

Anticipated Joint Venture between Anglian Water Group Ltd and Northumbrian Water Group Ltd

Decision on relevant merger situation and substantial lessening of competition

ME/6692-17

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 1 August 2017. Full text of the decision published on 24 August 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.

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SUMMARY

1. The proposed transaction relates to the anticipated joint venture between Anglian Water Group Ltd (**Anglian**) and Northumbrian Water Group Ltd (**Northumbrian**). Anglian and Northumbrian have agreed to transfer their respective non-household (**NHH**) retail water and sewerage businesses to a 50/50 joint venture company (the **Merger**). Anglian and Northumbrian are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that the Parties 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 overlap in the supply of water and sewerage retail services to a range of non-household customers (**NHH customers**) (ie small and medium sized enterprises (**SMEs**)), larger use customers and multi-site customers) in England and Scotland. In particular, the Parties are already incumbent providers of retail services in Essex, Suffolk and Hartlepool due to their affiliation with the incumbent monopoly wholesale operators active there.
4. Competition in the supply of water and sewerage retail services to NHH customers in England is at an early stage, as most NHH customers in England have only been able to choose their retail supplier since 1 April 2017.
5. On a cautious basis, given the potential for materially different conditions of competition, the CMA has focused its assessment of the impact of the Merger on the supply of water and sewerage retail services to SME customers in Hartlepool, Essex and Suffolk.
6. The CMA has used evidence on switching, the Parties' submissions and internal documents and third party views to test whether the Parties have an incumbency advantage and are closer competitors than other competitors in these areas when supplying SMEs. The evidence available to the CMA indicates that entry has already occurred and that several competitors are now serving SME customers in all three areas. In addition, the CMA has received evidence that these competitors are capable of competing effectively against the Parties and a number will continue to do so post-Merger.
7. The CMA has evidence that there is sufficient competition remaining with respect to other customer segments and on a broader geographic basis, including England and Scotland.

8. The CMA believes that these constraints, taken together, are sufficient to ensure 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.
9. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Background

Water and sewerage sector in England

10. Wholesale water and sewerage services comprise water abstraction, treatment and delivery and wastewater collection, treatment and disposal. Wholesale water and sewerage services are supplied by regional monopoly operators which are responsible for the wholesale supply of water and/or sewerage services to household (**HH**) and NHH customers in their respective regions (**Supply Areas**). In this context, NHH customers includes businesses, charities and public sector organisations. Please see the map in Annex 1, which shows the supply areas in the UK.
11. The conduct of the regional monopoly wholesale providers 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 wholesale operators can charge to different customer groups.¹
12. At present, there are 17 regional monopoly wholesalers in the UK:
 - (a) Ten companies hold Instruments of Appointment as regional monopoly water and sewerage companies (**WASCs**) under the Water Industry Act 1991 (**WIA91**), which allow them to provide wholesale water and sewerage services; and
 - (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.

¹ 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](#).

13. Retail water and/or sewerage services comprise meter reading, billing and collective payment from customers. Prior to 1 April 2017, only NHH customers using at least 5 mega-litres² (MI) per annum in England or 50MI per annum in Wales could choose their retail water and/or sewerage services provider. From 1 April 2017, retail water and sewerage competition was extended to all NHH customers in England (**Market Opening**) (but not HH customers). As such, NHH retail water and/or sewerage services can now be provided by in any Supply Area by any business holding a licence (known as a water and sewerage supply licence, **WSSL**) to provide such services. This can include entities owned by the wholesaler in a given Supply Area or by a separate NHH retail company under a separate licence. At present, 25 retail companies hold WSSLs and are active in the English NHH retail market.³
14. Default tariffs regulated by Ofwat will continue to constrain the (retail) prices charged to customers who do not switch to a new retailer, or who are transferred to a licensee as a result of 'retail exit' until 2020.
15. The Parties provide wholesale services in the same Supply Areas:
 - (a) In the Hartlepool Supply Area, Anglian is the WOC and provides wholesale water services, while Northumbrian in its capacity as the WASC in the wider Northumbrian area provides wholesale sewerage services; and
 - (b) In each of the Essex and Suffolk Supply Areas, Northumbrian is the WOC and provides wholesale water services and Anglian is the WASC providing wholesale sewerage services to the majority of each of these Supply Areas.
16. As such, the Parties are the incumbent water or sewerage retail service providers to NHH customers in each of the Hartlepool, Essex and Suffolk Supply Areas, as they are the retailers associated with the wholesale services providers in those Supply Areas.

