

# Water in Europe

By

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## 1. Introduction

This paper presents developments in the water sector in Europe in three sections.

- Firstly, it offers a summary overview of some developments which may be significant trends
- Secondly, it analyses the major changes which have taken place in the ownership of the major private sector water companies since the beginning of 2006.
- Thirdly, it looks at some of the events and developments in different European countries and regions.

While it attempts to identify all major events, it is not intended to be an exhaustive survey of developments in the water sector in all European countries.

This version of the paper is a draft for discussion at the Reclaiming Public Water meeting in January 2008. A final version will be published and circulated following that meeting.

## 2. Issues and trends

### 2.1. Public sector and private equity ownership

- There is a trend away from multi-utility multinationals and/or stock exchange quoted companies towards increased ownership by the state or by private equity.
- There are now very few major private water companies which are part of larger multinational groups, following the successive sales of Veolia, SAUR, RWE and (soon) Suez: FCC/Aqualia is the main remaining example.
- Some companies remain quoted on the stock exchange, including Veolia and Suez, but the French state fund CDC is becoming the most important owner of shares in the major French water companies.
- Most English water companies are now owned by private equity funds, making heavy use of debt financing.

### 2.2. Use of public sector finance for investment

Water systems make heavy use of EU or national public sector finance mechanisms, even where private companies are involved. This can be seen across Europe:

- the UK making heavy use of EIB loans for PPPs;
- French affermage contracts where responsibility for investment lies with public finance mechanism including the agences d'eau;
- government finance for investment in water systems eg in Germany and Hungary;
- the reliance on EU cohesion funds for water investment in new member states;
- the 'sweetheart' support for Veolia from the EBRD.

### 2.3. Illegal behaviour by private companies

Illegal behaviour by private companies has been observed

- in England (where 4 companies have been prosecuted, fined and/or forced to make repayments for giving incorrect information to the regulator) and
- in Italy (where Acea and Suez have been fined for anti-competitive behaviour).

### 2.4. Resistance to privatisation and pro-public initiatives

Resistance to water privatisation remains strong across Europe.

- In Italy, a 1-year moratorium on water privatisation has been introduced by parliament, while the draft law to make water privatisation illegal continues its progress.
- The mayor of Paris has stated that the water distribution services of Paris will be remunicipalised in 2009 when the existing concessions expire.
- The water service in Elber, Albania was remunicipalised in 2006
- There has been a strong and successful campaign against water privatisation in Northern Ireland.

## 2.5. Commercialisation of public operations

The commercialisation of public operations appears to be increasing.

This can take the form of public water companies introducing market-based instruments in the delivery of in-house operations, often as a result of municipal shareholders' initiatives or changes in the legal and regulatory framework.

- Stockholm's new municipal government have recently announced that the municipal water operator Stockholm Vatten would change policy to focus on short term, "demand-driven" maintenance. This is likely to lead to neglect of the long term development of the system.
- Wholly publicly-owned Scottish Water has introduced a number of PPPs for the delivery of its capital investment programme. Under the UK government's Private Finance Initiative, BOT contracts have been awarded to private consortia for the construction and operation of wastewater treatment plants. Subsequently, public-private joint ventures called "Scottish Water Solutions" have been established that would be responsible for the delivery of 70% of Scottish Water's capital investment programme. An act passed in 2005 by the Scottish devolved parliament provided for the introduction of retail competition for Scottish Water's 150,000 business customers. The Scottish executive was also committed to reducing cross-subsidies between commercial and domestic water consumers.

Commercialisation also takes the form of public water operators engaging in commercial operations outside their in-house base, for example by bidding for contracts domestically or internationally, and buying shares in private water companies.

- Turin's in-house water provider SMAT bought 44% of private water company Società Acque Potabili (SAP) in 2005 and is using SAP as a vehicle for expansion in Italy and abroad, particularly in the Mediterranean and China. In 2007, SAP's subsidiary APS won a 30-year contract for managing water supply and sanitation services in the Palermo region, Sicily (1.2 million inhabitants). According to Palermo's municipal operator AMAP, one year after the award APS had reduced investments by Euro 31.9 million out of a Euro 145.6 million projected investment programme.
- Sevilla's municipally owned PLC EMASESA provides water supply and sanitation services in-house to 1 million inhabitants. "To fully benefit and make use of their technical and human resources, EMASESA have decided to expand the activity to other markets", domestically and internationally. Target domestic markets encompass the whole of Spain while international expansion efforts would focus on Latin America, Eastern Europe and Mediterranean countries. EMASESA's objectives include participation in "international cooperation programs and governmental agreements (national, regional and municipal Administrations) with public institutions of Latin America and other geographical areas". It should be noted that EMASESA's Board of Directors includes representatives of trade unions and civil society organisations.

## 2.6. Upward pressure on prices: WFD, corporatisation

A number of factors are increasing the price of water to households.

- The Water Framework Directive (WFD) is being used by the EU and governments to increase prices for households, in the name of cost recovery. Prices rise to compensate for reductions in state subsidies, and cost recovery policies are more advanced for households than for industry or agriculture.
- Corporatisation may involve the creation of a new element of 'equity' capital, which then requires servicing with dividends, as well as creating new transaction costs (as in Northern Ireland). The reduction of central government support to local authorities may be the major driver of commercialisation of the service which maximises profits to replace lost government revenue (as in Finland)

## 2.7. Bottled water campaigns

There are major campaigns against bottled water currently running in France, led by a number of councils committed to public water services e.g. Paris, and in the USA, where there have been congressional hearings on the subject in 2007. In the UK the tap water supplied by Thames Water was rated higher than all but two of 20 bottled waters in a blind tasting.

## 3. Private companies

### 3.1. Ownership

The great majority of European water operators remain in public ownership. Amongst those which have been or remain privately owned, there is no consistent pattern of ownership emerging to replace the multinationals. In some cases public authorities have re-purchased ownership of the water companies (the state in the case of SAUR in France and Elber in Albania, municipalities in the case of Gelsenwasser in Germany); in other cases, especially in England, private equity funds have bought companies; in a few cases local companies have purchased shareholdings from the multinationals (e.g. GW-Borsodváz in Hungary); in some cases shares are being sold to the public (e.g. Tallinn).

Groups dominated by non-water business have sold their water interests completely, including Bouygues, E.on, and RWE (largely). Suez and Veolia, the two largest water companies, have effectively experienced the same process, with the water and waste operations discarded by their own overgrown children. Veolia Environnement was floated as a water and waste management company in 2002 by Vivendi, the media multinational which had itself originally grown out of the water and waste business of Generale des Eaux. In 2007, Suez, which originally grew out of the French water company Lyonnaise des Eaux, confirmed its plans to merge with GDF to form a large energy group. Suez Environnement will be floated off on the stock exchange as a separate water and waste company, with all shares initially held by Suez/GdF shareholders.

The exception is the Spanish group FCC, which has expanded both inside and outside Spain through its subsidiary Aqualia (and, to a smaller extent, the Spanish construction group Sacyr Vallehermosa, which operates on both Spain and Portugal – and Brazil – through its Valoriza division).

The net result of these ownership changes and the tendency for companies to withdraw from international activities is that there are now only 7 companies which operate water services in more than one EU country.

**Table 1. Water companies active in more than one country in EU**

Group	Home country	Growth prospect	Countries (water operations only)
Suez	FR	=	Czech Republic, France, Germany, Hungary, Italy, Romania, Slovakia, Spain, UK
Veolia	FR	+	Czech Republic, France, Germany, Hungary, Italy, Romania, Slovakia, UK,
SAUR	FR	-	France, Spain, Poland
FCC/Aqualia	ES	+	Spain, Czech republic, Italy, Portugal
Sacyr Vallehermosa/Valoriza	ES	=	Spain, Portugal
United Utilities	UK	-	UK, Estonia, Bulgaria, Poland
Gelsenwasser	DE	-	Germany, Hungary, Poland

The main ownership trends amongst the largest companies are set out below, together with brief profiles on the largest companies active in Europe.

**Table 2. Multinational groups sell water interests**

Water company	Home country	Former parent	Former parent main sector	Date sold	Sale method	Current main shareholder	%	New owner type
Suez Env.	France	Suez/GDF	Energy	2008	IPO	CDC/state	35(est.)	State/state fund
Veolia Env.	France	Vivendi	Media	2002	IPO	CDC+EDF	14	State fund
SAUR	France	Bouygues*	Construction	2005	Sale	CDC	40	State fund
Thames Water	UK	RWE	Energy	2006	Sale	Macquarie	100	Private equity
Gelsenwasser	Germany	E.on	Energy	2003	Sale	Bochum/ Dortmund	100	Municipality

### 3.2. French companies and state holdings

In April 2007 PAI sold SAUR to a consortium led by the French state bank Caisse des dépôts et consignations (CDC), which holds over 40% of the shares. In effect, SAUR has been partially nationalized. This was done in order to prevent a foreign private equity takeover of the French operations:

“The consortium's offer was chosen not only because it was the best, but also because it will allow the water distribution company to remain French-owned.”<sup>1</sup> This is part of a more general bi-partisan French strategy to “create a state capitalism actively ensuring local French control of major private companies...the priority sectors are infrastructure, property and healthcare”.<sup>2</sup>

CDC and the French state are now also the main shareholders in both Suez and Veolia. CDC already owns 10% of Veolia, with another 4% owned by the French electricity company EDF, which is itself still 70% owned by the French state. The plans for Suez Environnement would also mean that the state and CDC together would hold about 17% .

