SLAUGHTER AND MAY

Competition & Regulatory Newsletter

5 - 18 April 2017 / Issue 8

Quick Links

Main article
Other developments
Merger control
Antitrust

Opening the floodgates? Gearing up for competition in the retail water market

On 1 April 2017 the non-household retail water market in England was opened to competition by the Department for Environment, Food and Rural Affairs (Defra) and the Water Services Regulation Authority (Ofwat).[1] This has been long in the making, even before the passing of the Water Act 2014 which provided for the new competitive market. The Scottish non-household retail market has been operating competitively since 2008.[2] Ofwat has said that England following suite has created the largest competitive water retail market in the world and means that more than 1.2 million businesses, charities and public sector bodies (i.e. all except domestic users) can choose their water and wastewater retail services provider rather than having to purchase water services from their former regional monopoly incumbent. Ofwat's Chief Executive, Cathryn Ross, remarked that the new retail market in England is "part of the biggest shakeup to the water industry since privatisation in 1989" and "heralds a new dawn for the water customer".

According to the UK Government, the changes could deliver up to £200m of benefits to customers and the UK economy. Ofwat believes that a competitive market will drive down prices, improve water efficiency, encourage innovation and improve customer service. In particular, the market will give large companies such as supermarkets and breweries, who operate across the country, the option of receiving just one bill, rather than the hundreds they might currently receive.

How will the market work?

Ofwat will regulate the market in line with the new legal and regulatory framework. Market Operator Services Limited (MOSL), a private company that works on behalf of, and which is funded solely by, its water company members will be responsible for the operation of the retail market.

New players and existing water and wastewater retailers need to obtain a water supply and sewerage licence (WSSL) from Ofwat. A licensee will be able to buy

For further information on any competition related matter, please contact the Competition Group or your usual Slaughter and May contact.

[1] This is regulated by the Water Industry Commission for Scotland. In Wales, businesses operating wholly or mainly in Wales will be able to choose their retailer for water (not wastewater services) only if they are supplied with at least 50 mega litres of water annually.

[2] See also the Water Act 2014 (Consequential Amendments etc.) Order 2017 (SI 2017/506).

wholesale services and sell them to eligible customers as a package along with other retail services, such as metering and billing.

There are five market codes, set out in the new legal and regulatory framework, which have been developed to govern and underpin the market. These include:

(i) the Markets Arrangements Code (MAC) which is a non-statutory code setting out the arrangements for the operation of the retail market including the creation of a panel to oversee the various codes, and the appointment and operation of a Market Operator. In March 2017 regional incumbents, water supply and sewerage licensees and MOSL signed the MAC Framework Agreement. Ofwat describes this as the contract document under which the MAC becomes binding and enforceable between all wholesalers, retailers and the market operator;

(ii) the Wholesale Retail Code which is a statutory code setting out the relationship between wholesalers and retailers. The code includes the standard form "Wholesale Contract" with provisions on the business, market and operational terms to be entered into by wholesalers and retailers, which in effect makes the code the contract;

(iii) the Retail Exit Code which was developed as a result of Defra's "Exit Regulations" which allow a regional incumbent to transfer its non-household customers to a retailer, whether part of the same group or to a third party. Where this occurs, WSSL retailers are required to make and keep under review a scheme setting out the terms and conditions for all customers who have not negotiated a contract. The code sets out the basis for such schemes of terms and conditions;

(iv) the Interim Supply Code which sets out the arrangements which will be put into place to ensure continuity and protection for customers and other market participants if a licensee stops being able to supply its customers in the new market, for example due to insolvency. The code describes the interim supply arrangements that will be implemented by Ofwat to address such situations, including Ofwat's powers to direct an alternative retailer to supply the customer of a failed retailer, the terms and conditions under which this alternative retailer must continue to supply the customer and the mechanisms and procedures open to affected customers; and

(v) the Customer Protection Code of Practice which sets out the minimum standards that all retailers must comply with when dealing with their customers. There are minimum standards on (i) sales and marketing activities, (ii) contracts and information, (iii) switching suppliers, (iv) billing and data, and (v) handling complaints and disputes.

Strategic decisions

Alongside ensuring compliance with the new arrangements, increased corporate activity preceded the market opening on 1 April. Companies made strategic choices including altering and strengthening their service offerings to compete in the new market, or divesting their non-household retail activities. There have been new entrants to the market including companies that have not previously operated in the water sector and companies that do operate within the water sector but have previously only operated within a limited geographical footprint (for example retailers who are already active in Scotland). In 2016 Severn Trent and United Utilities announced a joint venture agreement to combine their non-household water

and wastewater retail businesses with the aim of delivering "an attractive proposition for large and small business customers across England and Scotland".[3]

Other regional incumbents have chosen to exit the non-household retail market. Thames Water **announced** in July 2016 that it would transfer its non-household retail activities to Scottish company Castle Water, a business retail specialist. Castle Water will take on billing and cash collection, whilst Thames Water will concentrate on its core regional household business and operational water and wastewater services. Similarly Portsmouth Water **announced** plans to divest its non-household retail functions to Castle Water and Southern Water **announced** the sale of its non-household retail business to Business Stream.