Water and sewerage sector in Scotland

17. In 2008, the NHH retail sector in Scotland was liberalised and opened to competition.
18. Scottish Water remains the monopoly provider of wholesale water and sewerage services in Scotland. However, entrants are able to apply for a

² A mega-litre is 5 million litres.

³ The full list of licensees can be found on [Ofwat's website](#).

water services licence, sewerage services licence, or both to enable them to supply retail services to NHH customers.

19. There are now 26 companies licensed to supply services in Scotland and all have a licence to provide both water and sewerage retail services.⁴

Parties

20. Anglian is a services group active in the areas of regulated and unregulated water supply and related services. It is the ultimate parent company of:
- (a) Anglian Water Services Ltd which has a statutory monopoly for the wholesale supply of water and sewerage services in the Anglian Supply Area⁵, ie it is the WASC for that area, and a statutory monopoly for the supply of wholesale water services in the Hartlepool Water Supply Area, ie it is the WOC for that area.
 - (b) Anglian Water Business (National) Ltd (**AWBN**), a water and sewerage retail service supplier to NHH customers in Great Britain.
21. The turnover attributable to the NHH retail activities of AWBN in the financial year of 2016 was approximately £[~~xxx~~] in the UK.
22. Northumbrian is a services group active in the areas of regulated and unregulated water supply and related services. It is the ultimate parent company of:
- (a) Northumbrian Water Ltd which is the WASC, in the Northumbrian Supply Area⁶ and the WOC in the Essex and Suffolk Water Supply Area.
 - (b) NWG Business Ltd (**NWGB**), which is a provider of water and sewerage retail services to NHH customers in Great Britain.
23. The turnover attributable to the NHH retail activities of NWGB in the financial year of 2016 was approximately £[~~xxx~~] in the UK.

Transaction

24. The Parties' will contribute the NHH water and sewerage retail businesses held in each of their subsidiaries, AWBN and NWGB, to Wave (the **JVCo**).

⁴ The full list of licensees can be found on the [website of the Water Industry Commission Scotland](#), the relevant authority for Scotland.

⁵ I.e. the east of England (excluding Essex and Suffolk Water's Supply Area).

⁶ Approximately the North east of England (excluding, for wholesale water, Hartlepool Water's Supply Area).

Anglian and Northumbrian will each hold 50 percent of the issued share capital in the JVCo.

Procedure

25. The Merger was considered at a Case Review Meeting.⁷

Jurisdiction

26. 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**).
27. 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 the WIA91. This involves a different type of assessment to the one envisaged under the general merger regime.⁸
28. 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 the 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

29. Since Market Opening, the Parties' NHH water and sewerage retail businesses are no longer carried on by subsidiaries holding WASC and WOC licences, but by subsidiaries holding WSSL licences (ie AWBN and NWGB). The CMA therefore believes that the NHH water and sewerage retail enterprises ceasing to be distinct cannot be characterised as water enterprises.⁹
30. Therefore, the CMA believes the general merger regime applies in this case.

⁷ See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, from paragraph 7.34.

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

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

Relevant merger situation

31. 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

32. On the basis of the evidence available, the CMA believes that the assets, rights and employees comprising the NHH water and sewerage retail businesses of the Parties which will be transferred to the JVCo constitute enterprises. This is for the following reasons:
- (a) Both NHH water and sewerage 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 water and sewerage 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 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

33. 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).
34. As described above, Anglian will acquire an 50% interest in JVCo and Northumbrian will acquire a 50% interest in JVCo.
35. As part of the joint venture agreement, both Parties will retain veto rights, [✂]. Both Parties will have the right [✂].

36. On the basis of this evidence, the CMA believes that the NHH water and sewerage retail enterprises of Anglian and Northumbrian will cease to be distinct and each Party will acquire, at least, material influence over the NHH water and sewerage retail business being contributed by the other.

Turnover test

37. The turnover of each of the NHH water and sewerage retail businesses of Anglian and Northumbrian contributed to the JVCo, and ceasing to be distinct, is well above £70m. Therefore, the turnover test in section 23(1)(b) of the Act is satisfied.
38. The CMA therefore 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.
39. The Merger 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 10 May 2017 requesting 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 United Kingdom under the Act. On 6 July 2017, the European Commission announced its decision to refer the Merger to the CMA for review.
40. The preliminary assessment period for consideration of the Merger under section 34A(2) of the Act started on 7 July 2017 and the statutory 45 European Commission working day deadline for a decision is therefore 8 August 2017.

