

Water and sewerage mergers: Guidance on the CMA's procedure and assessment

Summary of responses to the consultation

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1. Introduction and summary

- 1.1 Following a consultation, on 13 November 2015, the Competition and Markets Authority (CMA) published guidance on water and sewerage mergers (referred to in the document as ‘the guidance’). This guidance will replace the CMA’s current guidance on water mergers, *Water Merger References: Competition Commission Guidelines* (CC9). It will also replace paragraphs 17.1 to 17.6 of *Mergers: Guidance on the CMA’s jurisdiction and procedure* (CMA2), issued in January 2014, and the *Mergers of water or sewerage undertakings in England and Wales: explanatory note* (CMA2supp), issued in April 2014.
- 1.2 The Water Act 2014 (WA14) amends the Water Industry Act 1991 (WIA) to reform the special water merger regime to bring it into closer alignment with the general merger regime. The Department for Environment, Food & Rural Affairs (Defra) expects these reforms to commence in November 2015. Once commenced, these reforms will, among other things, remove the need for an automatic reference of a water merger for a phase 2 investigation and introduce a process that allows for a phase 1 investigation.¹ In line with the general merger regime the WA14 allows the CMA to accept undertakings in lieu (UILs) of a reference. To ensure that there are the appropriate safeguards within the regime, the reforms require the Water Services Regulation Authority (Ofwat) to provide its opinion on qualifying water mergers to the CMA during a phase 1 investigation, and for the CMA to take into account Ofwat’s advice. When forming its opinion on these points, Ofwat must apply the methods set out in its ‘statement of methods’.²

Purpose of this document

- 1.3 The purpose of this document is to provide an overview of the responses to the consultation on the guidance and the CMA’s view on the issues raised.
- 1.4 The CMA is a non-ministerial department formed on 1 April 2014. It is a competition and consumer authority which took over a number of functions formerly performed by the Office of Fair Trading and those of the Competition Commission. The CMA works to promote competition for the benefit of

¹ Under the current special water merger regime, the CMA has a duty to refer mergers between two or more water enterprises in England and Wales for a phase 2 investigation if the turnover of the water enterprises is greater than £10 million.

² This requirement is set out in section 33B(2) of the WIA. For further information please see Ofwat (2015), [Ofwat’s approach to mergers and statement of methods](#).

consumers, both within and outside the UK, and to make markets work well for consumers, businesses and the economy.

- 1.5 The guidance is applicable to water and sewerage mergers in England and Wales only. The general merger regime, under the Enterprise Act 2002, applies to water enterprises in Northern Ireland and Scotland.

Responses to the consultation

- 1.6 The consultation document that accompanied the draft guidance set out a series of specific questions on which respondents' views were sought. This document sets out a summary of the responses received to each of those questions and the CMA's views on those responses.

Consultation questions

- 1.7 The table below sets out the questions on which the consultation document sought views.

Question	
1.	Is the content, format and presentation of the draft guidance sufficiently clear? If there are particular parts of the guidance where you feel greater clarity is necessary, please be specific about the sections concerned and the changes that you feel would improve them.
2.	Is the level of detail helpful? Are there any parts of the draft guidance which you feel would be improved by being either more, or less, detailed?
3.	Is the draft guidance sufficiently comprehensive? Does it have any significant omissions? Do you have any suggestions for additional content that you would find helpful?
4.	Do you have any other comments about the draft guidance?

- 1.8 Many respondents expressed general views, and not all responses followed the questions provided in the consultation document. This document summarises responses by key issue and outlines the CMA's view on the issues raised.

- 1.9 This document should be read in conjunction with the consultation document and cross refers to relevant sections of the final water merger guidance throughout. It is not intended to be a comprehensive record of all views expressed by respondents: respondents' full responses are available on the

[consultation page](#). This summary of responses is not a definitive statement of the CMA's policy or procedures in relation to the exercise of its merger control functions in the water and sewerage sectors. Parties seeking guidance on those procedures should refer to the final published version: [Water and sewerage mergers: Guidance on the CMA's procedure and assessment](#) (CMA49), which is available on the CMA's webpages. Where this document is different from the guidance, the guidance takes precedence.

2. Issues raised in the responses to the consultation

- 2.1 We received seven responses to the consultation. This included the Office for Gas and Electricity Markets (Ofgem), the Consumer Council for Water and five water companies. A full list of respondents can be found in Annex A.
- 2.2 Overall respondents welcomed the guidance and felt that it detailed a clear process for water and sewerage merger parties.
- 2.3 In response to the consultation, respondents:
- requested greater clarity on engagement with third parties during a phase 1 investigation;
 - commented that the analytical approach was too similar to Ofwat's statement of methods;
 - requested greater detail on the level of analysis required at phase 1 compared to phase 2; and
 - raised concerns about the timetable for a phase 1 investigation.
- 2.4 The responses to these issues and the CMA's view are summarised below.

Engagement with third parties during the phase 1 assessment

Summary of responses

- 2.5 One respondent requested greater clarity on when third parties would have the opportunity to provide views or evidence during the phase 1 assessment. The respondent asked whether this would be possible in relation to an issues letter or during the process for UILs.
- 2.6 This respondent stated that it would be useful to publish the issues letter (or a version of it) and allow third parties to submit further evidence. The respondent also requested that it is made clearer in the guidance on whether, and if so, when, the CMA will consult third parties on UILs.

The CMA's views

- 2.7 The CMA guidance explains fully the way in which it will obtain and seek views from third parties in relation to the proposed merger. The guidance explains that the CMA invites comments from third parties on the proposed merger at the start of an investigation and will if necessary request further information from third parties as the investigation progresses. During phase 1

the evidence provided by third parties will be taken into account when the CMA forms its decision on whether to refer a merger for a phase 2 investigation.