Companies may now face the additional challenge of deciding how to respond to the potential introduction of competition in the household retail market. In June 2016 Ofwat set out its emerging **findings** in a cost benefit analysis of a residential retail market. The decision on whether to open the household retail market to competition is currently with the Government. Ofwat's report suggests that, although introducing competition could result in significant quantifiable benefits of approximately £3 billion, in terms of net reductions to customer bills these could be as little as £8 per customer per year. However the report does cite other benefits such as innovation and improved customer service. The Chief Executive of Ofwat said that "customers tell us they think they should have the freedom to choose and don't understand why water is the only retail market in which there isn't some form of competition". However she also highlighted the challenges involved in introducing competition to the domestic water sector, especially regarding customers' potential unwillingness to switch given the low cost savings which are forecast.

Conclusion

The opening of the non-household retail market in England has been long anticipated and, despite some early scepticism about how quickly competition might take root, the corporate activity we have seen so far suggests it is likely to thrive. This is also supported by the recent Scottish experience, in relation to which Defra's 2011 **White Paper** reported significant customer transfers to new suppliers as well as around 42 per cent of the market renegotiating their supplies without having to change supplier - receiving either better prices or more tailored service provision, and in many cases both.

The prospects for introducing competition in the domestic water sector are inevitably more speculative. There is no Scottish experience to mirror and the potential for customers to recoup only minor savings by switching supplier may affect their willingness to switch and engage with the market generally. The challenge for the Government and regulators may therefore be whether this could result in a similar level and type of customer disengagement to that which the Competition and Markets Authority (CMA) **investigated** in the energy sector, and if so how to tackle it.

[3] Slaughter and May advised United Utilities in relation to this transaction.

Other developments

Merger control

European Commission blocks HeidelbergCement and Schwenk's takeover of Cemex Croatia

On 5 April 2017 the European Commission announced that it has prohibited the proposed joint acquisition of Cemex Croatia by HeidelbergCement and Schwenk. The two German cement companies had plans to acquire Cemex Croatia (a subsidiary of the Cemex Group) through their joint venture, Duna Dráva Cement (DDC).

The Commission found that the transaction raised serious competition concerns in relation to the Croatian markets for grey cement. Cemex is the largest cement producer in Croatia, whilst DDC and HeidelbergCement are the two largest importers of cement into Croatia. Had the takeover been approved, the parties' combined market shares would have been around 45-50 per cent, reaching over 70 per cent in certain regions of the country. Furthermore, the Commission determined that each cement plant had a catchment area of a radius of only around 250 kilometres and therefore few cement manufacturers would have been able to compete with the merged entity.[4]

The Commission concluded that the takeover would have significantly reduced competition on the Croatian markets for grey cement and that there was "clear evidence" that this would have led to increased prices. Rather than offering to divest an existing cement business, the parties proposed to grant access to a cement terminal in southern Croatia currently leased by Cemex. The Commission decided that this would not have been sufficient to allow a supplier to "compete effectively and on a lasting basis" with the merged company. In particular, (i) the proposed remedies offered only access to a storage facility without existing customers, brands, sales staff or established access to cement; (ii) a competitor leasing the terminal would have high transport costs to reach customers; and (iii) the remedies were insufficient in scale as the terminal's capacity is limited.

This is the second merger to be blocked by the Commission in the space of a few days. The Commission prohibited the merger between the London Stock Exchange and Deutsche Börse on 29 March 2017.

HeidelbergCement and Schwenk are challenging the Commission's jurisdiction in this case at the General Court.[5] As part of the same transaction, the parties also plan to acquire Cemex Hungary. The Commission referred the analysis of the potential effects in Hungary to the national competition authority. The Commission notes that the Croatian authority did not request the referral of the relevant aspects of the transaction.

[4] Cement, like most construction materials, is sold within a relatively small radius of the site where it is manufactured, due to high transport costs and security of supply issues. As such, competition between cement manufacturers is limited to relatively small geographic zones.

[5] Cases T-902/16 *HeidelbergCement v Commission* and T-907/16 *Schwenk v Commission*. In assessing its jurisdiction, the Commission took account of HeidelbergCement and Schwenk's respective turnovers on the basis that, although the takeover would be implemented through DDC, its parent companies were significantly involved in the initiation, organisation and financing of the deal.