Counterfactual

41. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual).
42. The Parties submitted that the counterfactual should take into account Market Opening. The Parties submitted that, absent the Merger, the Parties would have competed independently for NHH retail customers in a market characterised by new entry and significant competition.
43. The CMA believes it is appropriate to assess the impact of the Merger by reference to the prevailing conditions of competition. However, given the nascent nature of the NHH retail market, the CMA notes that the competitive conditions observed from 1 April 2017 to date may not be reflective of the

medium and longer term conditions of competition. The CMA has considered the implications of this in its competitive assessment.

Frame of reference

Product scope

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

Water and sewerage retail services

46. The Parties submitted that the relevant frame of reference should encompass both water and sewerage retail services to NHH customers.
47. Evidence from third parties responding to the CMA's market test supported this view. Third parties, including Ofwat, noted that customers are more likely to want a single water and sewerage bill and, from a supply side perspective, there is little difficulty for a retail supplier offering one service to begin offering both. In particular, evidence provided by Market Operator Services Limited¹⁰ (**MOSL**) on the switching of retail customers to other suppliers since 1 April supports the view that customers want to single-bill, as the vast majority of the switchers (around 95%) chose the same water and sewerage retail service supplier.
48. The CMA therefore believes it appropriate to assess the impact of the Merger in the following product frame of reference: the supply of water and sewerage retail services to NHH customers.

¹⁰ MOSL is a private company that works on behalf of, and is funded solely by its water company members. Companies are required to be members of MOSL to compete in the market. In March 2017 MOSL was appointed the 'enduring' market operator. In this long-term role, MOSL is responsible for the effective and efficient operation of the water retail market and plays a central role in its evolution through its continued work with the Code Panel.

Customer segmentation

49. 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.¹¹
50. 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.
51. In particular, as in previous decisions,¹² while noting that the continuum of customers in terms of their size means that there is no precise way to distinguish different segments of larger or smaller customers, the CMA considered the extent to which it was appropriate to distinguish between the following customer segments:
- (a) Small and medium sized enterprises (**SMEs**);
 - (b) Multi-site customers; and
 - (c) (Other) large customers.

Parties' submissions

52. The Parties submitted that it is not necessary for the CMA to distinguish between different customer types for the following reasons:
- (a) SMEs and large users are likely to have a similar level of switching post-Market Opening;
 - (b) All retailers will be able to supply all groups as evidenced by the position in Scotland post its NHH retail market opening in 2008; and
 - (c) There is no material difference in the services supplied to large users and SMEs, other than larger users may require a dedicated account manager.

¹¹ [Merger Assessment Guidelines](#), paragraphs 5.2.28 – 5.2.30.

¹² [Severn Trent Group Plc / United Utilities Group Plc \(ME/6575/15\)](#) and [Pennon Group Plc / South Staffordshire Plc \(ME/6657/16\)](#).

Third Party views and MOSL switching data

53. From a demand side perspective, responses from third parties, such as competitors and Ofwat have indicated that smaller customers ie SMEs may have less incentive to switch and, if they do consider switching, less incentive to consider all potential suppliers than larger or multi-site customers.
54. These views are further supported by a consideration of the MOSL switching evidence¹³ since Market Opening, The CMA believes that this evidence shows that customers in what could be considered as reasonable starting point for defining an SME customers (ie categories M5¹⁴ and below) typically had lower switching rates in the first three months after Market Opening.
55. In addition to these potential ‘demand-side’ differences between SMEs and other customers, the CMA notes that differences in total bill size could also lead to ‘supply-side’ differences. As supported by internal documents submitted by the Parties, [redacted],¹⁵ meaning that retail companies could have less incentive to pursue SME customers. This could be particularly true for SMEs with relatively high customer acquisition costs or costs to serve.¹⁶ The CMA notes that in Scotland, CCWater found that “*larger businesses were more likely to be targeted by retailers and brokers*”.¹⁷ Ofwat also suggested that customer inertia combined with low awareness of retail competition could lead to higher acquisition costs for lower value customers relative to more engaged, larger, customers.

¹³ MOSL as the market operator, is responsible for delivering and operating the central information systems and processes required for the NHH water and sewerage retail services market. In that capacity, it receives switching information from all market players.

¹⁴ MOSL segments customers according to their level of usage and trade effluent into 9 categories as set out below:

Segment	Water consumption	Trade effluent
M1	Less than 100 l/d	No
M2	100 l/d to 1,000 l/d	No
M3	100 l/d to 1,000 l/d	Yes
M4	1,000 l/d to 3,500 l/d	No
M5	1,000 l/d to 3,500 l/d	Yes
M6	3,500 l/d to 13,700 l/d	No
M7	3,500 l/d to 13,700 l/d	Yes
M8	Greater than 13,700 l/d	No
M9	Greater than 13,700 l/d	Yes

The CMA notes that considering categories M1-M5 as a proxy for SME customers could be potentially over inclusive in that: (i) the categorisations do not distinguish between multi-site and single site customers; (ii) the level of water usage may across some categories be considered on the higher end of SME usage.