A recent comparison of Suez Environnement and Veolia found that both companies have a return on capital of around 11%, but that Veolia has a much larger debt, partly due to continued expansion, even in developing countries, and partly due to the debts of Vivendi being dumped on the company when it was spun off (“il traîne une dette colossale, 15,6 milliards d'euros, y compris l'héritage laissé par Vivendi Universal.”)<sup>3</sup>

**Table 3. France: Water Company ownership, December 2007**

(Type of owner: State= state; SE = stock exchange quoted; PE=private equity)

Company	Type of owner	Comments
<b>Suez Environnement</b>	SE/state	35% owned via state/CDC shareholdings. From some time in 2008.
<b>Veolia Environnement</b>	SE/state	14% owned by CDC + EDF
<b>SAUR</b>	PE/state	Largest stake (47%) held by CDC

#### 3.2.1. Suez

Suez remains one of the two dominant companies in France, Europe and the world. France accounts for 48% of its water business in Europe. Beyond France, it retains its significant presence in Spain, through Aguas de Barcelona and its subsidiaries; in Germany, Czech republic, Hungary and Slovakia, through concessions established in the 1990s; in Italy, partly in partnership with Acea; and in the UK, where Suez sold its remaining shares in Northumbrian water in 2004, but re-entered the country through Agbar's purchase of Bristol water in 2006.

In 2007 Suez, together with la Caixa, bought up a majority of the shares in Aguas de Barcelona (Suez had previously held a dominant stake in AgBar), and by November 2007 the two companies had obtained 56% of AgBar's shares.<sup>4</sup> Suez has already transferred its only remaining South American operations (Santiago, Cartagena) to AgBar, used AgBar to buy a UK company (Bristol), and allowed AgBar to expand in South Korea. This might be a way of channelling all the remaining non-French water into Agbar, so that a French entity could take over the French interests, and then a private equity buyer - or a big Spanish company - can buy Agbar and everything else. However Suez has also bought the 33% stake in Aguas de Valencia which was sold by SAUR, apparently to prevent Veolia buying it.<sup>5</sup>

**Table 4. Suez subsidiaries in water in Europe**

Country	Company	% owned	Website	Employees
Czech Republic	Ostrava VaK	44.5	<a href="http://www.ovak.cz">www.ovak.cz</a>	450
Czech Republic	SPVS	82	<a href="http://www.spvs.cz">www.spvs.cz</a>	200
Czech Republic	VAK Brno	46	<a href="http://www.bvk.cz">www.bvk.cz</a>	593
Czech Republic	VaK Karlovy Vary	49.8	<a href="http://www.vakkv.cz">www.vakkv.cz</a>	523
Czech Republic	VAS Brno	33.4	<a href="http://www.vastd.cz">www.vastd.cz</a>	1200
Czech Republic	VHS Benesov	100	<a href="http://www.vhs-sro.cz">www.vhs-sro.cz</a>	160
France	Lyonnaise des Eaux France	100	<a href="http://www.lyonnaise-des-eaux.fr">www.lyonnaise-des-eaux.fr</a>	8341



Germany	Eurawasser	100	www.eurawasser.de	500
Hungary	Budapest Water	12.5		1511
Hungary	Eaux de Kaposvar	35		
Hungary	Pecsi Vizmu	48		
Italy	Acea	9.9	www.aceaspa.it	5517
Italy	Acque SpA	5.4	www.acque.net	
Italy	Acque Toscane	70	www.acquetoscane.it	
Italy	Acquedotto del Fiora	40	www.fiora.it	
Italy	Nuove Acque	23	www.nuoveacque.it	200
Italy	Publiacqua	40	www.publiacqua.it	635
Slovakia	Trencianska spolocnost, TVS	51	www.tvs.sk	
Spain	Aguas de Barcelona	28	www.agbar.es	35772
Spain	Aguas de Valencia	33		
UK	Bristol Water	100	www.bristolwater.co.uk	399

### 3.2.2. Veolia

Veolia is the only group which states that it plans to actively expand its water operations, worldwide. It has gained new contracts in the Czech republic, and its first contracts in Slovakia, in Banska Bystrica and Poprad. In practice, however, much of this expansion takes the form of BOT or management contracts: for example it has a presence in the Netherlands, but only as operator of a BOT wastewater treatment plant in Rotterdam; its new operations in Denmark, Ireland and Romania are also for treatment plants. Veolia's presence in the UK consists of three water-only companies which it has held for about 10 years: it has sold its stake in Southern Water. Veolia left Spain when it sold its interest in FCC, but retains a 50% stake in Proactiva, a joint venture with FCC for water and waste operations in Latin America..

Veolia is actively seeking expansion in Hungary, Armenia, and Russia, where it has formed a joint venture, Eurasian Water partnership, with Russian groups. Outside Europe, all its new contracts are for treatment plants or management contracts, even in China.

Veolia consists of water, waste, heating and public transport operations. It therefore has little option but to continue operating in these sectors, as it has no other core business, such as energy, to retreat to. Given that private equity companies are interested in both water and waste, Veolia itself may be a target for private equity bids. As with SAUR, and probably Suez, there would no doubt be an initiative to ensure that the French water operations remained in French hands: the state-owned CDC is already one of the two leading shareholders in Veolia.

**Table 5. Veolia subsidiaries in water in Europe**

Country	Company	Owns%	Website	Employees
Czech Republic	1. JVS	50	www.1jvs.cz	451
Czech Republic	Aqua Pribram	100	www.aqua-pb.cz	150
Czech Republic	PVK	100	www.pvk.cz	1846
Czech Republic	SCVK	49.6	www.scvk.cz	2294
Czech Republic	Středomoravská Vodárenská	50	www.smv.cz	279
Czech Republic	Vodarna Plzen	49.2	www.vodarna.cz	420
Czech Republic	Vodarny Kladno-Melnik (VKM)	71.5	www.vkm.cz	
Czech Republic	VOSS Sokolov	50	www.voss.cz	189
Czech Republic	Prostejov			
Czech republic	Slany			
France	Generale des Eaux	100		
Germany	MIDEWA	25.1	www.midewa.de	
Germany	Stadtwerke Görlitz	74.9	www.stadtwerke-goerlitz.de	420
Germany	Berlinwasser	24.9	www.berlinwasser.de	6506
Hungary	FCSM Budapest	12.5	www.fcsmt.hu	

Hungary	Szeged Waterworks	49	www.szegedvizmu.hu	
Italy	Acqualatina	22		
Italy	Genova Acque	20	www.amgaspa.it/servizi/genova_acque.html	
Italy	SIBA	50		
Italy	Siciliacque	19		140
Poland	PWiK Tarnowskie Gory	33.85		
Romania	Apa Nova Bucuresti	83.69		
Romania	Apa Nova Ploiesti	80	www.apanova-ploiesti.ro	380
Slovakia	Banska Bystrica			
Slovakia	Poprad			
UK	Folkestone and Dover	100		
UK	Three Valleys Water	100	www.3valleys.co.uk	1046
UK	Tendring Hundred	100		

### 3.2.2. SAUR

SAUR was for many years owned by the construction company Bouygues (for a period EdF also held a significant stake) and then sold the majority of SAUR's operations to PAI Partners in a "leveraged acquisition", except for the African and Italian operations, which remain owned by Bouygues.

In April 2007 PAI sold SAUR to a consortium led by French public finance institution Caisse des dépôts et consignations (CDC), with 47%, joined by French waste management and waste transport specialist Seche Environnement (33 per cent) and infrastructure investment vehicle AXA IM (20 per cent). SAUR had been the subject of a bid by Macquarie, but France's Association of Mayors expressed serious reservations at the prospect of a foreign bank managing public sector concessions.<sup>6</sup>

In Poland, SAUR owns 51% of SAUR-Neptun-Gdansk, the other 49% being owned by the city council. Its other major European holding was a 33% stake in Aguas de Valencia, but it sold this to Suez in 2007. SAUR still owns in Spain 33% of Emalsa, the water company for Las Palmas in the Canary Islands: it bought this stake in September 2005, when another 33% was also bought by Valoriza.

**Table 6. SAUR water operations in Europe**

Country	Company	Sector	% owned	Website	Employees
France	SAUR	water	100	<a href="http://www.saur.fr">www.saur.fr</a>	6100 (2004)
Poland	SAUR-Neptun-Gdansk	Water	51	<a href="http://www.sng.com.pl">www.sng.com.pl</a>	700 (2002)
Spain	Emalsa	Water	33	<a href="http://www.emalsa.es">www.emalsa.es</a>	347(2002)

### 3.3. UK companies and private equity

The ownership of the privatized water companies in England and Wales shows a major growth in the role of financial and private equity investors. Four of the 10 large water and sewerage companies – Anglian, Southern, Thames and Yorkshire - were owned by private equity or financial groups by the end of 2007. Four others are still quoted on the stock exchange: of these, Northumbrian is 45% owned by three financial investors; Pennon Group, owners of South-West Water, has 30% of its shares owned by 5 major financial shareholders, including Axa (5%) - who are also in the consortium buying SAUR in France - and Ameriprise (7.5%). Only one is now owned by a multinational group - Wessex, owned by Malaysian company YTL; and one is a not for profit company (Glas Cymru). Of the smaller water only companies, three are still owned by Veolia, one is now owned by Suez/Agbar, one by a Hong Kong group, one by a private UK group (Biwater), and the rest are owned by private equity.

