

Anticipated joint venture for non-household retail water and sewerage services between Pennon Group Plc and South Staffordshire Plc

Decision on relevant merger situation and substantial lessening of competition

ME/6657/16

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 10 March 2017. Full text of the decision published on 21 March 2017.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. Pennon Group Plc (**Pennon**) and South Staffordshire Plc (**SSP**), through their subsidiaries South West Water Limited and South Staffordshire Water Plc respectively, have agreed to form a new joint venture company through which they will combine their non-household (**NHH**) retail water (and, in the case of Pennon, sewerage) businesses (the **Merger**).¹ SSP and Pennon are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that enterprises will cease to be distinct as a result of the Merger, that the turnover test is met and that, accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties have explained that the Merger is being entered into in preparation for the opening of the English NHH retail water and sewerage sector to full competition from April 2017 (**Market Opening**).¹ Currently, the

¹ These reforms do not extend to Wales. The Parties do not operate in Wales.

Parties are both active in supplying NHH customers within their regulated regional monopolies but do not compete to supply retail water and sewerage services to NHH customers elsewhere in England.² The Parties overlap in the supply of retail water services only (SSP does not currently supply retail sewerage services).

4. Given the upcoming reform, the CMA has assessed the effects of the Merger in England relative to what may realistically have happened, absent the Merger, following Market Opening.
5. The CMA considered a range of evidence in assessing the competitive constraint that the Parties would face post-Merger, including: (i) shares of supply; (ii) the Parties' submissions and internal documents; and (iii) views of third parties, including the sectoral regulator Ofwat.
6. The CMA found that:
 - (a) The merged entity will have a low share of supply after Market Opening and will face a significant number of competitors;
 - (b) The evidence from third parties and internal documents did not indicate that the Parties would have been particularly close competitors after Market Opening for any particular type of NHH customer or in any particular region; and
 - (c) The vast majority of third parties, including Ofwat, were not concerned by the Merger.
7. The CMA concluded that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in the supply of retail water and sewerage services to NHH customers in England.
8. The Scottish NHH retail sector has been open to full competition since 2008, and the Parties currently compete in the supply of retail water and sewerage services to NHH customers in Scotland. The CMA assessed the effects of the Merger in Scotland relative to the prevailing conditions of competition. However, given the very limited presence of the Parties (the merged entity will have a share of supply less than [0-5]% in Scotland) the CMA does not believe that there is a realistic prospect of an SLC as a result of horizontal

² Currently, only NHH customers using at least 5 mega-litres per annum in England, or 50 mega-litres in Wales, can choose their retail services provider.

unilateral effects in the supply of retail water and sewerage services to NHH customers in Scotland.

9. The Merger also involves a vertical relationship, as SSP, via its subsidiary Echo Managed Services Limited (**Echo**), supplies billing and customer information software ('**RapidXtra**') to water companies. The CMA considered whether competition concerns could arise as a result of SSP engaging in input foreclosure, damaging the ability of other water retailers to compete, by, for example, limiting or worsening the terms on which retailers can access RapidXtra.
10. Given in particular the low increment to SSP's market share arising from the Merger in the supply of retail water and sewerage services to NHH customers in England or Scotland, the CMA concluded that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects.
11. For these reasons the Merger will **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Background

Water and sewerage sector in England and Wales

12. Water and sewerage services are currently supplied by regional monopoly operators which are responsible for the wholesale and retail supply of water and/or sewerage services to household (**HH**) and NHH customers in their respective regions (**Supply Areas**). In this context:
 - (a) Wholesale services comprise water abstraction, treatment and delivery, and wastewater collection, treatment and disposal.
 - (b) Retail services comprise meter reading, billing and collecting payment from customers.
 - (c) NHH customers include businesses, charities and public sector organisations.
13. The conduct of these regional monopolies in their respective Supply Areas is regulated by Ofwat (the economic regulator for the water sector in England

and Wales) via licences. These licences limit the prices that regional operators can charge to different customer groups.³

