



**The completed acquisition of the Bristol Water Group  
plc by Sociedad General de Aguas de Barcelona, S.A.**

**A consultation paper by Ofwat**

**June 2006**

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# 1 Purpose

## 1.1 This document:

- describes the completed acquisition by Sociedad General de Aguas de Barcelona, S.A. (Agbar) of Bristol Water Group plc. Bristol Water Group plc was the ultimate parent and owner of 100% of the ordinary share capital of Bristol Water plc (Bristol Water) an appointed water undertaker regulated by Ofwat.
- explains the statutory position on mergers;
- describes Agbar's ownership and structure; and
- sets out the regulatory issues and our initial assessment of these issues.

## 1.2 We invite views on the issues discussed in this paper, including:

- the capacity of Agbar to be the owner of a regulated water business;
- whether the entities that will provide Condition P undertakings to Bristol Water (see Section 4 of this paper) are the appropriate entities to do so;
- the need for modifications to Bristol Water's instrument of appointment (its 'licence') to ensure that, whoever its owners, it has sufficient financial and managerial resources to carry out its functions as a water company and is appropriately ring-fenced from the rest of the Agbar group.

Respondents may also comment on any other issues relating to the acquisition that they believe are relevant.

## 1.3 Responses to this paper are required by no later than **5 July 2006**.

## 2 Details of the acquisition

- 2.1 On 15 May 2006 Agbar acquired Bristol Water Group plc. Bristol Water Group plc was the ultimate parent and owner of 100% of the ordinary share capital of Bristol Water, an appointed water undertaker regulated by Ofwat. The offer was £10.60 in cash for each Bristol Water Group plc share and valued Bristol Water Group plc's existing issued ordinary share capital at approximately £165 million. Bristol Water also has preference shares that are not held by Bristol Water Group plc and were not acquired by Agbar. The acquisition was financed using Agbar's existing facilities.
- 2.2 Agbar has considerable experience and expertise in the provision of regulated water services through its international water operations. Agbar describes itself as the leading company in the water sector in both Spain and Chile. It also has water businesses in Colombia, Mexico and Cuba. As at December 2005 it provided water services to approximately 22 million people world-wide.
- 2.3 In addition to the water business, Agbar also has a number of other subsidiaries including Adeslas, described by Agbar as the Spanish market leader in the health insurance market and Applus+, described by Agbar as the market leader in the Spanish inspection, certification and technological services market. Furthermore Applus+ has subsidiaries in 11 countries, which include China and the USA.
- 2.4 Agbar is listed on the Madrid, Barcelona and Bilbao Stock Exchanges. Its Chilean subsidiaries Aguas Andinas and Inversiones Aguas Metropolitanas (the holding company of the former) are both listed on the Chilean Stock Exchange. Inversiones Aguas Metropolitanas is also listed on the New York Stock Exchange in the form of American Depository Shares.
- 2.5 Bristol Water is an appointed water undertaker, regulated by Ofwat. With a regulatory capital value of around £235m at 31 March 2006, it is the third largest of the thirteen water only companies in England and Wales. It supplies water to approximately 475,000 homes and business customers across the Bristol and surrounding area.

### **3 The statutory position on mergers**

- 3.1 The Water Industry Act 1991 (WIA91) put in place a special merger regime for mergers between water and sewerage companies. Under section 32 of WIA91 (amended by the Enterprise Act 2002 (EA02) and Water Act 2003), the Office of Fair Trading (OFT) must refer to the Competition Commission a merger of two or more water enterprises (which includes those providing sewerage services) in England and Wales where the turnover of each is £10 million or more.
- 3.2 In addition to the sector-specific merger provisions in WIA91, the EA02 sets out circumstances under which the OFT has a duty to refer a merger in any sector, including water, to the Competition Commission for further investigation of the competition issues arising from anticipated or completed mergers.
- 3.3 Agbar has informed us that neither Agbar nor any of its principal shareholders has interests in any water or water and sewerage companies in England and Wales other than its acquisition of Bristol Water Group Plc. Ofwat has contacted the OFT to ensure they are aware of the transaction. However, Agbar has informed us that it does not intend to make a formal notification to the OFT given the absence of overlap between Agbar, its major shareholders and the acquired businesses.
- 3.4 The purpose of this consultation paper is to consult solely on any regulatory issues arising from the acquisition in relation to Bristol Water as the appointed water undertaker and whether any modifications should be made to Bristol Water's licence.