**Table 7. UK: Water Company ownership, December 2007**

(Types: State= state; SE = stock exchange quoted; M = multinational; PE=private equity; NPC=not-for-profit company; P= privately owned company)

Company	Principal owner	Country	Type	Comments
Anglian Water	Osprey/AWG	UK	PE	Consortium of 3 PE funds, inc. 3i
Northumbrian Water		UK	SEC	25% owned by Ontario Teachers Pension Fund,



				15% by fund managers Amvescap, 5% by Barclays Bank
<b>North West Water</b>	United Utilities	UK	SEC	
<b>Severn Trent Water</b>	Severn Trent	UK	SEC	
<b>Southern Water</b>	Greensands	UK	PE	Main partners are JP Morgan and Challenger. Bought October 2007
<b>South West Water</b>	Pennon Group	UK	SEC	Pennon is 30% owned by 5 financial investors
<b>Thames Water</b>	Macquarie	Australia	PE	
<b>Welsh Water</b>	Glas Cymru	UK	NPC	
<b>Wessex Water</b>	YTL	Malaysia	M	
<b>Yorkshire Water</b>	Citigroup/HSBC	UK	PE	Bought November 2007
<b>Bournemouth and West Hampshire Water</b>	Biwater	UK	P	Private company, operates internationally, but not in EU outside UK.
<b>Bristol Water</b>	Agbar/Suez	ES/FR	M	
<b>Cambridge Water</b>	Cheung Kong Infrastructure	Hong Kong	M	
<b>Cholderton Water</b>	Cholderton Estate	UK	P	Private family owned
<b>Dee Valley</b>	-	UK	SEC	35% of shares owned by Axa SA.
<b>Folkestone and Dover</b>	Veolia	FR	M	
<b>Mid Kent Water</b>	UTA and HDF	Australia	PE	Utilities Trust of Australia (UTA); Hastings Diversified Utilities Fund (HDF). Bought Swan Group, the holding company of Mid Kent Water. Swan also owns 51% of Halcrow water Services.
<b>Portsmouth Water</b>	South Downs Capital	UK	PE	South Downs Capital is 36% owned by SMIF/Land Securities (PE). SMIF=Secondary Market Infrastructure Fund. SMIF itself was bought by Star Fund (PE) in 2003, sold in 2006 to Land Securities (PE)
<b>South East Water</b>	UTA and HDF	Australia	PE	Macquarie bought South East Water from SAUR in 2003; sold it to UTA/HFM in October 2006, prior to purchase of Thames Water.
<b>South Staffordshire Water</b>	Alinda Capital Partners	USA	PE	Bought in 2007 from from Arcapita (Bahrein)
<b>Sutton &amp; East Surrey Water</b>	Aqueduct Capital	DE	PE	Aqueduct Capital is part of Deutsche Bank. Bought holding company East Surrey Holdings Group (ESH) for £189m in 2006 from Kellen Acquisitions Ltd – part of Terra Firma. Kellen had bought ESH only in October 2005, and then sold off gas companies.
<b>Tendring Hundred</b>	Veolia	FR	M	
<b>Three Valleys</b>	Veolia	FR	M	

The English and Welsh companies have been withdrawing shareholder equity capital and replacing it with debt finance. The gearing of the water companies – the percentage of capital financed by debt - has risen from an average of 0% to an average of 60%, with a number of companies having gearings over 75%. Thus instead of shareholders putting money into the industry, there has been a significant *withdrawal* of shareholder equity from the water companies. This represents a return to the same form of finance used by public sector water operators – indeed, a significant part of the borrowing has been from the European Investment Bank (EIB), a public sector bank owned by the European Union which is able to lend at very good rates. In addition, some of the companies are now using long-term index-linked bonds, where the interest is fixed at a small real amount plus the rate of inflation. Normally only governments use this kind of bond, because they are prepared to take the risk of inflation, but utility companies can do so if their prices are effectively linked to inflation by a public regulator: then the risk is carried by users (or the government). Macquarie for example is refinancing Thames Water through , and in August 2007 announced it was issuing £900 million index-linked bonds through a Cayman Islands subsidiary.<sup>7</sup>

### 3.3.1. United Utilities

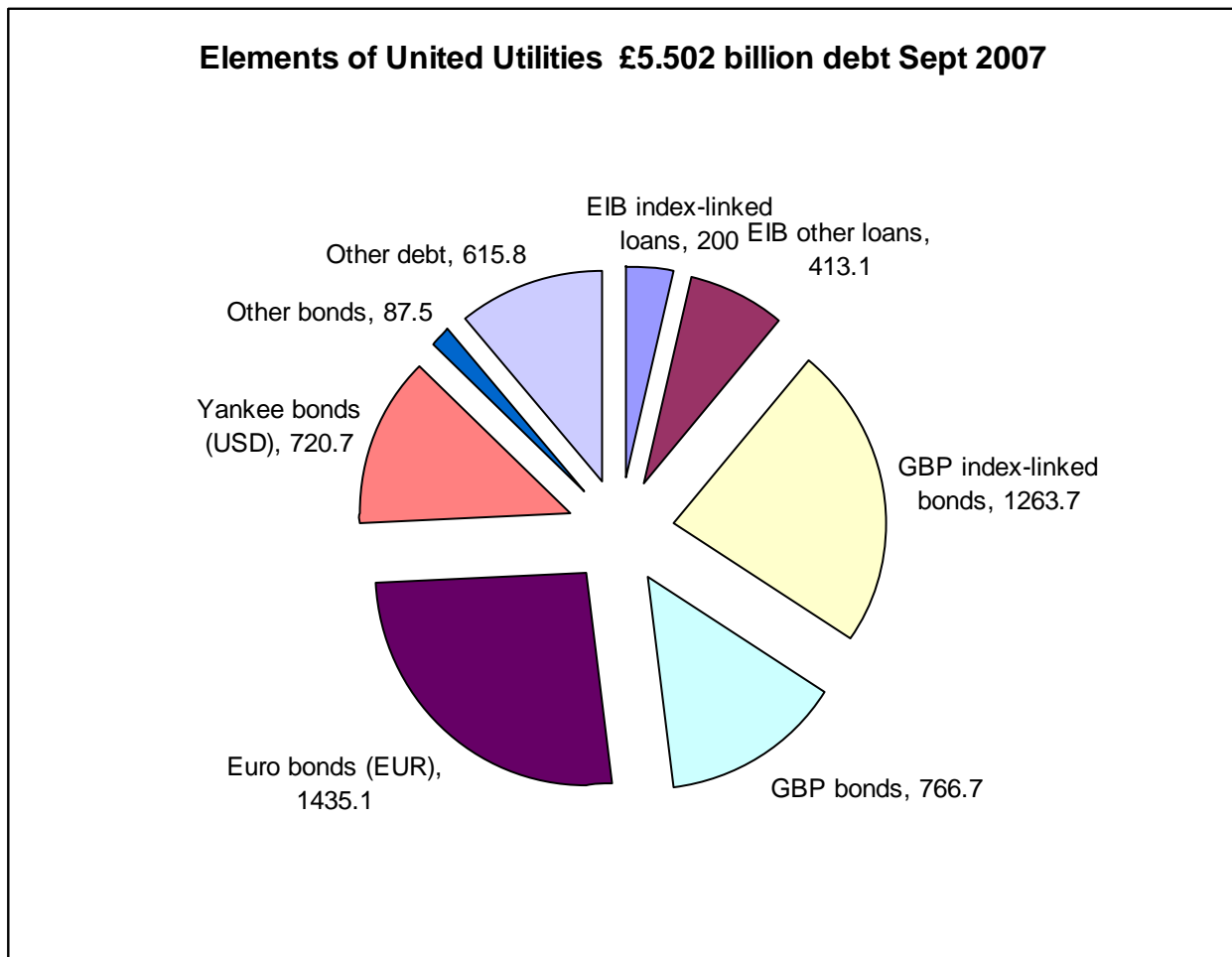
The new financial structure of United Utilities (UU), as reported in November 2007, illustrates these trends.<sup>8</sup>

- 1 UU is replacing shareholder's equity with debt, by returning over £450m. to shareholders in 2007 and replacing it with more debt. This increases the proportion of its business financed by debt: "We are aiming for a more efficient capital structure with a gearing target towards the upper end of Ofwat's 55 per cent to 65 per cent range."
- 2 UU has now issued around £1.5 billion of index-linked debt, about 27% of its total debt. The latest

such bond has a maturity of 30 years and pays 1.66% interest over inflation. Although the total cost of these bonds increases if inflation rises, the company's "allowed revenues are also linked" to inflation under the regulatory regime, and so the risk of inflation is effectively removed from the company and carried by the users instead.

- 3 UU has a total of £613.1m loans from the EIB, which represents 12% of all UU's debt finance. About a third of this EIB debt is also index-linked.