14. At present the following groups of suppliers operate in England and Wales under this regime:
 - (a) Ten companies hold Instruments of Appointment as regional monopoly water and sewerage companies (**WASCs**) under the Water Industry Act 1991 (**WIA91**);
 - (b) Seven companies hold Instruments of Appointment to provide water only services (**WoCs**) pursuant to WIA91. All of their customers receive sewerage services from one of the WASCs; and
 - (c) Various companies have applied for and received 'inset' appointments to serve defined areas within a WASC or WoC area (entailing a variation to the appointment(s) of the relevant WASC or WoC).
15. Currently, only NHH customers using at least 5 mega-litres⁴ (**MI**) per annum in England or 50MI per annum in Wales can choose their retail water services provider. These customers can choose between one of 13 different suppliers operating under a water supply licence pursuant to section 17A WIA91 (**WSL Licence**).⁵
16. The Water Act 2014 (**WA14**) created a framework to extend retail water and sewerage competition to all NHH customers in England⁶ from April 2017 (**Market Opening**).
17. As part of Market Opening, Defra and Ofwat are introducing the following key reforms:
 - (a) From April 2017, abolishing the 5MI limit in England so that all NHH customers can switch supplier;
 - (b) Enabling WASCs to transfer their NHH customers to third parties (known as 'retail exit'); and

³ Ofwat periodically reviews where the limits should be set using a process of 'comparative competition', which broadly disallows any costs companies incur inefficiently, relative to other operators. See further [Ofwat's website](#).

⁴ A mega-litre is 1 million litres.

⁵ The WSL Licence allows a licensee to use the supply system of a WASC or a WoC to supply retail water (but not sewerage) services to customers in the Supply Area of a WASC or WoC. The majority of suppliers operating under a WSL Licence are in the same corporate group as a WASC.

⁶ The changes will apply to customers served by licenced undertakers that operate wholly or mainly in England. This means that a small number of customers based in England but served by licensed undertakers mainly based in Wales, such as Dwr Cymru, will not be eligible to change supplier from April 2017 unless their usage levels exceed 50MI a year.

- (c) Enabling the entry of third parties wishing to supply NHH retail customers after Market Opening, via application for a Water Services Supply Licence and/or a Sewerage Services Supply Licence (**WSSL**) (known as 'retail entry').
18. Default tariffs regulated by Ofwat will continue to constrain the prices offered to customers.

Water and sewerage sector in Scotland

19. In 2008 the NHH retail sector in Scotland was liberalised and opened to competition following the enactment of the Water Services etc. (Scotland) Act 2005.
20. Scottish Water remains the monopoly provider of wholesale water and sewerage services in Scotland. However, entrants are able to apply for a water services licence, sewerage services licence, or both under section 6 of the Water Service etc. (Scotland) Act 2005 to enable them to supply retail services to NHH customers.
21. There are now 24 companies licensed to supply services in Scotland and all have a licence to provide both water and sewerage retail services.

Parties

22. SSP is a services group active in the areas of regulated and unregulated water supply and related services, ultimately jointly controlled by Mitsubishi Corporation and KKR & Co. LP. It is a holding company for:
- (a) South Staffordshire Water Plc, one of the seven English/Welsh WoCs; and
- (b) SSWB Limited, a water retail company currently competing in the retail supply of water to NHH customers in Scotland.
23. The UK turnover attributable to the NHH retail activities of South Staffordshire Water Plc in the financial year ending 31 March 2016 was £[~~£~~].
24. Pennon is a FTSE 250 company operating and investing in utility infrastructure businesses. It is a holding company for:
- (a) South West Water Limited, one of the ten English/Welsh WASCs; and
- (b) Source for Business Limited, a water retail company currently competing in the retail supply of water to NHH customers in Scotland.

25. The UK turnover attributable to the NHH retail activities of South West Water Limited in the financial year ending 31 March 2016 was £[~~3~~].

Transaction

26. In preparation for Market Opening (subject to necessary approvals), the Parties' WASC and WoC subsidiaries will exit the NHH retail market⁷ and transfer their businesses to separate subsidiaries. Pennon and SSP then propose to combine their respective NHH retail water and, in the case of Pennon, sewerage businesses in a new joint venture company (the **JVCo**) where Pennon and SSP will hold 80 and 20 per cent of the issued share capital respectively.

