relationship with MKW was a mutually beneficial partnership. Uponor also believed itself to be the sole supplier of pipeline materials to GU and SAUR. Uponor did not believe the proposed merger would promote greater competition in the water industry, and questioned whether in the long term it was in the public's best interest to have fewer service providers.

## Members of Parliament and Members of the European Parliament

10.153. Sir Keith Speed (declaring an interest as a director of FDWS) conveyed his support for the proposed acquisition. David Shaw (Dover) wrote to support the proposal mainly on the grounds that it would result in a more effective corporate entity in the Dover and surrounding area. He also asked that consideration be given to the support from a constituent society, the Dover Society, for the merger proposals on the grounds of reducing industry fragmentation and (through the proposed `mini-grid') of securing more efficient use and distribution of water.

10.154. The following 11 Members of Parliament, however, wrote expressing their own concerns, or the concerns of interested parties and constituents, at the proposed merger for a number of reasons, including its likely detrimental effects on competition in the region and service levels for MKW customers: Sir Andrew Bowden (Brighton, Kemptown and a consultant to SWS), Julian Brazier (Canterbury), Dame Peggy Fenner (Medway), David Rendel (Newbury), Rt Hon Sir John Stanley (Tonbridge & Malling), Matthew Taylor (writing as Liberal Democrat Environment spokesman), Sir Teddy Taylor (Southend East), Ann Widdecombe (Maidstone) and Mark Wolfsen (Sevenoaks).

10.155. Jonathan Aitken (Thanet South) and Roger Gale (Thanet North) also stressed the problems for their constituents which the proposal would cause, as a result of water being transferred to the areas, adjacent to MKW, already controlled by other GU and SAUR companies. It appeared to Mr Gale to be abundantly plain that the purpose of the proposed `mini-grid' would be to remove water currently available to his constituents in order to redress the shortage in Folkestone, Dover and the south-eastern area, and he wished to resist any proposal that was likely to diminish still further supplies that were already likely to be inadequate to meet local needs.

10.156. Two Members of the European Parliament (MEPs), Sir Jack Stewart-Clark (East Sussex and Kent

South) and Peter Skinner (Kent West), also wrote to express concern.

## Private individuals

10.157. One-hundred and forty private individuals and local councillors sent letters expressing concern at the proposed merger.

D G GOYDER *(Chairman)*

N F MATTHEWS

K M H MORTIMER

M R PROSSER

G H STACY

P A BOYS *(Secretary)*

9 December 1996