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**Working Party No. 2 on Competition and Regulation**

**ROUNDTABLE ON COMPETITION AND REGULATION IN THE WATER SECTOR**

**-- Germany --**

*The attached document is submitted by the delegation of Germany to the Working Party No. 2 of the Competition Committee FOR DISCUSSION under Item IV at its forthcoming meeting on 10 February 2004.*

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## ROUNDTABLE ON “COMPETITION AND REGULATION OF WATER SUPPLY”

*Contribution by the Federal Republic of Germany, Bundeskartellamt*

### 1. Legal framework

#### 1.1 *The role of the Federal Government, the federal Länder and the municipalities in the federal system*

1. The most distinctive feature of the German water industry (water supply and waste water management) in international comparison is probably the central role of the municipalities. The federal separation of powers into three levels of government, i.e. the Federal Government, the federal states (“Länder”) and the municipalities, is provided for in the constitution (so-called Basic Law, “Grundgesetz”). The municipalities’ right of self-administration laid down in Article 28 (2) of the Basic Law also covers the areas of water supply and waste water management. While the Federal Government has the framework competence, the direct competence for water supply lies with the federal *Länder* and the municipalities.

2. The municipalities have the administrative powers for water supply and waste water management. As a result of municipal self-government, cities and municipalities are free to choose between self supply and third-party supply and different legal forms of the own water supplying entity (publicly-owned companies, municipal utilities, public-law institutions, special-purpose associations, water and land associations, commercial and mixed-economy companies). In addition they are free to choose between public-law and private-law contractual relationships between suppliers and customers and to determine supply conditions.

3. Under the municipal codes of the *Länder*, municipalities can impose general connection and usage obligations on households and commercial enterprises if the municipalities have the decisive influence on the water supply facilities. Due to the so-called locality principle, municipal water suppliers are as a rule not allowed to supply to neighbouring areas.

#### 1.2 *Exemption under competition law*

4. Public water supply continues to be an exemption under German competition law. Contrary to the general prohibition of cartels and price-fixing arrangements, it is possible in the water supply sector to conclude demarcation and exclusive franchise agreements (Section 131 (8) of the Act Against Restraints of Competition (GWB) in conjunction with Section 103 of the ARC<sup>old</sup>). Under a franchise with an exclusive dealing clause, the municipality commits itself to grant the franchisee exclusive use of public ways for laying and operating pipes for the direct water supply of end customers in its area. Under a demarcation agreement, the water suppliers geographically divide the market between them by means of one of the contracting parties committing itself to refrain from the public supply of water via fixed pipelines in particular areas. In practice, however, demarcation agreements are so far only of limited significance: Irrespective of economic and technological conditions (such as insufficient network interconnection), the territorial monopolies are already secured by the law, i.e. through municipal connection and usage obligations, the so-called locality principle and exclusive franchises.

5. Nevertheless the prohibition of abusing a dominant position under Sections 19 et seqq. of the ARC and Article 82 of the EC Treaty and the specific control of abusive practices under Section 103 (5-7) of the ARC<sup>old</sup> also apply to the water supply sector. In addition, demarcation and franchise agreements may be subject to the prohibition under Article 81 of the EC Treaty if cross-border trade is affected.

### **1.3 Price surveillance**

6. Depending on whether the contractual relationship between the water supplier and the customer is a public-law or private-law relationship, a different type of price surveillance applies. Currently each of these two types accounts for around 50 per cent of water consumption nation-wide.

7. In the case of a public-law contractual relationship, charges are levied under the municipal charges acts of the *Länder*. As a rule water prices are determined by the water supply companies, which take into account the principles of fee law (in particular cost recovery and equal treatment), and decided on by municipal representatives. The level of charges is subject to the supervision of local authorities by the *Länder*. Consumers can complain against notices of charges from public providers before the administrative courts.