**Chart A. Bonds, index-linked bonds and EIB financing of UU debt 2007**



Source: United Utilities PLC Half yearly financial report Six months ended 30 September 2007

### 3.4. FCC/Aqualia (Spain)

FCC is a long-established Spanish construction, urban services, and cement group. For a few years it became de facto controlled by Veolia, but Veolia sold its shares in FCC in 2004. The environmental services division includes waste management and water. It expanded by acquisition in 2006, with major purchases including Austrian waste company ASA, UK waste company WRG, and Czech water company SMVAK. It is also active in other infrastructure operations, including roads and motorways and airports.

Aqualia is the water company in the environmental services division of FCC. In Spain it employs over 4400 employees, on contracts covering 900,000 inhabitants in Almería, Ávila, Badajoz, Jaén, Lleida, Oviedo, Puerto de la Cruz (Tenerife), and Salamanca. All the other European water operations of FCC were acquired in 2006. The largest was the purchase by FCC of the Czech water company Severomoravské Vodovody a Kanalizace Ostrava (SmVaK), the third largest in the Czech Republic, serving 737,000 people. SmVaK has changed ownership a number of times since the 1990s, with shares held by Anglian Water, then Suez, then by the Slovak private equity group Pentra, and then FCC.<sup>9</sup> SmVaK has expanded within the Czech republic by taking over services for more municipalities, but it does not have any subsidiaries or operating contracts outside the Czech republic. In January 2006, FCC won a 30 year concession covering 275,000 people in the 22 municipalities in the Sicilian province of Caltanissetta (Italy), in a joint venture with local contractors. It "includes investing over 248 million euro, mostly from European funds, 150 million euro of which will be

invested in the next three years.”<sup>10</sup> It also won a 40 year contract at La Lezíria del Tajo in Portugal.

Beyond Europe, FCC operates in water and waste through Proactiva, a 50-50 joint venture with Veolia. Proactiva has private water operations in Mexico, Brazil, and Colombia. The future of these contracts is uncertain. In Algeria FCC has contracts for the Mostaganem and Cap Djinet desalination plants.

## 4. Privatisation and commercialisation

### 4.1. Privatisation drive in Portugal

State owned Aguas de Portugal is in the process of privatising its subsidiary Aquapor, which is responsible for providing water services to 345,000 consumers in 24 municipalities. Aquapor is being privatised through the sale of its entire capital. At the same time, the Portuguese government has provided for the privatisation of Aguas de Portugal through listing on the stock exchange.

Furthermore, Spanish private operator Sacyr Vallehermoso owns 100% of Administración y Gestión de Sistemas de Salubridade (AGS), which claims to hold 40% of the private water market in Portugal. Finally, FCC/Aqualia holds a 40 year contract at La Lezíria del Tajo.

### 4.2. Corporatisation in northern Europe

#### 4.2.1. Gelsenwasser (Germany)

Gelsenwasser is owned by the stadtwerke of the municipalities of the cities of Bochum and Dortmund, which bought the company from E.on in 2003. It provides water, wastewater and gas services to a number of municipalities in Germany. At the end of 2007 the stadtwerke were discussing the possibility of merging with Gelsenwasser, which would create a single municipal company with annual sales of about €1.5 billion.

<sup>11</sup> RWE owns 47% of the Dortmund stadtwerke, Dortmunder Energie und Wasser (DEW21).

Gelsenwasser has expanded into eastern Europe, but it sold its shares in the Hungarian company GW-Borsodváz Kft in 2005 to a local Hungarian company. It still owns shares in water companies in the Czech republic - 30.58% of Chevak Cheb; 50% of Terea Cheb; and 50% of KMS Kraslicka Mestska Spolecnost. In Poland, it owns 46% of PWiK Glogow.

In 2007 it was reported that Gelsenwasser had bought an unspecified stake in a small French water services company, Nantaise des Eaux Services. According to Les Echos, Nantaise des Eaux supplies 300,000 customers, has 170 employees, and annual sales of €15.6million. About half the business of the Nantaise des Eaux group is engineering.<sup>12</sup>

**Table 8. Gelsenwasser: subsidiaries in water in Europe**

Country	Company	% owned	Website	Empl oyees
Czech Republic	Chevak Cheb	30.58	<a href="http://www.chevak.cz">www.chevak.cz</a>	243
Czech Republic	Terea Cheb	50%	<a href="http://www.terea-cheb.cz">www.terea-cheb.cz</a>	116
Czech republic	KMS Kraslicka Mestska Spolecnost	50%		
France	Nantaise des Eaux Services		<a href="http://www.nantaise-des-eaux.com">www.nantaise-des-eaux.com</a>	170
Germany	Gelsenwasser	100%	<a href="http://www.gelsenwasser.de">www.gelsenwasser.de</a>	1277
Poland	PWiK Glogow	46%	<a href="http://www.pwik.glogow.pl">www.pwik.glogow.pl</a>	175

#### 4.2.2. Finland

A recent study of water services in Finland identifies the central government’s withdrawal of finance from local authorities as a key reason why local water companies have become more commercial. The municipalities have responded to the government cuts by setting the water operators short-term financial objectives to attract resources to replace those withdrawn by central government:

“the Finnish state has been continuously decreasing financial support for municipalities while and the same time encouraging them to adopt private sector practices and to intensify inter-municipal operation. In this still ongoing reform process, the municipalities have significant freedom in how to

implement reforms, which allows them to find their own ways of organizing. Municipalities have become more entrepreneurial by embracing private sector managerialism and by adopting a more active role in attracting national and global resource flows to their local areas. Since the state's role as financier is decreasing, municipalities are increasingly turning to investment bankers and financial consultants for advice on how to secure financial resources for their budgets. Thinking mostly in financial terms, the financial actor's advice has a reinforcing effect on municipalities' inherent individualism and new entrepreneurialism. Municipalities are commercializing their public services operations and their self-reform is leaning toward short-term financially-oriented local solutions"<sup>13</sup>

### **4.3. Business as usual in new member states, eastern and south east Europe**

#### **4.3.1. New member states**

In Bulgaria, Sofia water utility Sofiyska Voda says that it plans to invest 415 million leva (€211.9 million euro) from 2009 to 2013 to upgrade the water and sewage infrastructure. Over a quarter of this (114.6 million leva) will come from EU accession funds, and it expects to raise a further 50 million leva from external sources, presumably private. By implication, the rest will be raised by increasing water prices in Sofia.<sup>14</sup> Sofiyska Voda is 57.8% owned by United Utilities and the EBRD.

In Estonia, Tallin-based Tallina Vesi is now floated on the Estonian stock exchange. United Utilities have reduced their stake in Tallina Vesi to 26.5%. The company is profitable. The municipality has complained of excessive price demands and "a backlog in the construction of the sewerage network".<sup>15</sup>

In Romania, Veolia planned in 2004 to cut 250 staff in Apa Nova because of "a trend of declining volume in water consumption". In fact it has exceeded this: 331 staff were cut in 2005 and 2006.<sup>16</sup> Veolia's new operations in Romania consist of BOT contracts for treatment plants. Berlinwasser also has projects in Romania.

Veolia has also gained its first contracts in Slovakia, in Banska Bystrica and Poprad.

#### **4.3.2. Russia, Ukraine, Georgia etc**

In November 2007, the EBRD has announced it would invest up to €105 million for a 10% stake in Veolia's subsidiary Veolia Voda, aiming to boost private sector participation in water supply and sanitation in Eastern Europe and specifically in Russia and Ukraine.

In October 2007, Swiss company Multiplex Solutions took over the water operator for Georgia's capital city, Tbilisi Water, for USD 85.66 million. Multiplex Solutions had no expertise in the water sector and would contract an operator to manage the system. Multiplex Solutions did not put forward the highest offer but was selected after it had pledged to further invest USD 350 million in infrastructure rehabilitation. It had also vowed to maintain current water tariffs for the following two years.

Veolia's subsidiary A. Utilities has been running water services in Yerevan, Armenia for five years with support from the World Bank's Municipal Development Project (MDP). Consultant and whistleblower Bruce Tasker has reportedly alleged corruption as substantial amounts of money would have been diverted to benefit MDP officials and their cronies. Mr. Tasker's allegations refer to the "embezzlement of tens of millions of dollars worth of public funds" and practices reducing the effectiveness of operations. For example, Mr. Tasker claimed that most of the fifty international specialists contracted by A. Utilities to contribute their expertise were ghosts.

In 1999, Veolia (then Vivendi Water) won a 30-year water supply contract with Almaty city government in Kazakhstan. This was the first case of private sector participation in water supply in a Former Soviet Union country. The new operator was Almaty Sui, a joint venture between Veolia (owning 55% of the shares) and GKP Vodokanal (holding the remaining 45 %).

In the region, Berlinwasser has projects in Azerbaijan and Turkey, while RWE and EVN operate a water BOT in Zagreb, Croatia.