Jurisdiction

27. Under the Act, where the CMA believes that it is or may be the case that a merger qualifies as a relevant merger situation and has resulted, or may be expected to result, in an SLC, it has a duty to refer it for an in-depth phase 2 investigation (the **general merger regime**).
28. Mergers of two or more water enterprises are an exception to this regime. In certain circumstances, the merger of two or more water enterprises is subject to a special merger regime which has been in place since the water industry was privatised in 1989 (the **special water merger regime**) under WIA91. This involves a different type of assessment to the one envisaged under the general merger regime.⁸
29. Accordingly, for the purposes of the current assessment, the CMA has had to determine whether: (i) there is a relevant merger situation (as defined by the Act); and (ii) whether that involves two or more water enterprises (as defined by WIA91) such that the Merger should be considered under the special water merger regime rather than the general merger regime.

Nature of the enterprises and appropriate merger regime

30. As noted in the CMA's guidance, to establish whether a transaction will result or has resulted in a merger of two or more water enterprises the CMA must determine if the merger parties are water enterprises. Both parties (or, where the merger is between more than two parties, at least two of those parties)

⁷ They will remain active in the household retail market.

⁸ See the [CMA's guidance on the procedure and assessment of water and sewerage mergers](#) (CMA49), November 2015.

must be water enterprises for the special water merger regime to apply.⁹ Section 35(1) of WIA91 explains that a water enterprise is an enterprise carried on by a company appointed under section 6 of WIA91 to be a WASC or a WoC.

31. As noted above, as part of the restructuring for Market Opening, the Parties' retail businesses will no longer be carried on by the Parties' WASC and WoC subsidiaries and will no longer be the subject of regulation by Ofwat under 'comparative competition'. The CMA therefore believes that the NHH retail enterprises ceasing to be distinct cannot be described as water enterprises.
32. Therefore, the CMA believes the general merger regime applies in this case.

Relevant merger situation

33. Section 23 of the Act provides that, in the case of anticipated transactions, a relevant merger situation is created if:
 - (a) There are arrangements in progress or in contemplation which, if carried into effect, will lead to enterprises ceasing to be distinct; and
 - (b) Either the share of supply test or the turnover test specified in that section of the Act is satisfied.

Enterprises

34. On the basis of the evidence available, the CMA believes that the assets, rights and employees comprising the NHH water retail businesses of the Parties, which will be transferred to the JVCo, constitute enterprises. This is for the following reasons:
 - (a) Both NHH water retail businesses are currently operating and generating turnover from their activities;
 - (b) The assets and employees being transferred include all the assets and employees required to run the NHH retail businesses;
 - (c) The JVCo will have independent responsibility for determining the strategic direction of the business (in relation to commercial strategy, management, marketing arrangements and branding) and will have

⁹ See the [CMA's guidance on the procedure and assessment of water and sewerage mergers](#), paragraph 2.9 onwards.

discretion as to pricing and other dimensions of competition (quality, responsiveness and service levels); and

- (d) All of the relevant assets and rights are being transferred to the JVCo on a permanent basis.

Ceasing to be distinct

35. Under section 26 of the Act, enterprises will 'cease to be distinct' if they are brought under common ownership or control. Section 26 of the Act allows for a number of types of control, including the ability materially to influence the policy of a person (material influence).
36. As described above, Pennon will acquire an 80% interest in JVCo and SSP will acquire a 20% interest in JVCo.
37. As part of the joint venture agreement, both Parties will retain veto rights, which cover matters including material changes to the business operations of JVCo, the appointment/removal of JVCo's general manager, and acquisitions or sales of JVCo's customer base (above a 10% threshold). Both Parties will have the right to appoint members to the Board of Directors.
38. On the basis of this evidence, the CMA believes that the NHH retail enterprises of Pennon and SSP will cease to be distinct and each Party will acquire, at least, material influence over the NHH retail business being contributed by the other.