¹⁵ [redacted].

¹⁶ A lower propensity to switch by a type of customer will tend to increase the costs of acquiring that type of customer. As discussed earlier, the available data appear to indicate that SMEs have a lower propensity to switch retail water provider.

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

Conclusion on customer segmentation

56. Therefore, based on the evidence outlined above, on a cautious basis, the CMA has assessed the impact of the Merger on the supply of water and sewerage retail services to SME customers separately.
57. On the same basis, the CMA believes that it may also be appropriate to assess the impact of the Merger on large and multi-site customers separately.
58. In any event, the CMA did not consider it necessary 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

59. For the reasons set out above, the CMA has assessed the impact of the Merger on the supply of water and sewerage retail services to SME, multi-site and large customers. As the evidence available to the CMA very clearly indicated that post-Merger there will be sufficient competition remaining for larger and multi-site customers and that therefore no concerns arise on these bases, these frames of reference are not discussed further.

Geographic scope

60. 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 to provide water and sewerage retail services to SME customers:
 - (a) regionally or across the whole of England; and
 - (b) across both England and Scotland together.

Regional or England

61. As described in the Background section, the incumbent retailer is typically the retailer associated with the wholesaler that has the statutory monopoly in a given Supply Area.¹⁸ In some areas of England, there are two wholesalers, with one providing water services and the other providing sewerage services,

¹⁸ Some wholesalers have sold their customer book rather than set up an associated retailer. After Thames Water and Portsmouth Water sold their customer books to Castle, and Southern Water sold its customer book to Business Stream, there are 9 incumbent retailers left in England (taking into account that Wessex Water and Bristol Water, Severn Trent Water and United Utilities, and South West Water and South Staffordshire Water formed joint ventures).

and consequently two incumbent retailers, each providing either water or sewerage retail services.¹⁹ As noted above, this is the case for the Parties in the three areas of Hartlepool, Essex and Suffolk (the **Overlap Areas**).²⁰

62. For the purposes of determining the relevant geographic frame of reference, the CMA has considered the extent to which incumbency features in these types of areas where there are two incumbents (referred to as “**dual incumbency areas**”) could lead to sufficiently different conditions of retail supply such that it is necessary to define regional markets by reference to these Supply Areas. In particular, the CMA has considered whether: (i) from a demand-side perspective, SMEs may be more willing to choose between the two incumbent providers; (ii) from a supply-side perspective, the incumbents benefit from significant advantages due to being already established in that area as the default retail supplier, which other suppliers may not be able to overcome for the purposes of seeking to acquire SME customers.
63. The CMA has considered evidence from the MOSL data switching since Market Opening, the Parties’ submissions and third parties’ views.

MOSL data

64. The CMA considered data provided by MOSL on the number of customer switches, covering the period between 1 April and 1 July 2017. The data identified the number of customer switches between different retail suppliers but did not identify individual customers or distinguish between different customer groups. Although the data does not break down by Supply Area, this data shows that there has been significantly more switching between incumbent companies that are also present in dual incumbency areas than between either of them and other companies.²¹ While the CMA notes that the data only spans a short period of time in a relatively nascent market, the CMA believes that this could indicate that there are potentially sufficiently significant demand and supply-side differences in these areas as to warrant a separate

¹⁹ Prior to Market Opening, WASC and WOCs (ie wholesalers) in these areas would enter into joint billing arrangements for retail services, whereby either the WASC or WOC would send one bill to customers in the relevant Supply Area.

²⁰ Since the Parties stated that they have unwound their joint billing arrangement (whereby one Party would send a single water and sewerage bill to the customers in the Overlap Areas) some time ago, each customer in these areas is currently dealing with two retailers, one for water and one for sewerage.

²¹ Specifically, in four of the eight water supply areas where an overlap between two wholesale incumbents is present, more than 50% of the water switches have been to an overlapping company. In relation to sewerage switches, more than 50% of switches have been to an overlapping company in three out of six sewerage supply areas.

The evidence also suggests that the area where retailers have competed with the greatest effect (in terms of accounting for the greatest share of switches) is typically in those areas where they overlap. This is the case for seven of the 11 retailers who have made a substantial impact in the market so far and who are associated with an incumbent wholesaler or which have purchased the customer book of an incumbent wholesaler.

assessment of the impact of the Merger on the supply of water and sewerage retail services to SMEs.

65. The CMA further considered evidence from third parties and the Parties submissions on demand and supply-side differences, which could support the observations provided by initial switching rates.