## 5. Reactions against privatisation: France, Italy, Ireland, UK

### 5.1. France

A coalition including NGO France Liberté, the city councillor association EAU, the green and communist parties and consumers association UFC-Que Choisir are promoting remunicipalisation of water supply and sanitation in France. France Liberté are calling for water remunicipalisation to be made a live issue in the upcoming March 2008 municipal elections throughout France. UFC-Que Choisir are also favouring remunicipalisation in light of a survey carried out by UFC-Que Choisir magazine, which found out that a private operations are imposing considerably high water tariffs. The worst case was that of SEDIF, operated by Veolia and responsible for water supply operations in the Greater Paris region, which had the highest tariff. As a result of pressure from the association EAU and UFC-Que Choisir, the municipality of Montreuil (100,000 inhabitants), which is currently served by SEDIF, has started a procedure which might end up in the remunicipalisation of water supply. This would be the second largest case of remunicipalisation in France after that of Grenoble (150,000).

In November 2007, outgoing Paris mayor Bertrand Delanoë has announced that, if re-elected, he would not renew the two affermage contracts to Suez and Veolia to entrust all water operations to a unique municipal operator. Miss Anne Le Strat, a green city councillor and CEO of the majority municipally-owned bulk water supply company Eau de Paris, welcomed the announcement.

### 5.2. Italy

Roughly 1/3 of Italian water operations are now deemed to be in the hands of private or public-private companies (mainly Italian). Another 1/3 is deemed to be in the hands of public operators and the remainder remains to be awarded to either private or public concessionaires. The Italian Forum of Movements on Water, an alliance of civil society organisations including trade union CGIL, are taking action to promote water supply and sanitation remunicipalisation by adopting a two-pronged strategy.

First, the Forum is raising the profile of water issues through local public campaigns which have culminated in a 40,000-strong demonstration in favour of publicly-run water services held in Rome in December 2007. Second, the Forum is promoting the adoption of national legislation aiming to stop and revert the privatisation of operations and to strengthen public water operations.

In November 2007, the Italian Parliament approved a moratorium promoted by the Italian Forum of Movements on Water. The moratorium would suspend all water privatisation processes in Italy for one year. The Forum is also promoting a law proposal, backed by the signatures of 406,000 Italian citizens, and which is now being considered by the Environmental Commission of the Parliament. The proposed law provides for:

- a) public ownership and operation of water services and infrastructure;
- b) exclusion of competition in the water sector due to the priority to be accorded to the public interest from the social and environmental point of view;
- c) remunicipalisation or renationalisation of all private operations;
- d) establishment of a national fund to financially support the renationalisation of water operations;
- e) financing of capital expenditure and part of operating expenditure through general taxation, with the remainder to be covered through tariffs;
- f) public participation in the provision of water supply and sanitation services;
- g) establishment of a national solidarity fund, made out of charging a levy of Euro 0.01 per cubic metre of water supplied and Euro 0.01 per bottle of water sold. The fund would support Water Operator Partnerships (WOPs) and Public-Public Partnerships (PUPs), particularly to promote the extension of water services.

### 5.3. Ireland and the UK: background

Water remains a contentious public issue in the Republic of Ireland and in all four parts of the UK, especially over privatisation and charges. The Republic of Ireland became an independent state in 1922.

Like other European countries, water services in the UK and Ireland became the responsibility of municipalities from the 19<sup>th</sup> century onwards. Unlike other European countries, however, metering of



households has never become established in any of the countries, and so the service has been financed through local taxation, or through charges based on property values set for local taxation, rather than consumption.

Up to the 1970s, the water services in the Republic of Ireland, England, Wales, Scotland, and Northern Ireland, shared a common form – a municipal service funded through local property taxes for households and metered charges for businesses. From that decade, a series of changes were made that resulted in different structures in terms of ownership and household payments.

**Table 9. Owners of water operators and basis of payments, UK and Ireland, 1970- 2007**

		1970	1980	1999	2007
<b>Republic of Ireland</b>	Ownership	Municipal	Municipal	Municipal	Municipal
	Household contribution	Rates	Central tax	Central tax	Central tax
<b>England</b>	Ownership	Municipal	Central govt	Private	Private
	Household contribution	Rates	Rates	Rates	Rates
<b>Wales</b>	Ownership	Municipal	Central govt	Private	Private non-profit
	Household contribution	Rates	Rates	Rates	Rates
<b>Scotland</b>	Ownership	Municipal	Municipal	Municipal	Devolved govt corporation
	Household contribution	Rates	Rates	Rates	Rates
<b>Northern Ireland</b>	Ownership	Municipal	Central govt	Central govt	Devolved govt corporation
	Household contribution	Rates	Rates	Rates	Rates?

#### 5.4. Republic of Ireland

In the Republic of Ireland, local property taxes on households (domestic rates) were totally abolished in 1977. The income previously generated by the rates was replaced by government funding for local council services, including water. In the Republic of Ireland therefore municipalities remain responsible for water services, but, like other municipal services, these are financed partly from central government, partly from locally collected motor taxes, plus charges for commercial users.

In the 1980s local councils tried to find other sources of revenue for services, and some tried to introduce specific water charges for households. But as a result of strong public opposition and a vigorous political campaign, these charges were abolished in 1997 (Impact 2004). This opposition was based mainly on the perception that water charges were an unfair way of sharing the costs of the service, whereas funding through general taxation is a progressive way of sharing the burden of financing. A recent paper noted: “The abolition of domestic water charges in Ireland shows how income distribution issues are ignored at one’s peril.” (Scott 2003)

In addition to funding through taxation, over £600m. of the finance for capital investment in water in Ireland has come through the EU cohesion and structural funds. More recently the government has attempted to introduce PPPs, with over 100 PPP projects at various stages of development in mid-2006. This too has been the subject of strong opposition. (Reeves 2006; SIPTU 2007). There has been successful opposition to various attempts to introduce charges for water, for example in 2006 a proposal for charges for local services was withdrawn, and in 2007 a proposal to charge schools for their water use was at least postponed for 2 years.<sup>17</sup>

#### 5.5. UK

##### 5.5.1. Northern Ireland

In Northern Ireland, responsibility for water services was removed from municipalities in 1973, and transferred to a special section of the Northern Ireland Department of the Environment. Around the same time, devolved government in Northern Ireland was suspended, and all departments came under direct rule by the UK government. The financing however remained unchanged: the government (now through the Department for Regional Development (DRD)) continued to collect local property taxes from households to finance local services, including water, with metered charges for business users. In 1999 a government paper stated that the total expenditure of the water services was £195m., of which over three-quarters was financed by the rates, which provided £150m; charges for commercial water use, trade effluent charges and



connection charges, provided £36m; and the balance of £9m came from central government. The paper noted that: “*the contribution this year by the average domestic ratepayer in Northern Ireland for water and sewerage services is £127*” (DoEe 1999, p.2).

In 2003 the UK government produced a consultation document on reforms to water services in Northern Ireland, proposing the introduction of a new charge for water services, additional to the rates paid for local services, and presenting a range of options for restructuring the service, including privatisation on the model of the English companies. A number of public private partnerships (PPPs) were also created as vehicles for capital investment under the private finance initiative, notably for new treatment works.

Three main arguments were used for the new charge: firstly, that people in Northern Ireland did not contribute anything towards the cost of the water service; secondly, that EU legislation required that water companies should charge users on the basis of ‘full cost recovery’; thirdly, that the burden of taxation in Northern Ireland is too low compared with the rest of the UK.

The responses to this consultation were overwhelmingly hostile, both to the proposed new charge and to the principle of privatisation, and to the claim that no payments were made for water services. This opposition came from all sections of the population, with the main unionist and republican parties appearing together on campaign platforms to oppose the charge - even a majority of small businesses were opposed to privatisation.<sup>18</sup> (WRNI 2003a; WRNI 2003b; Hall 2003) By 2006 this opposition was calling for a mass refusal to pay the new charge if it was introduced<sup>19</sup>.

The UK government nevertheless decided to proceed with the introduction of the new charge and the creation of a government owned company – Northern Ireland Water (NIW) - with effect from April 2007<sup>20</sup>. NIW was in fact created and came into existence in April 2007, and published a detailed strategic business plan for the 7 year period up to 2013/14 (Northern Ireland Water 2007).

This corporatisation, if continued, will itself increase costs significantly. There are extra administrative costs of (a) £54 million per year associated with the company, especially the costs of administering a new charge separate from the rates; and (b) £48 million per year in dividends which will have to be paid to the company because the UK government has assigned it a notional shareholder capital of £650 million per year – an arbitrary figure which could have been zero. The combined effect of the corporatisation alone is to increase the total cost of the water service by over 30% (Hall 2007).