Turnover test

39. The UK turnover of the NHH retail businesses contributed to the JVCo and ceasing to be distinct exceeds £70 million so the turnover test in section 23(1)(b) of the Act is satisfied.

European Commission Referral

40. The Merger also meets the thresholds under Council Regulation (EC) 139/2004 (the **EC Merger Regulation**) for review by the European Commission. The Parties submitted a reasoned submission to the European Commission on 20 December 2016 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. The CMA informed the Commission that it agreed with the referral request and considered the Merger capable of being reviewed in the UK under the Act. On 1 February 2017 the European Commission announced its decision to refer the Merger to the CMA for review.

Conclusion on jurisdiction

41. For the reasons set out above, the CMA believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation for consideration under the general merger regime.
42. The preliminary assessment period for consideration of the Merger under section 34(A)2 of the Act started on 2 February 2017. The statutory 45 European Commission working day deadline for a decision is therefore 5 April 2017.

Counterfactual

43. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.¹⁰
44. The Parties submitted that, in this case, the counterfactual should take into account the upcoming regulatory change in the English NHH retail sector as the prevailing conditions of competition will not exist beyond April 2017.
45. The Parties submitted that the position in Scotland is different because the Scottish NHH retail water and sewerage services market has been open since 2008 and both Parties are currently active in Scotland. For Scotland, the Parties submitted that it would be appropriate for the CMA to assess the impact of the Merger against the prevailing conditions of competition.

England

46. The CMA agrees with the Parties that the prevailing conditions of competition will not exist beyond April 2017 and, due to Market Opening, there is a

¹⁰ [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D).

realistic prospect of a more competitive counterfactual in relation to NHH retail supply in England at that time.

47. The CMA notes that the Parties' submissions and internal documents indicate that, absent the Merger, the Parties would not have exited from NHH retail supply and would have competed. SSP would also have begun offering retail sewerage services.
48. Therefore, the CMA has assessed the effects of the Merger in England against a counterfactual where, in the absence of the Merger, the Parties would have competed post-April 2017 in an open NHH retail sector. The CMA has considered the extent to which the Parties would have been close competitors absent the Merger and the extent to which other NHH retail suppliers will remain or emerge in the context of Market Opening.¹¹

Scotland

49. Both the Parties operate in Scotland, and the CMA has found no evidence to suggest that there is a realistic prospect of a more competitive counterfactual in Scotland than the prevailing conditions of competition.
50. Therefore, the CMA has, in accordance with its general approach, assessed the impact of the Merger in Scotland against the prevailing conditions of competition.
51. However, the Parties have only very limited retail activities in Scotland. SSP and Pennon have [X] and [X] NHH retail customers in Scotland respectively, and the Merger would result in a combined share of supply of less than [0-5]% in Scotland. Therefore, the CMA does not believe that there is a realistic prospect of an SLC as a result of horizontal unilateral effects in Scotland, and the CMA has not considered the overlap between the Parties' activities in Scotland any further.

Frame of reference

52. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important

¹¹ [Merger Assessment Guidelines](#), paragraph 4.3.2.

than others. The CMA will take these factors into account in its competitive assessment.¹²

53. The Parties overlap in the supply of water retail services to a range of NHH customers in England and Scotland.¹³
54. The Parties submitted that the relevant market is the provision of water and sewerage services to all NHH customers in England. The Parties submitted that it was not necessary to distinguish between different customer types.

Product scope

55. For the purposes of determining the appropriate product frame of reference, the CMA considered whether:
 - (a) water and sewerage retail services should be considered together or separately; and
 - (b) the supply of NHH retail water and sewerage services should be segmented according to different customer types.

Water and sewerage retail services

56. The Parties referred to the CMA's approach in *Severn Trent/United Utilities*,¹⁴ where the CMA considered water and sewerage services together. On the basis of the evidence available, the CMA believes that this approach is appropriate in the present case as well, for the following reasons:
 - (a) Third parties (including incumbent and future suppliers and Ofwat) indicated that the vast majority of customers would wish to purchase their water and sewerage services from the same retailer, and anticipated that almost all companies active after Market Opening will offer both services;
 - (b) All WSSLs that have been issued so far (including those issued to the Parties) have been for a water licence and a sewerage licence to the same company;¹⁵ and

¹² [Merger Assessment Guidelines](#), paragraph 5.2.2.