8. Prices by private providers on the other hand are subject to the competition authorities' control of abusive practices (Section 19 of the ARC, Section 103 (5-7) of the ARC<sup>old</sup>), which includes punishment for excessive pricing. Since in most cases the abusive conduct does not reach beyond the territory of a federal *Land*, such abuse proceedings are as a rule not conducted by the Bundeskartellamt, but by the competition authorities of the *Länder*. For the purpose of price-level control, the so-called comparable markets concept has been mainly applied in practice. Currently, research is being conducted on how to carry out abuse control using appropriate benchmarking models. Price differences between comparable supply areas serve as indications of excessive prices. They can, however, be justified by special hydrogeological and geographic characteristics of the supply area. Consumers can take legal action before the civil courts.

### **1.4 Health and water protection**

9. On the basis of European law the German drinking water ordinance („Trinkwasserverordnung“) sets the framework for microbiological, chemical and other qualities of drinking water. It includes furthermore general requirements such as the German minimization rule which stipulates that the concentration of contaminants in drinking water shall be kept as low as possible on the basis of state-of-the-art technology, within the framework of justifiable expenses and considering the circumstances of each individual case. In particular drinking water must be free from pathogens, fit for human consumption and pure. The ordinance sets limit or reference values for about 50 microbiological, chemical and physical parameters. The provision of water which does not meet these requirements is punishable as a criminal offence in some cases, in others it is classified as an administrative offence. The public health offices of the federal *Länder* are responsible for the hygienic supervision of drinking water as well as water collection and supply facilities. Apart from the drinking water ordinance the water laws of the federal *Länder* also include health protection provisions.

10. Water protection results from the interaction of a whole range of federal laws and laws of the *Länder*. As a federal framework act the water management act (“Wasserhaushaltsgesetz”, WHG) is of particular importance in this respect. Section 7(a) WHG regulates inter alia the conditions for discharging waste water on the basis of the waste water ordinance which includes specific regulations for various industries.

11. In order to protect water in the direct surroundings of water collection facilities, water protection areas are designated which are subject to constraints limiting their exploitation. These currently cover about 15 per cent of Germany's territory.

12. The amount of water abstracted by the supply companies is limited by means of authorisations for water abstraction granted by the water authorities. Many federal *Länder* levy fees amounting from 0.015 to 0.31 Euro/m<sup>3</sup>. As a rule the water supply companies themselves also assume water protection tasks.

## **2. Market structures and results**

13. Due to the fact that competence for water supply and waste water management in Germany lies with the local authorities the sector is characterised by the existence of relatively few major, but a large number of smaller supply companies (approx. 60 per cent of the total water amount is in the hands of 3.6 per cent of the companies) with various legal forms. Water supply and waste water management are generally still carried out by separate companies. Approx. 7000 companies are active in the water supply sector, likewise approx. 7000 companies are active in the sector of waste water management.

14. These companies are primarily owned by the municipalities. Approx. 85 per cent of the water supply companies are operated in a public-law form of organisation and 15 per cent in a private-law form of organisation. Only 1.6 per cent of the companies are entirely privately owned. Municipalities increasingly conclude management or operator contracts with outside third parties. After the conclusion of management contracts ownership of the facilities required for the supply of drinking water remains with the local authorities, whereas it is generally transferred to private parties after the conclusion of operator contracts. In accordance with the provisions of public procurement law under the ARC the award of management and operator contracts by public contracting entities to outside third parties must be put out to tender at European level if the EU thresholds are exceeded, and at national level if the EU threshold is not reached.

15. According to a study in Baden-Württemberg the costs of the water supply companies are roughly broken down into the following drinking water supply services: transport, pressure adjustment, storage, local distribution 56 per cent, extraction, procurement, treatment 33 per cent and administrative costs and miscellaneous costs 11 per cent. The fixed cost share in the water sector is high, ranging from 75 per cent up to 90 per cent.

16. Around 76 per cent of the water supplied to the end consumer by the public water supply companies is for private households and small businesses, approx. 16 per cent for industrial customers and 8 per cent for other institutions (schools, hospitals, etc.). Bulk consumers such as breweries or farmers have their own special rights for abstracting water granted on the basis of the water management act which implements Directive 2000/60/EEC of 23 October 2000. 95 per cent of the German industry is self-sufficient. A mere 5 per cent, mainly food companies which require a high quality of water, are supplied by public water suppliers.