However, the implementation of the water charge was suspended as a result of the reintroduction of democratic elections in Northern Ireland. Elections for an assembly were held in early 2007, and the proposed water charge was a major issue, with all the main parties pledging opposition to the charge. These elections were followed by the creation of a Northern Ireland executive in May 2007, including representatives of both the main unionist party (the DUP) and the main republican party (Sinn Fein). The UK government then transferred to the new executive responsibility for a number of public services, including water. At the first meeting of the executive, it decided to suspend water charges for 2007/08 and set up a comprehensive review of water services. This review is required to look at two basic questions: “what the real cost of providing water and sewerage services is [in Northern Ireland]; and how these costs should be met”, and then consider the best arrangements for management and governance of water services within public ownership.<sup>21</sup>

### 5.5.2. Scotland

In the early 1990s, the government also proposed to privatise water in Scotland, but public opposition there was even higher: successive polls showed 91%<sup>22</sup> or 86%<sup>23</sup> of people definitely opposed. In March 1994 Strathclyde Regional Council, covering nearly half the population of Scotland, organised a postal referendum on the issue: seven out of ten voters returned papers, a total of 1.2 million people, of whom 97% rejected water privatisation.<sup>24</sup> The government finally abandoned the attempt to privatise Scottish water, and issued an emphatic leaflet at Scottish local elections in May 1994 with the headline “Tories say no to privatisation.”<sup>25</sup> Public resistance to water privatisation remains high in Scotland: a poll in 2004 found that 70% are still opposed.<sup>26</sup>

Water services in Scotland thus remained the responsibility of municipalities until the 1990s, and were then

transferred to three area boards. After the creation of a devolved government in Scotland, which took over responsibility for water services, the area boards were merged in 2002 into a single corporation, Scottish Water, owned by the Scottish Executive. The basis of charging households is the local property tax band, with metered charges for commercial consumers. (Cooper et al. 2006)

Following the elections in May 2007, the Scottish National Party now controls the Scottish executive. It has ruled out converting Scottish water into a non-profit mutual company.<sup>27</sup> The regulator, the Water Industry Commission for Scotland, has openly suggested that the necessary investment programme cannot be funded through the public sector.<sup>28</sup>

### 5.5.3. Wales

Water in Wales was privatised along with the English companies in 1989. In 2000, the private company was taken over by a not-for-profit company, Glas Cymru. This was created not as an act of political reform, but as a mechanism devised by a consortium of USA multinational electricity companies who were buying the merged electricity and water company covering Wales (Hyder) but did not want to keep the water business. No private buyer was interested, so they had to create a vehicle to take it off their hands. It was broadly supported by the public and by the Welsh Assembly, but the company is not owned by the public sector, nor is it a cooperative, nor a mutual company. It is a not-for-profit company controlled by its directors, who re-appoint their own successors. It has no shareholders, and all its capital is debt finance, mainly bonds.

### 5.5.4. England: fraud and misleading information

In England and Wales, water services were removed from municipalities in 1974 and transferred to semi-nationalised Regional Water Authorities (RWAs). The RWAs continued to charge households on the basis of the same property values used for municipal rates – the rates bills of municipalities fell accordingly. In 1989 these were sold as private companies, but the basis of financing remained largely unchanged: even after privatisation, the companies charge the majority of households on the basis of property tax valuations, with metered charges for commercial users (metered charges are also applied to new houses, where meters are routinely installed, and a minority of households who volunteer for metering).

Since 2004 there have been a series of revelations about private companies deliberately deceiving the regulator, leading to customer refunds, fines and criminal investigations.

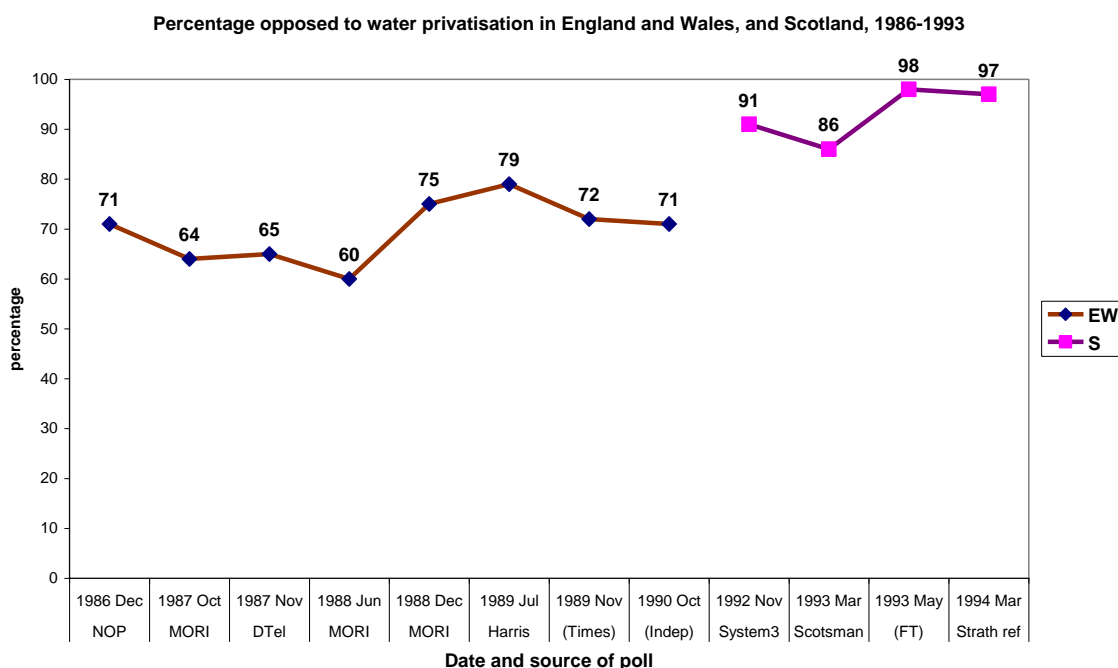
- A Severn Trent manager, David Donnelly, said in 2004 that he had been instructed by his bosses to exaggerate figures of debts owed by non-paying customers.<sup>29</sup> A year and a half later OFWAT produced a report which “found that Severn Trent Water had provided regulatory data that was either deliberately miscalculated or poorly supported. This led to price limits being set for the water company that were higher than necessary, which would have resulted in customers paying £42 million more by 2009-10.” The company was forced to repay the £42 million.<sup>30</sup> A few months later, in June 2006, OFWAT proposed to fine Severn Trent – this has not yet been done, but the possible level of the fine has been estimated at £50 million.<sup>31</sup> In November 2007 the Serious Fraud Office finally announced that it was going to prosecute Severn Trent for three criminal offences in relation to misreporting of leakage data.<sup>32</sup>
- Southern Water confessed to having made mistakes about its responses to customers, and failure to make payments due to customers.<sup>33</sup> The Serious Fraud Office decided not to prosecute, but OFWAT have fined Southern water £20 million – the problems were found to go back to before 2000. Ofwat Chief Executive Regina Finn said: “Southern Water deliberately misreported its customer service performance to Ofwat and systematically manipulated information to conceal the company's true performance over an extended period of time. The company benefited directly from this misreporting at the last two price reviews, meaning Southern was able to increase its prices by more than it should have done. Customers received higher than necessary bills because of the company's deception.”<sup>34</sup>
- Thames Water (then owned by RWE) admitted that they had misrepresented data on its response to customer enquiries, which also affects customer bills. OFWAT propose to fine Thames only £12.5 million because OFWAT considers that the misreporting was not deliberate.<sup>35</sup>
- Tendring Hundred ( a Veolia company) admitted it had made an “accounting error” in its estimates of income from metered customers, and overcharged customers £5 per head as a result of this unfortunate mistake. The company was not fined.<sup>36</sup>

### 5.5.5. Opposition to water privatisation in England and Wales

There has never been general support for the privatisation in England (or elsewhere in the UK). Strong public opposition to water privatisation was apparent throughout the 1980s. The first proposals in 1985 were widely criticised: even a Financial Times editorial suggested that: “the water industry has many special characteristics which seem to justify public ownership”<sup>37</sup>. A vigorous campaign against the policy was led by the unions, along with “a wide range of different interest groups...[including] some naturally sympathetic bodies such as Labour local authorities, but mostly non-political organisations, such as the Countryside Commission, the National Farmers' Union, the British Pensioners' Association, Greenpeace, the River Thames Society and the Royal Society for the Protection of Birds.”<sup>38</sup> The government decided in July 1986 to postpone the plans, because: “it did not seem a particularly attractive policy to introduce so close to an election”.<sup>39</sup> A poll in December 1986 showed that 71% were opposed to water privatisation, and only 21% in favour.<sup>40</sup> The opposition partly reflected scepticism about the effects of privatisation, with more than half expecting water services to get worse under privatisation,<sup>41</sup> but also a stubborn continuation of a belief in the importance of the public sector. A January 1988 poll showed a majority in the UK favouring a “mainly socialist society, in which public interests and a controlled economy predominated, and where caring for others was more highly rewarded than creation of wealth”<sup>42</sup>; and a June 1988 poll showed that 40% “felt nationalisation gave ordinary people a larger stake in the country” against 35% preferring privatisation.<sup>43</sup> Water in England and Wales was nevertheless privatised in 1989.