Parties' submissions

66. The Parties submitted that the geographic scope for the CMA's assessment should be national, encompassing England and Scotland together.
67. The Parties stated that the retail businesses of former WASCs/WOCs will inevitably have an initially strong position in their associated wholesaler's Supply Area, but that this 'incumbency' advantage will decline over time as other retailers can easily enter different Supply Areas to win SME customers in these areas. In that regard, the Parties submitted that:
- (a) From a demand-side perspective, SME customers can be served by any retailer, they are motivated to find the best price and not just the most convenient supplier, and can easily find information on other non-incumbent retail suppliers;
 - (b) From a supply-side perspective, customer acquisition costs are low (around [REDACTED] % of total retail costs) and, in this context, the Parties do not benefit from any specific incumbency advantages as:
 - (i) Retailers not previously present in a given Supply Area could use third party intermediaries (**TPIs**) to target customers. These TPIs already target SMEs and had existing relationships with some SMEs due to the brokering of other utility contracts;
 - (ii) Although some aspects of retail services such as meter reading activities may require a local presence, this does not impact on the question of geographic scope as meter reading activities could be easily outsourced to local agents.
68. However, the CMA notes that the Parties' internal documents also recognised that from a supply-side perspective there were advantages to scale.²² In that context, [REDACTED],²³ [REDACTED].

²² Cf. Merger Notice Annex 17.1: [REDACTED]

²³ See Annex 16.1, 17.1 and 24.1 of the Merger Notice.

Third party views

69. From a demand-side perspective, the evidence from third parties that SMEs were significantly more likely to choose incumbents in dual incumbency areas was not significant. The CMA's market test indicated that SMEs will be motivated by a range of factors when considering switching, including price, so called 'single homing' (ie receiving both water and sewerage bill) and reliability of service. Only the last factor places incumbent retailers at any advantage. The CMA's market test did not indicate that this was a sufficiently significant factor in SME decision making, even in the context of potential general customer inertia such as to make SME's significantly more likely to consider incumbent suppliers.
70. Evidence from third parties did however indicate potential supply-side advantages for incumbent suppliers relating to scale and consequently the costs associated with serving SME customers. In particular, third party retailers noted that:
- (a) Costs of marketing to customers could be higher in areas where they did not have a strong existing presence;
 - (b) Meter reading costs could vary and be more expensive in areas where they had lower customer density;
 - (c) The above two factors in the context of regional variation in margins could lead to a regionally varied competitive strategy. In this context, a number of incumbent retailers indicated a regionally focused competitive strategy with regard to SMEs whereby they expanded their presence incrementally from their existing customer base.

Conclusion on Regional or England

71. On a cautious basis, given the evidence from the MOSL switching data and some indication of supply-side differences leading to differences in the conditions of competition in dual incumbency areas, the CMA assessed the impact of the merger on the retail supply of water and sewerage services to SMEs in Hartlepool, Essex and Suffolk.

England, Scotland or England and Scotland

72. Given the observations and conclusions regarding the appropriate geographic scope for the supply of water and sewerage retail services to SME customers, the CMA has not found it necessary to reach a conclusion as to whether the geographic frame of reference should be broader. The CMA notes that no

concerns would arise on a broader frame of reference encompassing England or Scotland or England and Scotland, given the number of alternative retailers active across England and Scotland. The Parties have very limited shares of supply²⁴ in England, with a number of alternative retailers present. The Parties also have very limited activities in Scotland.²⁵

Conclusion on frame of reference

73. For the above reasons, and on a cautious basis, the CMA has assessed the impact of the Merger in the supply of water and sewerage retail services to SME NHH customers in Hartlepool, Essex and Suffolk.
74. However, given that no concerns arise on this, more cautious, or any other plausible basis, the CMA has not found it necessary to conclude on the geographic frame of reference.

Competitive assessment

Horizontal unilateral effects

75. 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.²⁶ Horizontal unilateral effects are more likely when the merger parties are close competitors.
76. The CMA assessed whether it is or may be the case that the Merger may be expected to result, in an SLC in relation to unilateral horizontal effects in the supply of water and sewerage retail services to SME customers in Hartlepool, Essex and Suffolk (the **Overlap Areas**). As noted above at paragraph 59 and 72, the CMA's assessment has focused on the supply of water and sewerage retail services to SMEs in Hartlepool, Essex and Suffolk, as the CMA believes no concerns could arise in relation to: (i) other customers segments; or (ii) SMEs on a broader geographic basis.