¹³ As explained above, South Staffordshire Water Plc is a WoC. However, the company currently acts as billing agent for Severn Trent Water in relation to the supply of sewerage services for household and NHH customers in those parts of South Staffordshire Water Plc's Supply Area where sewerage services are supplied by Severn Trent.

¹⁴ [Severn Trent / United Utilities \(ME/6575/15\)](#)

¹⁵ See [Ofwat's website](#). One company, which already has an appointment to supply water services in its Supply Area, has applied for a sewerage licence in order to permit it to supply both water and sewerage retail services to current customers after Market Opening.

- (c) Third parties indicated that the incremental costs of providing retail sewerage services for a company already supplying retail water services are relatively low.

Customer segmentation

- 57. The CMA may sometimes assess a merger within separate frames of reference for separate customer groups if the effects of the merger on competition for one group of customers is different from its effects on another group, and it requires separate analysis. In considering this issue, the CMA may consider a range of factors, including whether customers have different preferences or have access to different sets of suppliers.¹⁶
- 58. NHH users of water and sewerage services range from small retail outlets using small amounts of water to much larger users sometimes operating at a number of sites. The CMA therefore considered whether it would be appropriate to identify separate frames of reference according to customer type.
- 59. The Parties submitted that it was not necessary for the CMA to distinguish between different customer types for the purposes of its assessment for the following reasons:
 - (a) Different customer types were likely to have similar levels of switching post-Market Opening;
 - (b) The Parties intend to compete for all customer types, and all retailers of water and sewerage services would be able to supply both large and small customers, as is the case in Scotland since market opening;
 - (c) Water companies and various other agencies (including Ofwat and Open Water) have publicised the effect of Market Opening and the ability of all NHH customers to switch; and
 - (d) There are no material differences in the services supplied to large users and SMEs, other than that large users may require a dedicated service account manager.
- 60. Ofwat told the CMA that it had not formally identified any distinct customer segmentations and that, after Market Opening, while customers might have different features and require slightly different services, it was not clear that there would be any barriers to entry that would prevent any retailers from

¹⁶ [Merger Assessment Guidelines](#), paragraphs 5.2.28 – 5.2.30.

serving any particular customer types, or that some customers would (or could) be served by only some retailers.

61. Some water companies told the CMA that smaller customers would have less to gain from switching, ie the costs of switching are likely to be relatively higher. In Scotland, research by CC Water found that suppliers are less likely to target smaller customers.¹⁷
62. The CMA notes that there is a continuum of customers in terms of their size and there is no precise way to distinguish different segments of larger or smaller customers. In *Severn Trent/United Utilities*, the CMA assessed the impact of the transaction in relation to SME, large user and multi-site customers, finding that those categories were supported by the parties to that transaction, most third parties, and evidence from Scotland.
63. In the present case, the CMA has similarly taken into account evidence of the impact of the Merger on SME, large user and multi-site customers in its competitive assessment; however, the CMA does not consider it necessary in this case to conclude on the precise scope of the product frame of reference given, as set out below, no competition concerns arise on any plausible basis.

Conclusion on product scope

64. For the reasons set out above, the CMA has assessed the impact of the Merger on the supply of retail water and sewerage services to a range of NHH customers.

Geographic scope

65. In light of the counterfactual (see paragraph 48), the CMA has considered the appropriate geographic frame of reference for the supply of NHH retail water and sewerage services after Market Opening in England in April 2017.

England post-Market Opening

66. As in *Severn Trent/United Utilities*, for the purposes of determining the appropriate geographic frame of reference in the present case, the CMA considered whether it is appropriate to consider competition:

(a) regionally or across the whole of England; and

¹⁷ CC Water, [Open for Business: Lessons for the non-household retail water market in England based on customer experiences in Scotland](#), 24 August 2016.