Dow/DuPont and ChemChina/Syngenta mergers gain European Commission approval

The European Commission has recently cleared two major agrochemical mergers – both following in-depth Phase II investigations:

(i) On 27 March 2017 the Commission conditionally **cleared** the proposed merger of Dow and DuPont, subject to the divestment of a substantial part of DuPont's existing pesticides business and its global research and development (R&D) activities (as well as the divestment of certain assets in Dow's petrochemical business). The Commission is satisfied that the remedies remove the market overlaps between the parties and will ensure innovation competition, which is particularly important in the pesticides market where R&D is essential to develop safer and more efficient products. DuPont has since announced its intention sell its divestment business to FMC Corporation.

(ii) On 5 April 2017 the Commission conditionally **approved** the proposed acquisition of Syngenta by ChemChina. Syngenta is a global leader in pesticides; Chinese State-owned ChemChina owns Adama, the largest producer of generic pesticides worldwide. The approval is conditional on ChemChina divesting significant parts of its European pesticides and plant-growth regulator business, including Adama's products under development. The Commission was concerned that the proposed acquisition would reduce competition in a number of existing pesticides markets and in the plant growth regulator markets (used to stimulate or slow down plant growth). The Commission is satisfied that the remedies offered by ChemChina fully address its competition concerns and that a purchaser of the divestment business will be able to compete sustainably with the parties in the European pesticides and plant-growth markets.

The Commission assesses parallel transactions according to the 'priority rule', i.e. on a first come, first served basis. As the Dow/DuPont merger was notified three months before the ChemChina/Syngenta acquisition, the Commission's assessment of certain markets in the ChemChina/Syngenta transaction was made on the assumption that the Dow/DuPont merger had taken place.

The Commission's competition concerns in Dow/DuPont were focused on innovation and R&D activities, as the parties are two of the five key players (the other three being Bayer, BASF and Syngenta) active globally in pesticides R&D. Innovation was not a concern of the Commission in its assessment of ChemChina/Syngenta, as ChemChina's subsidiary Adama does not develop its own active ingredients for pesticides but rather produces generic pesticides based on existing active ingredients that are no longer covered by patents.

A third major agrochemical transaction, Bayer's proposed acquisition of Monsanto (announced on 14 September 2016) is currently being reviewed by several competition authorities worldwide, and is expected to be formally notified to the Commission in the near future.

Antitrust

European Competition Network publishes hotel booking industry report

On 6 April 2017 the European Competition Network (ECN) Working Group - made up of the European Commission and 10 national competition authorities (NCAs) - published a **report** on its monitoring exercise in the online hotel booking sector.

For a more detailed analysis of the ECN's report on the online hotel booking sector, please see our upcoming briefing on the topic.

Between 2014 and 2015 several NCAs investigated the use of most favoured nation (MFN), or parity, clauses in agreements between online travel agents (OTAs) and hotels. Despite intensive coordinated investigations which the French, Italian and Swedish NCAs conducted as 'lead NCAs' on behalf of the ECN, the investigations resulted in divergent outcomes across Europe.

The divergence arose over the assessment of 'narrow MFN' clauses - which require hotels to give OTAs rates that are the same as or better than those published on hotels' own websites. In July 2015 the three lead NCAs accepted commitments from Booking.com replacing wide with narrow MFN clauses. However, the German NCA took an opposing line and prohibited narrow parity clauses a few months later. The picture was complicated further by the emergence of legislation in France and Austria prohibiting the narrow MFN, lobbied for by powerful hotel associations.

The ECN Working Group was established in December 2015 to monitor the effects of these different outcomes on the market. This involved an extensive twelve-month exercise during which questionnaires were sent to 16,000 hotels, 20 OTAs, 11 metasearch sites and 19 large hotel chains.

The report found no evidence to suggest that narrow parity clauses are anti-competitive. While the ECN indicated that it would keep the online hotel booking sector under review, the UK CMA (one of the participating NCAs) has explicitly stated that it "has decided not to prioritise further investigations" in this sector. The German Bundeskartellamt (BKA), on the other hand, maintained its position in its press statement that narrow MFNs restrict competition, pointing to the need to "take into account the specific circumstances of the national markets". The BKA's prohibition decision against Booking.com's narrow parity clause still stands and is the subject of appeal to the Düsseldorf Court.

Brussels	London	Hong Kong	Beijing
T +32 (0)2 737 94 00	T +44 (0)20 7600 1200	T +852 2521 0551	T +86 10 5965 0600

© Slaughter and May 2017

This material is for general information only and is not intended to provide legal advice. For further information, please speak to your usual Slaughter and May contact.