The actual experience of privatisation reinforced the unpopularity of the policy. This view was not confined to a particular political perspective. The Daily Mail, a staunch supporter of the Conservative party, ran consistently critical coverage, typified by a feature in 1994 entitled ‘The Great water Robbery’, which slated the companies on all counts: “... the water industry has become the biggest rip-off in Britain. Water bills, both to households and industry, have soared. And the directors and shareholders of Britain's top ten water companies have been able to use their position as monopoly suppliers to pull off the greatest act of licensed robbery in our history ”.<sup>44</sup>

**Chart B. Public opposition to water privatisation in Britain, 1986-1993**

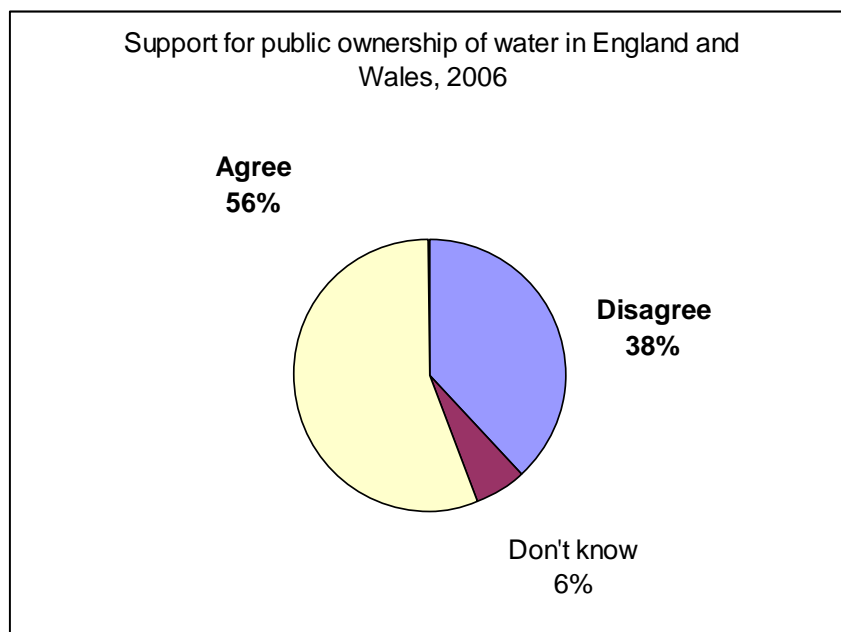


Source: Opinion polls reported in Financial Times, Guardian, Times, Independent, Scotsman and Herald, 1986-1993.

The public still believes that water should be in the public sector, 17 years after the water companies of England and Wales were privatised. In June 2006, 56% of people in an opinion poll believed that the country “would have fewer problems with water supplies if the industry was renationalised and the private companies replaced with a government-owned water board”, while 38% disagreed. The results were consistent across all age groups and regions (see Annex 1 for detailed results).<sup>45</sup> This poll was taken in the context of water shortages, drought orders, restrictions on consumption, high levels of reported leakage,

companies reporting increased profits and higher pay for directors, while water prices continue to rise.

**Chart C. Popular support for public ownership of water industry in Britain 2006**



Source: BBC Daily Politics Show Poll Fieldwork : June 14th-15th 2006. Conducted by Populus.  
[http://www.populuslimited.com/pdf/2006\\_06\\_20\\_Daily\\_Politics.pdf](http://www.populuslimited.com/pdf/2006_06_20_Daily_Politics.pdf) (see Annex)

## 6. Impact of the EU on the water sector

### 6.1. Summary

The EU affects water sector not only through directives specific to the sector, such as the Water Framework Directive, but also through other general policies such as the cohesion funds, the limits on government borrowing, and laws related to competition such as the procurement directives. The table below summarises the main elements affecting water.

**Table 10. EU policies and impact on water sector**

Category	Instrument	Content	Public service effect
Sectoral directives	Environment	e.g. Groundwater, nitrates	+
	Service levels	e.g. Drinking water, wastewater treatment	+/-
	WFD	Participation, cost recovery	+/-
Economic instruments	Cohesion funds	Accession, regional	+
	Stability pact	Limits borrowing, debt	-
	EIB, EBRD	Loan finance for investment	+/-
Competition	Internal market	<i>Competition rules( but no directive)</i>	-
	State aid	Limits conditions of public corporations	-
	Procurement	Trend to required tendering	-
	PPPs	Encouragement of private partnerships	-

### 6.2. Environmental directives and Water Framework Directive

The EU has passed a number of directives affecting water. They include general laws on the protection of water and water bodies e.g. on groundwater; laws aimed at controlling commercial activities with a strong influence on water quality e.g. concerning nitrates; laws directly regulating municipal activities in the water and waste water sector e.g. concerning drinking water and wastewater treatment; and an overarching law, the Water Framework Directive (WFD). For a review of all the directives, see [http://www.watertime.net/docs/WP1/D7\\_Int\\_Context\\_final.pdf](http://www.watertime.net/docs/WP1/D7_Int_Context_final.pdf)

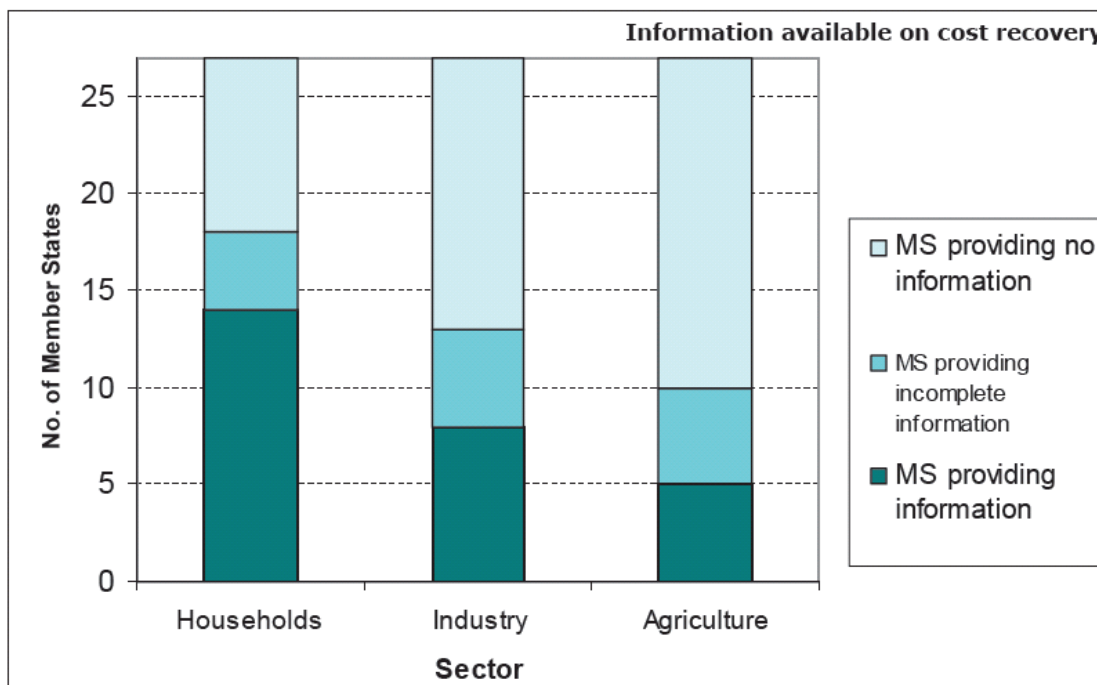
The directives on environmental quality and service levels, especially the wastewater treatment directive, have required higher levels of investment. Combined with the constraints on public borrowing and debt, this has created incentives to use private companies, for example through concessions or PPPs/PFI, to build and operate the necessary treatment plants.

The WFD article includes provisions, for example concerning public participation, which are in principle beneficial. It also includes provisions on cost recovery (Article 9), saying that member states must “take account of the principle of recovery of costs of water services”, and that member states must ensure “by 2010 that water-pricing policies provide adequate incentives for users to use water resources efficiently” and “an adequate contribution of the different water uses, disaggregated into at least industry, households and agriculture, to the recovery of the costs of water services”. But the definition of an adequate contribution is left open, and “member states shall not be in breach if they decide in accordance with established practice not to apply” these requirements.

However these provisions are being used to put pressure on countries to increase water charges. In Hungary, where major capital investment is still financed from central government, EU officials have indicated that they expect central government support to be phased out by 2015. It has been estimated that this will involve price rises of 5-85 percent, with large regional differentiation, with Budapest on the top.<sup>46</sup>

Article 9 also requires cost recovery to be assessed separately for the three main categories of users – households, industries, and agriculture – and so cross-subsidy is implicitly discouraged. Households may in fact be suffering worst. The EC report on implementation of the directive in 2007 found that there is more attention given to cost recovery from households, and also that the level of cost recovery for households is 70-100%: higher than for business (40-100%) or agriculture (1-100%). The effect could therefore be to increase household prices faster than others (despite the fact that households consume less than 20% of total water abstracted in the EU 15, on average).