²⁴ Anglian's share of supply for England is around [5-10]% in the supply of water and sewerage retail service to NHH customers and the Merger would result in a negligible increase in its national share of around [5-10]% with several other large competitors remaining. While these shares encompass all customer segments, the evidence available to the CMA, in particular when considering initial (relatively low) switching rates as indicated by the MOSL data, does not indicate that these would vary significantly for SME customers or any other segment.

²⁵ Anglian and Northumbrian have [5-10]% and [0-5]% NHH retail customers in Scotland respectively and the Merger would therefore result in a negligible increment.

²⁶ Merger Assessment Guidelines, from paragraphs 5.4.1.

77. The CMA's concern is that the Merger may allow the Parties to charge higher prices to SME customers in these areas than they otherwise would,²⁷ or deteriorate their service.
78. In order to assess the likelihood of the Merger resulting in horizontal unilateral effects, the CMA has considered:
- (a) Shares of supply;
 - (b) Closeness of competition between the Parties; and
 - (c) Competitive constraints from alternative suppliers.

Shares of supply

79. As a consequence of the incumbent position arising from their associated wholesale activities, the two Parties currently both serve the vast majority of customers in each of the Overlap Areas.²⁸ This is reflected in the shares of supply of the Parties in these areas, which treats water and sewerage in a single product frame of reference. Specifically;
- (a) In Hartlepool, Anglian has [50-60]% of supply points and Northumbrian has [40-50]%;
 - (b) In Essex, Anglian has [40-50]% of supply points and Northumbrian has [50-60]%; and
 - (c) In Suffolk, Anglian has [30-40]% of supply points and Northumbrian has [60-70]%.
80. While the very high combined shares in the three areas indicates the currently very limited presence of other suppliers in these areas, the CMA does not believe that these shares of supply provide a sufficiently reliable indicator of the competitive dynamic that would prevail absent the Merger. This is because, given the nascent nature of the market and the limited amount of customer switching to date, current shares of supply are not necessarily fully reflective of customer preferences or the strength of suppliers when they are competing for these customers. Rather they could still 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,

²⁷ The CMA understands that there will be no default tariffs or other regulatory protections after the expiry of the PR14 price control in March 2020.

²⁸ While these shares encompass all customer segments, the evidence available to the CMA, in particular when considering initial (relatively low) switching rates as indicated by the MOSL data, does not indicate that these would vary significantly for SME customers or any other segment.

they may not fully reflect any post-Market Opening repositioning of suppliers. In this context, the CMA notes that evidence from third parties and the Parties' internal documents indicates that market participants are observing market developments and adjusting competitive strategy accordingly. For these reasons, the CMA has placed limited weight on shares of supply.

Closeness of competition

81. As noted above, due to their associated but separate water and sewerage wholesale activities, each of the Parties is an incumbent retail supplier of either water or sewerage retail services in the Overlap Areas. Pre-Merger and immediately post-Market Opening, the Parties' customers in the Overlap Areas receive separate bills for retail water services and retail sewerage services from each of the Parties. Following Market Opening, these customers are free to choose a new supplier, including either of the Parties, for the purposes of receiving a single bill for water and sewerage services.
82. The CMA has considered whether, absent the Merger, given their position as incumbent water or sewerage retailer the Parties would have been particularly close competitors for the retail supply of both water and sewerage services from the point of view of SME customers. This could be the case if SME customers currently supplied with either retail water or sewerage services by the Parties would be significantly more likely to choose between the Parties when considering switching to a single supplier of retail services.
83. The CMA has considered (i) MOSL switching data; (ii) Parties submissions, including the Parties' internal documents and own switching data from the Overlap Areas; and (iii) views of third parties in reaching its conclusions on closeness of competition.

MOSL Data

84. As noted above, the MOSL data indicates that in the initial three-month period since Market Opening, there has been significantly more switching between incumbent companies that are present in dual incumbency areas than between either of them and other companies. As noted above, this could indicate that SMEs are more likely to consider switching between the Parties, as the relevant incumbents in the Overlap Areas.
85. However, the CMA notes that there are several limitations to this data and therefore whether it can indicate that absent the Merger, the Parties would compete strongly in the Overlap Areas;

- (a) First, the data captures a relatively short period at an early stage of competition in this market;
 - (b) Second, the data is aggregated across all customer groups and does not identify switching by Supply Area but rather between suppliers. As such, it does not capture relevant switching between the Parties as driven by the specific conditions of competition in those areas.
86. Therefore, the CMA believes that the MOSL data provides an initial presumption, absent other evidence, on the extent to which the Parties compete and, absent the Merger, may have competed in the Overlap Areas. However, the CMA also believes that given its limitations, this evidence needs to be considered in the round alongside other evidence relating to the conditions of competition that could have prevailed absent the Merger in the medium to longer term in the Overlap Areas.