## 4 Agbar's ownership and group structure

- 4.1 Agbar is an established international water group. Its main shareholders include Holding de Infraestructuras y Servicios Urbanos, S.A. (HISUSA) with a 47.2% interest. HISUSA represents an indirect investment by Suez, S.A., (51%) and by "la Caixa" (49%). Suez holds, through Suez Environment Espana, S.L., a further 1.5% interest in Agbar.
- 4.2 Suez is an international industrial and services group with interests in the management of public utilities in electricity, gas, energy services, water and waste management.
- 4.3 La Caixa (Caja de Ahorros y Pensiones de Barcelona) is a Spanish non-profit financial institution, allowed to carry out the same operations and offer the same products as commercial banks. "La Caixa" has no shareholders. "La Caixa" must devote at least 50% of its net income for the year to reserves and the remaining balance to the Community Projects Fund, which is managed by "la Caixa" Foundation. This Foundation finances social, educational and cultural projects.

Other shareholders include:

- Torreal with a 6.7% interest;
  - Keblar de Inversiones, with a 3% interest;
  - Alazan Inversiones 2001, with a 2% interest;
  - Institutional investors (Spain), with an 8.5% interest;
  - Institutional investors (outside Spain), with a 9.5% interest;
  - Others, with a 21.6% interest.
- 4.4 As explained in section 2 Agbar has acquired the ordinary share capital of Bristol Water Group plc, the (previous) parent and owner of 100% of the ordinary share capital of Bristol Water, an appointed water undertaker regulated by Ofwat.
- 4.5 Agbar recognises that Suez and La Caixa, through their board representation and HISUSA shareholding, could be viewed as being able to materially influence Agbar, and therefore Bristol Group and Bristol Water. However, Agbar considers that it is independent of both Suez and La Caixa. This is discussed further in section 5 under "ring fencing".

## 5 Regulatory issues

### The capacity of Agbar to be the owner of a regulated water company

- 5.1 We accept that competition for ownership of water companies may be beneficial because it can stimulate existing owners to become more efficient in the provision of water services as well as encouraging prospective owners to take advantage of opportunities that may not have been fully exploited by the existing ownership.
- 5.2 However, we have a duty to act in a way which we consider is best calculated to secure that the functions of water and sewerage undertakers are properly carried out. Therefore we must be satisfied, in each particular case, that the prospective owner has the probity and the operational and financial capacity to assume that role.
- 5.3 For the year ended 31 December 2005, Agbar reported revenues under International Financial Reporting Standards of 3,123.4 million euros, EBITDA of 502.2 million euros and earnings per share of 1.71 euros per Agbar share. More than 80% of EBITDA is generated through its regulated businesses, providing stable and recurrent cash flows. As at 31 December 2005 Agbar reported shareholders' equity of 1,549.3 million euros.
- 5.4 As at 18 April 2006, Agbar's market capitalisation was 3,170.7 million euros. Prior to the acquisition Agbar had a credit rating A+ according to Standard and Poors and A1 according to Moody's.
- 5.5 Agbar has identified a number of countries and regions where it wishes to expand. Agbar believes the UK water market is of particular interest, due to its regulated, mature and stable characteristics. It is Agbar's view that Bristol Water Group plc, having recently divested the bulk of its non-regulatory assets, and through Bristol Water, a water only company having a customer base of over one million people, represents an attractive investment for Agbar in the UK both in terms of size and risk profile.
- 5.6 Agbar has said that it attaches great importance to the skills and experience of the existing management and employees of Bristol Water Group companies. However Agbar plans to strengthen the boards by appointing a select number of executives and non-executives to the Bristol Water Group plc company boards, including Bristol Water. This includes the appointment of a chief executive officer.
- 5.7 In addition Agbar understands Ofwat's requirement for three independent non-executive directors in the regulated business and the importance of their role. It is Agbar's intention to support the Bristol Water management in further developing its business and it currently envisages that the existing senior management team of Bristol Water will remain in place.

Agbar have no current intention to change the day to day operations of the business.

- 5.8 Ofwat will seek references from the main Spanish municipalities where Agbar is currently rendering water services.
- 5.9 We invite views on the capacity of Agbar to be the owner of a regulated water company.