(b) across both England and Scotland together.

67. The Parties referred to the CMA's approach in *Severn Trent/United Utilities*, where the CMA considered the appropriate geographic frame of reference after Market Opening to be the whole of England, but not England and Scotland together.
68. The CMA notes that there is some evidence indicating that, after Market Opening, a regional frame of reference may be appropriate. In particular, [✂] and some third parties suggested that retail suppliers are likely to continue to focus on the Supply Areas of their associated wholesale companies where they have an incumbency advantage. However, in the present case, the CMA considers it unnecessary to consider competition regionally since the areas in which the Parties currently operate are not geographically proximate.
69. Conversely, there is also evidence to indicate that the appropriate geographic frame of reference after Market Opening should encompass both England and Scotland. In particular, the CMA notes that numerous English water companies have entered the Scottish NHH retail market, and some Scottish retailers have already entered (or made preparations to enter) the English NHH retail market (such as Business Stream and Castle Water).¹⁸
70. Ofwat told the CMA that it does not perceive any significant barriers preventing retailers from offering an England-wide or an England and Scotland-wide service, and that the Open Water programme (of which Ofwat is a member) is seeking to promote interoperability across both jurisdictions.
71. However, the CMA notes that, whereas the Scottish NHH retail market is reasonably established, having been open since 2008, there remains uncertainty as to how the English NHH retail market will develop. Therefore, on a cautious basis, and consistent with *Severn Trent/United Utilities*, the CMA has assessed the effects of the Merger on competition in England only.

Conclusion on frame of reference

72. For the reasons set out above, the CMA has assessed the impact of the Merger on the supply of retail water and sewerage services to a range of NHH customers in England.¹⁹

¹⁸ Clear Business Water Limited and Cobalt Water Limited have applied for and been granted WSSLs.

¹⁹ That is to say in the areas covered by Market Opening, ie the areas supplied by an undertaker based wholly or mainly in England.

Competitive assessment

Horizontal unilateral effects

73. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.²⁰
74. The CMA assessed whether the Merger may be expected to result in an SLC in relation to horizontal unilateral effects in the supply of retail water and sewerage services in England after Market Opening in April 2017.

Shares of supply

75. The Parties submitted evidence on their current shares of supply based on publicly available data across all customer segments and for water and sewerage retail services separately. Table 1 shows the shares of supply for all customers, for water and sewerage services together, by revenue.²¹

²⁰ Merger Assessment Guidelines, from paragraph 5.4.1.

²¹ The Parties also supplied share of supply data by number of customer accounts. This showed similar shares of supply for the Parties.

Table 1 – Share of supply for water and sewerage services in England, by revenue

	Revenue (£m)	Share of Supply
South West Water (including Bournemouth Water)	[X]	[5-10]%
South Staffordshire Water	[X]	[0-5]%
<i>Combined</i>	[X]	[5-10]%
Water Plus	[X]	[30-40]%
Castle Water	[X]	[10-20]%
Anglian Water Services	[X]	[5-10]%
Yorkshire Water Services	[X]	[5-10]%
Northumbrian Water	[X]	[5-10]%
Southern Water Services	[X]	[5-10]%
Water 2 Business	[X]	[5-10]%
Affinity Water	[X]	[0-5]%
South East Water	[X]	[0-5]%
Sutton and East Surrey Water	[X]	[0-5]%
<i>Total</i>	[X]	<i>100.00%</i>

Source: the Parties

76. This data shows that, on Market Opening, JVCo will have a low share of supply in England, around [5-10]%. The Parties also provided share of supply data separately for SME and large customers, as well as data relating to their multi-site customers. This data did not indicate any materially different position for any particular customer type from the aggregate position indicated by the shares of supply in England shown in Table 1.
77. However, given that Market Opening has not yet occurred, the CMA believes that shares of supply for England are not a reliable indicator of the competitive constraints which will be faced by the Parties post-Merger. This is because current shares are not the result of customer preferences or the competitive strength of suppliers, but reflect the historic regional boundaries of the Supply Areas and the number and nature of the customers who happen to be located within those boundaries. In addition, they do not reflect any post-Market Opening repositioning of suppliers. For these reasons, the CMA has placed limited weight on shares of supply.²²

²² The Parties also provided share of supply data for the supply of (i) water services only; and (ii) sewerage services only, in England. Given SSP's current status as a WoC, the merged entity would have a slightly higher combined share of supply in a putative frame of reference for water only services: 8% by revenue and 10% by customer account numbers.