Parties' submissions

87. The Parties submitted that they are not particularly close competitors, as although they are incumbent retailers in each of the Overlap Areas:
- (a) SMEs are more likely to be incentivised to switch by a low price than convenience (ie single billing) and the Parties are not best placed to compete particularly strongly on price in the Overlap Areas. This is because [X].
 - (b) Customers in the Overlap Areas have little awareness of their current retail services provider, as such they are not more likely to consider switching to one of their existing suppliers (ie the Parties). This is because pre-Market Opening Northumbrian provided its services in Essex and Suffolk under a different name, since Market Opening it has identified itself as Northumbrian and, post-Merger, the Parties will again re-brand as 'Wave' (the name of the JVCo).
 - (c) SMEs have limited search costs which are easily reduced, as a result of the presence of TPis and websites such as England on Tap, which enable customers to contact multiple suppliers at the same time.
88. The CMA notes that the Parties' internal documents provide some broadly supportive evidence for these submissions;

- (a) Northumbrian internal documents indicate that they believe that SMEs can be motivated to switch by a number of factors, including price;²⁹
- (b) Anglian's internal documents recognise that their ability to price competitively may be limited in the Overlap Areas;
- (c) The Northumbrian business plan recognises that customers currently receiving a bill for only water or sewerage services may have a greater initial incentive to switch in order to single bill, but not that their choice of future suppliers will be driven by simple convenience.³⁰

89. However, the CMA also notes that, although limited in terms of overall number of switches, the Parties' data on switching between the Parties in the Overlap Areas indicates that a significant proportion of SME customers switched between the Parties in the three months since Market Opening.

Third party views

90. Third party views on closeness of competition were mixed. Some third parties noted that given the Parties' existing retail positions in these areas, the Parties may be better placed to win customers than other retailers. However, when considered in the context of factors which drive SME choice it was not clear that the Parties would be particularly well placed to win customers simply because of their existing relationship. In this context, Ofwat noted that although 'single billing' could be a significant driver for customer switching, it was not clear that an existing bill was the most attractive means of attracting customers to single bill.

Conclusion on closeness of competition

91. The CMA believes that initial switching evidence indicates that the Parties' incumbent positions could mean that they are close competitors for SME customers in these areas. However, the CMA notes that there is evidence to suggest that (i) the switching data has some limitations (ii) brand awareness may be low; and (iii) SME search costs are not particularly high. In the next section, the CMA has therefore considered the extent to which the Parties, while not necessarily particularly close competitors in terms of offering from an SME's perspective, may nonetheless have an advantage over other competitors seeking to compete in the Overlap Areas.

²⁹ Cf Annex 19.2, page 9, Merger Notification

³⁰ Cf Annex 16.1, NWG Business plan, p. 23, Merger Notification

Competitive Constraints

92. Horizontal effects are more likely where customers have little choice of alternative supplier. The CMA considered the extent to which post-Merger, the merged entity will be constrained by alternative suppliers.
93. The Parties submitted that, post-Merger, they would compete in the retail supply of water and sewerage services to SMEs in the Overlap Areas with a large number of competitors, who are actively targeting SME customers including Castle Water, Everflow, Water Plus (a JV between Severn Trent and United Utilities), SES and Clear Business Stream.
94. The Parties submitted that competitors' ability to compete effectively in the Overlap Areas was supported by the fact that there had been switching to a number of other suppliers in the three months since Market Opening.
95. The Parties further noted that constraints from these competitors would be stronger than indicated by current switching in the longer term as: (i) these competitors had active strategies to compete nationally for SMEs in the Overlap Areas; (ii) these competitors would not be materially disadvantaged by facing higher costs when targeting SMEs in the Overlap areas and therefore could compete effectively against the Parties.
96. For the purposes of determining whether sufficient competitive constraint would remain post-Merger, the CMA considered evidence on:
 - (a) Evidence of existing constraint from alternative retailers competing in the Overlap Areas;
 - (b) Differences in costs to acquire and serve SME customers that could mean that non-incumbent retailers are materially less able to compete;
 - (c) Suppliers' plans to compete in the Overlap Areas.