### **Ring fencing**

5.10 Any activities of Agbar or its group companies that could prejudice the financial and managerial viability of Bristol Water would be of concern to us. Such concerns have, in the past, been addressed by licence modifications to ensure that the water company is ring fenced from the other activities of the group.

5.11 Bristol Water's licence includes the current standard of ring-fencing provisions (Condition F) which *inter-alia*:

- requires Bristol Water to operate as if it were a separate company, to act solely in the interests of the water company and for its Board to act independently of the parent company;
- ensures that there is no cross subsidy between Bristol Water and its associated companies;
- requires Bristol Water to ensure that its dividend policy rewards efficiency and the management of economic risk, and will not impair the company's ability to finance its functions as a water undertaker;
- requires Bristol Water to have sufficient financial and managerial resources to carry out its activities;
- ensure that its financial affairs can be assessed and reported on separately from other businesses and activities of its group;
- requires Bristol Water to maintain an investment grade corporate credit rating;
- prohibits (without Ofwat's consent) cross defaults, whereby Bristol Water's financial liabilities are increased or accelerated because of a default of any other companies in the group; and
- requires Bristol Water to publish its results as if it were listed on the Stock Exchange.

5.12 All water companies need the active co-operation of their owners in carrying out their functions. Most water (and water and sewerage) companies have a condition in their licences (Condition P) that requires them to obtain legally enforceable undertakings from their owners. The companies giving the undertakings are required to:

- give the regulated business any information it needs to comply with its licence;

- refrain from any action that could cause the regulated business to breach its licence; and
- maintain a minimum of three independent non-executive directors on the board of the regulated business.

5.13 These undertakings help to protect customers by strengthening the ability of the regulated business to comply with the conditions of its licence and to maintain its independence from the rest of the group to which it belongs.

5.14 Bristol Water has Condition P in its licence which requires it to secure undertakings from its ultimate holding company (previously Bristol Water Group plc). However, we propose to modify the Condition to require Bristol Water to secure undertakings from:

- its UK holding company; and
- its ultimate controller where:

Ultimate Controller means any person (including, without limitation, a corporate body) who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of Ofwat) in a position to control, or to exercise material influence over, the policy or affairs of the regulated business or of any holding company of the regulated business.

Bristol Water has agreed in principle to these changes.

5.15 Agbar is not controlled by any individual shareholder but there is one large shareholder HISUSA, which is jointly owned by Suez S.A. and La Caixa.

5.16 We understand that under Spanish law, Agbar's directors must act in the interests of Agbar (which is defined as the common interests of all Agbar's shareholders) and with loyalty and "in good faith" towards Agbar. This implies a duty on Agbar's directors not to act in their own interests where this would conflict with the interests of Agbar. In addition the Aldama Corporate Governance Code in Spain prohibits directors acting in the interests of the shareholders that appointed them where those interests are contrary to those of Agbar. We understand that this stems from the fact that, under Spanish law, a director, once appointed, becomes a member of a corporate body whose relationship is with Agbar and not with the shareholder which proposed their appointment.

5.17 As a listed company Agbar is subject to strict disclosure requirements, especially regarding the relationship with directors and shareholders. Spanish law and corporate governance codes (reflected in Agbar's board regulations) require a director to inform the board of any actual or potential conflicts of interest and the relevant director is to abstain from participating in any decision as regards the relevant fact which gives rise to the

conflict. The conflict also has to be disclosed in the annual corporate governance report, which is made public.

- 5.18 Furthermore, Agbar's directors are under a duty not to disclose confidential information about the company, including disclosure to the shareholder that proposed their appointment.
- 5.19 If a director fails to comply with the obligations noted above, then he or she may be liable to civil and, in some cases, criminal sanctions, and resolutions adopted in relation to the matter may be challenged and rendered void.
- 5.20 On the basis of the arguments noted in paragraphs 5.15 - 5.19, Agbar considers that it should provide the Ultimate Controller undertaking required under Condition P (explained in paragraph 5.14) whilst Bristol Group should provide the undertaking as the UK holding company.
- 5.21 We understand the logic of Agbar's arguments and put particular weight on the fact that Agbar is listed on a recognised stock exchange. This means that Agbar must comply with the listing requirements which will provide market protection to shareholders, including minority ones, and provide a liquid market in Agbar's shares. Therefore we have accepted provisionally that Agbar and Bristol Water Group plc are Ultimate Controller and UK parent respectively. However, respondents' views are still welcome.
- 5.22 We invite views on whether the ring fencing conditions described are adequate or whether further conditions are required to ensure that the regulated business remains appropriately ring fenced within the Agbar group.