**Chart D. Information on cost recovery for water in EU, 2007.**



Source: SEC(2007) 362 Accompanying document to the Communication From The Commission To The European Parliament And The Council 'Towards Sustainable Water Management in the European Union' First stage in the implementation of the Water Framework Directive 2000/60/EC Brussels, 22.3.2007

[http://ec.europa.eu/environment/water/water-framework/implrep2007/pdf/sec\\_2007\\_0362\\_en.pdf](http://ec.europa.eu/environment/water/water-framework/implrep2007/pdf/sec_2007_0362_en.pdf)



### 6.3. Cohesion funds

The EU makes significant financial provision for the costs of investment in water (and other environmental, transport and energy infrastructure) through the various accession, structural and cohesion funds. These are significant public finance mechanisms for redistributing money raised through general taxation to countries in most need. On average the EU collects about €20 Euros in taxes from every person in the EU each year to support investment in water and sanitation alone.<sup>47</sup>

During the period 1994 to 1999, environmental investment financed from the Structural Funds amounted to over € 9 billion. The impact on coverage in less wealthy regions and member states was significant:

“In Greece, the number of urban areas connected to main drainage almost doubled between 1993 and 1999, increasing the population covered to over 70%. In Ireland, the proportion covered rose from 44% in 1991 to 80% in 1999. In Portugal, the population connected to drinkable water supply rose from 61% in 1989 to 95% in 1999 and that connected to main drainage from 55% in 1990 to 90% in 1999. The Funds also helped to increase water supply in regions with a serious shortage. In Italy, for example, supply was expanded by over a third over the programming period.”<sup>48</sup>

Overall, this central support for infrastructure and other measures had a major effect on economic growth; in Greece, GDP in 1999 was 9.9% higher than it would have been without the central cohesion funds, in Portugal 8.5% higher.<sup>49</sup>

### 6.4. Stability pact

The economic and market policies of the EU have had a general restrictive impact on public finances of member states and accession countries. The EU convergence criteria, the so-called “Stability Pact”, agreed in 1992, require that members and prospective members of the EU must reduce their general government financial deficit (GGFD) to 3% of GDP, and their national debt to 60% of GDP. (EU Consolidated Treaty 2003: art. 104). This has affected all public services in two ways: firstly, it has encouraged the sale of public enterprises as a way of reducing debt; secondly, it has encouraged restructuring which involves private sector financing of investments – e.g. through sale of public enterprises, or through the use of ‘public-private-partnerships’ (PPPs), including concessions and the private finance initiative of the UK - and so reclassifies debt finance for capital expenditure as non-governmental. This latter effect was especially significant in sectors such as water which required major capital investment.

### 6.5. Competition rules and internal market

The competition and internal market provisions of the EU treaty have had the sharpest effect on public services, including water. These effects can be considered under three main headings: liberalisation directives; procurement rules, and state aid rules.

#### 6.5.1. No directive, but tried

There is no directive requiring liberalisation of the water sector, unlike the electricity, gas, post, telecoms, and rail sectors which are subject to such rules (and have experienced many problems as a result). When Commissioner Bolkestein was in charge of DG Markt he made clear in speeches that he supported liberalisation in the water sector, commissioned a report on how competition could be introduced in the sector, and the Commission’s 2003 paper on the strategy for the internal market of the EU for the next three years identified water in particular as a sector where the DG wanted to open more of the market to private sector operators – but all this pressure failed to convince enough people, and the parliament stated that it did not think water was suitable for liberalisation.

#### 6.5.2. Procurement and PPPs

The Procurement Directives of the EU are a set of rules requiring public tendering throughout the EU of all public authority contracts to purchase goods, building works, or services from the private sector. There are two areas of ambiguity surrounding the procurement directives, both of which have a significant impact on public and private provision of water services.

The first concerns the position of services which are carried out on behalf of a public authority by an ‘arms-length’ public sector organisation. In many countries, municipalities provide water (and other) services



through arms-length companies, which are still 100% owned by the municipality. Many municipalities have joined together and formed inter-municipal associations to enable them to provide water services on a larger scale, especially in rural areas. National laws and practice allow all public authorities to decide to carry out services themselves, and there is no requirement for services to be tendered if the authority is not outsourcing the work to the private sector.

However, private contractors have brought cases arguing that work awarded to an arms-length company or an inter-municipal association may not be covered by the exemption for in-house operations, and should be treated as an outsourced contract, thus triggering the requirement of the procurement directives for tendering. The ECJ case law is extremely complex but some of the decisions have meant that even where a company is 100% municipally owned, and even when the service is delegated to an inter-municipal company, these may be considered to be so arms length as to require prior tendering.<sup>50</sup>

The second area of uncertainty concerns concessions, which is a common form of contract under which water supply and sanitation services are delegated. However, as confirmed by an EC paper in 2001, the procurement directives do not cover concessions, and so formal competitive tendering under EC procurement rules is not required in respect of such contracts.<sup>33</sup> As a result, concessions in France or Italy may be opened to tender under national laws, but are not required to be open to companies from other EU countries.

Both of these questions are expected to be reviewed again in the green paper on PPPs due in 2004, along with the question of whether to require tendering of activities assigned to companies owned by public authorities.

### **6.5.3. State aid**

The state aid rules of the EU treaty were intended to prevent governments from providing financial support for companies that would give them an advantage in competition with other European companies.

Following a landmark judgment by the ECJ in the Altmark case, which set out 4 criteria which would make state aid for a public sector operator acceptable, the EC issued a set of guidelines which incorporated these Altmark criteria. One of the central problems with these criteria, however, is that they also treat competitive tendering as a key process which validates state subsidies. The fourth Altmark criterion – the need to demonstrate the reasonableness of the state subsidy – is automatically fulfilled if the service has been subjected to competitive tender; if not it has to demonstrate that it is as efficient as a ‘well-run company’, which is an uncertain requirement. The Altmark rules make competitive tendering even more attractive because the procurement process effectively ensures that the first two criteria are met as well: the definition of the public service obligation (condition 1) has to be made as part of a contract specification; the advance specification of the calculation of subsidy have to be specified (condition 2) in order to obtain comparable tenders. Altmark’s third condition, concerning proportionality of the aid, may also be most simply demonstrated through competitive tendering, arguing that the competitive process will always effectively discount any excess and return it to the public authority or to users of the service through lower charges.<sup>51</sup>

### **6.6. Development banks: EIB and EBRD**

The EIB (European Investment Bank) is the EU’s financing institution, whose aim is to “contribute towards the integration, balanced development and economic and social cohesion of the Member Countries”. Outside the EU the EIB implements the financial components of agreements concluded under European development aid and cooperation policies. In 2001, EIB lending for environmental projects (including water and sanitation), both within and outside the EU, totalled €9bn. Water projects accounted for 29% of total EIB lending in environmental projects from 1990 to 2001. The EIB has been used extensively to finance investments in water and other infrastructure where the private sector has been involved, for example in many PPPs and PFI projects in the UK.

The European Bank for Reconstruction and Development (EBRD) has been a significant player in the privatisation of water and sanitation in eastern Europe. The Bank was established in 1991 with the aim of assisting countries of central and eastern Europe (CEE) and the former Soviet Union with the transition to market-orientated economies. The EBRD generally pursues the “promotion and optimisation of private sector participation”, together with other objectives such as decentralisation, commercialisation and

corporatisation of services, development of regulatory structures and environmental improvement. The conditionality of EBRD finance “typically” includes private sector involvement and other reforms such as decentralisation, commercialisation and corporatisation, cost recovery, tariff reform and creditworthiness strengthening (EBRD 1999). The EBRD has financed many of the major water privatisations in CEE, such as Sofia, Bulgaria; Budapest, Hungary; Tallinn, Estonia; and Bucharest, Romania.

The EBRD has also acted as a partner shareholder, buying equity stakes in private water companies. The first examples of this were the EBRD’s purchase of Bechtel’s shares in the private water ventures in Tallinn and Sofia. The latest example of this is the investment in November 2007 of €105 million in 10% of the shares of Veolia Voda. This is Veolia’s venture to obtain privatised water business in Russia and CIS countries.<sup>52</sup>

The EBRD has also imposed a de facto conditionality of private sector involvement through its Multi-Project Facility (MPF) schemes. MPFs are funds set up under an agreement between the Bank and a specific private sector company to cover several projects on a wholesale basis, which effectively made use of the loans conditional on the involvement of the specific private company. In 1995, the Bank provided Suez-Lyonnaise des Eaux with a USD\$90m multi-project facility, which in 2000 it extended for a further 3 years, and in 1997, the Bank issued a similar-sized USD\$89.5m MPF to Générale des Eaux (now Veolia). In June 1995, just one month before the agreement on the multi-project facility to Lyonnaise des Eaux, Thierry Baudon left his post as deputy vice president of the EBRD and joined Suez-Lyonnaise des Eaux as managing director, international project finance (Hall et al 2004).

## 7. Notes

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<sup>6</sup> Utility Week 30 March 2007

<sup>7</sup> Thomson Financial News CNF Regulatory News formerly Company News Feed **August 24, 2007: Thames Water Cayman - Issue of Debt**

<sup>8</sup> United Utilities PLC Half yearly financial report Six months ended 30 September 2007

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<sup>9</sup> <http://www.smvak.cz/en-GB/default.aspx?ar=4>

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<sup>13</sup> R. Windischhofer. Municipal Entrepreneurialism and the Commercialisation of the Finnish Water Sector. PhD thesis. University of Tampere. 2007

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<sup>17</sup> The Irish Times December 19, 2007 Water charges for schools put back until 2009; Daily Mail December 19, 2007 Wednesday Water, water everywhere... so why the hell do we pay for it?

<sup>18</sup> Irish News **August 29, 2003: Water** charge rethink urged

<sup>19</sup> Water Charges Non-payment Campaign. 2007 <http://www.waterchargesnonpayment.com/>

<sup>20</sup> [http://www.drdni.gov.uk/index/water\\_policy.htm](http://www.drdni.gov.uk/index/water_policy.htm)

<sup>21</sup> <http://www.northernireland.gov.uk/executive-statements-index/executive-statement-100507.htm> ;

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