Existing constraint from alternative suppliers

Switching data

97. As noted above, there are limitations to relying exclusively on the MOSL switching data to provide an indication of competitive conditions that could prevail absent the Merger in the Overlap Areas.
98. The Parties submitted their own data on SME customer switching between the Parties in the Overlap Areas. This data shows that:

- (a) Total switching numbers are low in all Overlap Areas, indicating that competition may have been limited to date;
- (b) As noted above, both Parties won a significant share of SME switches from each other.
- (c) However, the switching data suggests that Everflow is an important rival to the Parties and has accounted for [a significant amount] of the switches in Essex and Suffolk and to a lesser extent in Hartlepool.
- (d) In addition, the switching data shows that other competitors were able to win SME customers in the Overlap Areas, although to a much more limited extent than Everflow. In Essex, SMEs have switched to 6 competitors aside from the Parties. In Suffolk, SMEs have switched to 3 other competitors aside from the Parties while in Hartlepool SMEs have switched to 2 other competitors aside from the Parties, although the total number of switchers is very low.

99. While the Parties' switching data directly relates to switching between the Parties in the Overlap Areas, the CMA notes that the sample sizes of the switching data are small (for each Overlap Area well below 100). As such, as with the MOSL data, the CMA has considered it alongside other sources of evidence. In particular, the CMA has considered the extent to which it can accurately reflect competition in the longer term based on evidence of competitors' ability to compete and plans to do so in the Overlap Areas.

Internal documents

100. Internal documents produced since Market Opening provide some further evidence of existing competitive constraint. They indicate that the Parties are monitoring a number of competitors for SME customers in their supply areas. For example, a recent internal document from Anglian discusses [REDACTED]. The same document also mentions that [REDACTED].

Third parties' views

101. Responses from third parties indicated that there were currently a number of players actively pursuing SME customers across the UK, including the Overlap Areas.

Conclusion on existing constraint

102. As noted above, the evidence available indicates that a number of other competitors are active and competing in the Overlap Areas albeit, except for

Everflow, currently to a more limited degree than the Parties. The CMA has considered the extent to which this is fully reflective of these competitors' constraint in the medium to longer term based on competitors' ability and plans to compete in the Overlap Areas.

Ability and plans to compete

103. The Parties submitted that alternative retailers seeking to compete in the Overlap Areas would not face materially higher costs to acquire or serve SME customers and would therefore have the ability compete effectively even in the context of low default margins as:
- (a) Acquisition costs were low and could be further lowered through effective engagement via TPIs who could also leverage existing supply relationships with SMEs from their interactions in relation to other utilities;
 - (b) While meter-reading costs could vary based on scale and customer density, meter reading services could be readily outsourced to meter readers with sufficient operational density to offer competitive terms to retailers entering a particular area.
104. A number of third party competitors stated that they do not intend to, or cannot, actively compete for SME customers in the Overlap Areas because they face materially higher costs to serve in terms of meter reading and acquisition costs (ie marketing to customers).
105. On the other hand, a number of other competitors told the CMA that they saw no particular difficulties in entering other local areas and thereby competing against incumbent retailers. In this context, four of those competitors stated that they (i) were capable of effectively competing and (ii) intended to compete, or were already competing for SME customers in the Overlap Areas and elsewhere.

Conclusion on competitive constraints

106. On the basis of the above evidence, the CMA considers that competition in the supply of water and sewerage retail services to SMEs in the Overlap Areas is not highly developed. However, the evidence available at this stage indicates that several competitors have entered. Everflow in particular has been very successful at attracting a large proportion of switchers since Market Opening. The evidence available to the CMA also indicates that their presence is likely to grow.

Conclusion on horizontal unilateral effects

107. As set out above, the CMA notes that to date not many customers, and in particular not many SME customers, have switched. However, CMA notes that there is evidence that entry has already occurred and that several competitors are now serving SME customers in all three Overlap Areas. In addition, the CMA has received evidence that a number of competitors are capable of competing effectively against the Parties and will continue to do so post-Merger. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to water and sewerage retail services to SME customers in the areas of Hartlepool, Essex and Suffolk.

Barriers to entry and expansion

108. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.³¹
109. The CMA has discussed supply side factors which may affect the extent to which non-incumbent retailers enter, expand and compete in different areas.
110. The CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

111. The CMA contacted customers and competitors of the Parties and Ofwat.
112. The majority of respondents, including Ofwat, raised no concerns regarding the Merger. Where concerns were raised this was in relation to the significance of the Parties' pre-Merger position and the extent to which there would be sufficient competition post-Merger. In this context, some competitors raised concerns regarding their ability to compete effectively in the current regulatory environment.
113. Third party comments have been taken into account where appropriate in the competitive assessment above.

³¹ [Merger Assessment Guidelines](#), from paragraph 5.8.1.

Decision

114. 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 any market or markets in the United Kingdom.

115. The Merger will therefore **not be referred** under section 33(1) of the Act.

Kate Collyer
Deputy Chief Economic Advisor
Competition and Markets Authority
1 August 2017

ANNEX 1 – SUPPLY AREAS IN ENGLAND AND WALES