## **Financing**

- 5.23 Agbar does not currently propose to make material changes to the financial structure of Bristol Water. Agbar has committed to discuss with Ofwat any such changes if they were contemplated in the future.

## **Management of the regulated water business**

- 5.24. We want to be satisfied that Bristol Water's acquisition by Agbar does not compromise effective management of the regulated business. Previous respondents to our consultation papers on changes of ownership have expressed concerns about the loss of managerial effectiveness as a result of corporate activity.
- 5.25 As explained in 5.6 and 5.7, it is Agbar's intention to support Bristol Water's management in further developing its business and it is envisaged that the existing senior management team of Bristol Water will remain in place. Agbar has no current intention to change the day to day operations of the business. Agbar envisages appointing a select number of

executives and non-executives to the Bristol Water company boards. This includes the appointment of a chief executive officer. In addition Agbar understands the requirement for three independent non-executive directors in the regulated business and the importance of their role.

- 5.26 We are not proposing any licence modifications in connection with the management of Bristol Water.

### **Comparative information**

- 5.27 One of the most important tools available to Ofwat for the regulation of water companies is the ability to make comparisons between them (comparative competition).

- 5.28 Following Agbar's acquisition, Bristol Water Group plc shares will no longer be listed on the London Stock Exchange and therefore we can no longer rely on its listing to make comparisons of how the market values it relative to other companies. This type of analysis informs our judgements for example on the appropriate cost of capital for water only companies.

- 5.29 However, the relatively low volume in which its shares were traded meant that we do not regard the loss of its listing as great a detriment as may be the case, for example, of a larger water and sewerage company.

- 5.30 Bristol Water currently has a listing of preference shares, which provides some market information, though less than would be gained from a listing of ordinary shares.

- 5.31 In addition, one of the licence conditions requires Bristol Water to publish financial information as if it were listed and subject to the rules of the London Stock Exchange. Consequently, this useful aspect of share listing is not lost to us.

- 5.32 We explain in paragraph 3.3 that, as far as we understand, neither Agbar nor any of its principal shareholders has an interest in any water or water and sewerage companies in England and Wales. Therefore based on this information the acquisition of Bristol Water Group plc does not involve the loss of an independently owned comparator for use in making regulatory judgements about efficiency and standards of services.

### **Prices and service standards**

- 5.33 Customers will expect Bristol Water to provide proper standards of service at appropriate prices irrespective of its ownership. Bristol Water will continue to have the obligations imposed upon it by legislation (especially the Water Industry Act 1991) and the conditions of its licence. We will continue to regulate Bristol Water under those provisions.

- 5.34 Bristol Water's existing price limits will remain unchanged from those determined by Ofwat for 2005-10, at the 2004 periodic review. Bristol

Water accepted these price limits. Future price limits for Bristol Water will be set as for all other companies. Customers should be able to assume that a change of ownership will have no adverse impact on the price or the quality of service that they receive. We will monitor this and, where appropriate, we will exercise our powers to that end.

### **Conclusions on the need for licence modifications**

5.35 Bristol Water's current licence is to the standard of other companies recently involved in corporate activity. We do not consider that the acquisition raises significant regulatory issues. Therefore we do not propose any licence modifications at this stage, other than to modify Condition P to reflect Agbar's ownership of Bristol Water. However, we would like to hear the views of others on whether they believe further licence modifications are necessary.

## **6 Responses to this consultation paper**

- 6.1 Responses to this consultation should be made in writing by no later than 5.00pm on **5 July 2006** to:

Keith Mason  
Director of Regulatory Finance and Competition  
Office of Water Services  
Centre City Tower  
Hill Street  
Birmingham  
B5 4UA

Fax: 0121 625 3609  
E-mail: [keith.mason@ofwat.gsi.gov.uk](mailto:keith.mason@ofwat.gsi.gov.uk)

- 6.2 At the end of the consultation period, each response will be placed in Ofwat's Library for public inspection unless respondents specifically request otherwise.