Closeness of competition

78. The CMA did not find any evidence to indicate that, absent the Merger, the Parties would be particularly close competitors after Market Opening. Rather, the CMA found:
- (a) The Parties' Supply Areas are not contiguous, and not even geographically close;
 - (b) The Parties' internal documents indicate that, before the Merger was agreed, both were planning to compete actively in the English water and sewerage market, for all customers, focusing on different parts of the country; and
 - (c) None of the third party respondents to the CMA's questionnaire said that the Parties were particularly close competitors.

Competitive constraints

79. In light of the imminent changes arising from Market Opening, the CMA also sought to assess the competitive constraint that the Parties will face by considering: i) available evidence relating to incumbent and potential new entrants that will be active after Market Opening; and ii) the views of third parties on the level of competitive constraint the Parties will face after Market Opening.
80. Six incumbent suppliers confirmed their intention to compete for NHH retail customers across the whole of England. In addition, third parties indicated that several new entrants will compete.²³
81. Ofwat also told the CMA that there would be a large number of competitors for all types of customer in England after Market Opening, noting that there are a large number of existing businesses with experience of water and sewerage NHH retail activities, including WASCs and WoCs and market participants in Scotland, for whom entry into England should be relatively straightforward.

Conclusion on horizontal unilateral effects

82. The CMA notes that there continues to be some uncertainty regarding how the supply of NHH retail water and sewerage services may develop in England after Market Opening in April 2017.

²³ Including Scottish Water Business Stream, the NHH retail water subsidiary of Scottish Water (the incumbent wholesale water supplier in Scotland).

83. However, on the basis of the evidence set out above, the CMA believes that, post-Market Opening, the JVCo will have a low market share and will face competition from many other retailers. The CMA has found no evidence to suggest that, absent the Merger, the Parties would have been close competitors.
84. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of retail water and sewerage services to a range of customers in England.

Vertical effects

85. Vertical effects may arise when a merger involves firms at different levels of the supply chain.
86. Vertical mergers may be competitively benign, or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC, not merely where it disadvantages one or more competitors.²⁴
87. SSP (via its subsidiary, Echo, which will not be contributed to the JVCo) supplies billing and customer information software (RapidXtra) to water companies. It supplies [X] water companies with this software [X]. The CMA has therefore considered whether, post-Merger, SSP might engage in an input foreclosure strategy, damaging the ability of other water retailers to compete by, for example, limiting or worsening the terms on which retailers can access RapidXtra. However, given the CMA's findings on horizontal unilateral effects (ie there are many competing retailers, the Merger gives rise to a low increment in SSP's retail share of supply and the Parties are not likely to be close retail competitors), the CMA does not believe that the Merger gives rise to a realistic prospect of an SLC with respect to vertical effects.

Barriers to entry and expansion

88. The CMA has not had to consider barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

²⁴ In relation to this theory of harm 'foreclosure' means either total foreclosure of a rival or partial foreclosure to competitively weaken a rival.

Third party views

89. The CMA contacted customers and competitors of the Parties, intermediaries involved in brokering retail services contracts with suppliers, and Ofwat.
90. The vast majority of respondents, including Ofwat, raised no concerns regarding the Merger. Of the limited concerns raised, the majority were not specific to the Merger.
91. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

92. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the UK.
93. The Merger will therefore **not be referred** under section 33(1) of the Act.

Andrew Wright
Director, Mergers
Competition and Markets Authority
10 March 2017

ⁱ The joint venture agreement relating to the merging of the NHH retail water and (in the case of Pennon) sewerage businesses is entered into between Pennon Group Plc, South Staffordshire Plc and Pennon Water Services Limited.