17. Most large industrial companies which discharge waste water have their own sewage plants used for the treatment of their waste water. In some cases cooperation agreements exist between large industrial companies discharging waste water and municipalities regarding the joint use of sewage plants to clean industrial and domestic waste water. Taking into account the provisions relating to the award of public contracts both municipal and industrial sewage plants are used on a mutual basis. If management and operator contracts in the waste water sector are awarded by municipalities to outside third parties, and if EU thresholds are exceeded, these contracts must also be put out to tender Europe-wide and in accordance with the provisions of public procurement law under the ARC.

18. The comparably high quality of services provided by German water supply and waste water management companies is acknowledged worldwide. This applies to the high water quality and supply security as well as the high rate of connection (approx. 98.6 per cent). From an ecological point of view the low leakage level (approx. 9 per cent) and low per-capita consumption should be emphasized which are achieved among others by uniform metering and consumption-based billing by means of household water meters and the trend among consumers and industry to economize. Charges for waste water disposal are based on drinking water consumption and rainwater and, to an increasing degree, on a split charge system.

19. In the past few years there were carried out several price comparisons in Europe taking account of different influential factors such as company structures, cost cover percentages, charges, taxes, the proportion of subsidies, environmental and hygiene requirements. These revealed on the one hand the actual relation between prices and charges in different states and on the other important indicators for potential cost-cutting capacities.

### **3. Discussion on improving efficiency and service through modernisation and more competition**

20. In recent years “sustainable water management” and “water competition” and ways to solve global water problems became the focal themes of politics, industry and mapped-out examinations. It became evident from the outcome of this discussion that the German water industry is intended to be modernised in terms of efficiency and competitiveness rather than fully liberalised. This strategy is in keeping with the resolution of the European Parliament (EP) of 14.1.2004 on the so-called “Green Paper on Services of General Interest”. The EP takes the view that due to the different characteristics of this sector and the localized competence for the supply of drinking water as well as other preconditions water supply including waste water disposal should not be liberalized. On the other hand it calls for modernisation.

21. In Germany a conflict with the traditional competencies of municipalities for providing services of general interest has played a significant role in the discussion about introducing more competition to the water sector (drinking, waste water.) In 2002 the German Bundestag passed a resolution on “Sustainable water management in Germany” which calls for the preparation of a modernisation strategy for the water sector. This includes in particular

- introduction of a uniform benchmarking system in the water sector as a competition surrogate,
- examination of the equal tax treatment of drinking water and waste water in order to encourage the operational concentration of supply and disposal services and development of synergistic potential and to create equal conditions for competition in the market as well as
- further changes to the legal framework in order to raise the scope of action of municipal companies and in particular to facilitate their participation in competition already in place in the market for water services.

#### Competition potential for and within the market in the water sector:

22. In Germany the possibilities of opening up the water supply market further have been widely discussed. Theoretically there are two approaches to this. The first is to intensify competition within the market, i.e. competition for the end consumer by means of joint network use by several providers (common carriage) similar to the model chosen for opening up the electricity and gas markets, and secondly, to intensify competition for the market, i.e. competition for the right to supply water in a supply area for a limited period.

23. The potential for competition within the market is considered to be relatively little compared with other network industries (e.g. electricity, telecommunications), the reasons for this being the economical and technical features of water supply: high transport costs, little opportunity of common carriage due to hygienic and water chemical limits and inadequate connections between the networks, etc. In Germany the autonomy rights of municipalities as laid down in the Basic Law also stand in the way of a common carriage model.

24. However, some practical experience has been gained in Germany as regards competition for the market. This can be achieved, for example, by assigning water supply rights to a third party for a limited period (based on an operator or cooperation model) on a tender basis. A number of municipalities are already making successful use of competition for the market in order to achieve higher productive efficiency and ultimately lower water prices in water supply.