- 2.8 The CMA has 40 working days to complete the initial phase 1 investigation which is the same review period under the general merger regime.
- 2.9 Therefore, the time period for review to decide whether to refer a proposed merger for a second phase investigation is limited. In addition, the CMA is under an obligation to ensure that confidential information is not disclosed.³ Given the time constraints and confidentiality restrictions, it is not the CMA's practice to provide third parties with the opportunity to comment on the issues letter.⁴ However the CMA may engage with third parties throughout the investigation where it has facts that relate to third parties which it needs to clarify.
- 2.10 However in light of the views expressed above we have included the following information in paragraphs 3.20 and 3.22 of the guidance:

In line with the general merger regime, while the CMA will interact with third parties, in light of the short timescales of a phase 1 investigation and the confidentiality constraints, it is not CMA practice to provide third parties with an opportunity to comment on the issues letter provided to the merger parties.

Where merger parties offer UILs, and the CMA considers that these might be suitable, the CMA will invite comments from third parties on the UILs before its final acceptance of any such UILs.

Flexibility of the analytical approach and methodologies

Summary of responses

- 2.11 One respondent suggested that to ensure flexibility in the CMAs approach to water merger assessment the guidance should not endorse or include too many aspects of Ofwat's statement of methods. The respondent highlighted one example where the guidance describes the potential impact on Ofwat's ability to make comparisons between cost and service levels when an independent firm is removed as a result of a merger. The respondent

³ The disclosure or use of information must comply with section 206 of the WIA.

⁴ For further information see [Mergers: Guidance on CMA's jurisdiction and procedure](#) (CMA2), paragraph 7.40.

recommended removing references in the guidance to the need for independence in comparators.

The CMA's views

- 2.12 Ofwat is required to use its statement of methods when providing its opinion to the CMA during a phase 1 investigation. While the analytical approach set out in the guidance document is consistent with Ofwat's statement of methods, the methodology outlined in this chapter is also in line with our previous phase 2 investigation guidance, *Water Merger References: Competition Commission Guidelines* (CC9) and with the recent CMA approach taken in the Pennon/Bournemouth merger.⁵ The analytical approach and methodologies outlined in Chapter 4 of the guidance document are applicable to both a phase 1 and 2 investigation.
- 2.13 It is important to note that the guidance highlights examples of the types of factors that the CMA will consider when assessing the impact on Ofwat's ability to make comparisons and does not preclude the CMA from considering other relevant factors. The guidance also recognises that the CMA's approach may change to reflect any future developments in Ofwat's approach to regulation, and how it uses comparators.
- 2.14 However, following our experience in the Pennon/Bournemouth merger assessment the following paragraph in the draft guidance has been removed from the guidance to provide the CMA with greater flexibility to adjust its approach and ability to adapt to future developments:

Consistent with previous merger investigations, the CMA might expect to take both a static and a forward-looking approach in its assessments. Under the static approach, the CMA would consider the potential impact a merger would have on Ofwat's most recent price control review framework. Under the forward-looking approach, the CMA would consider potential future impacts, based on possible changes in the merged firm's performance in future, and potential changes in Ofwat's regulatory framework (where these are foreseeable).⁶

⁵ For more information see CMA (2015), Pennon Group/Bournemouth Water merger inquiry final report.

⁶ For more information see the [draft guidance on the CMA's procedure and assessment in water and sewerage mergers](#), paragraph 4.24

The level of certainty of a referral for a phase 2 investigation

Summary of responses

- 2.15 One respondent requested greater clarity and certainty at pre-purchase stage on whether a merger case is likely to be referred for a phase 2 investigation. Particularly in relation to the level of significance that would cause prejudice in light of the different evidential thresholds for a phase 1 investigation compared to a phase 2.

The CMA's views

- 2.16 The guidance encourages merger parties to engage with the CMA and Ofwat in pre-notification discussions. These discussions provide the merger parties with an opportunity to, among other things, clarify the information required by the CMA and Ofwat, and where merger parties expect that a merger may raise potential concerns related to Ofwat's ability to make comparisons, to discuss these issues with the CMA and Ofwat. Engaging in these discussions also maximises the opportunity for the CMA to fully consider the appropriateness of a decision that an exception to the duty to refer applies.
- 2.17 The CMA has carefully considered the level of analysis that is required at phase 1 compared to phase 2. The guidance recognises that more complex cases, or cases where the views of Ofwat and the merging parties are not aligned are more likely to be referred for a phase 2 investigation. We recognise that in some cases it may be appropriate to accelerate a case to a phase 2 investigation where there is sufficient evidence. In practice the level of detailed analysis at phase 1 is likely to be determined by the information Ofwat requires in order to provide its opinion to the CMA and would need to be considered by Ofwat and the CMA on a case by case basis.

The timetable of a phase 1 investigation

Summary of responses

- 2.18 One respondent expressed concern that the proposed timetable is too short given the detailed analysis which is required for a phase 1 investigation.

The CMA's views

2.19 The CMA does not set the statutory timeframe for review of a merger, this is the responsibility of Defra.⁷ However, we believe that the water merger regime should be consistent with the general merger regime. The CMA is confident that the analysis required to reach a decision at phase 1 can be undertaken within the statutory time limit. The CMA has undertaken large and/or complex merger reviews in other sectors, including other regulated sectors, which have resulted in phase 1 remedies being accepted.⁸ There are aspects of the phase 1 process that provide some flexibility. For example, pre-notification discussions with the CMA and Ofwat provide a valuable opportunity to consider the issues raised by the potential merger and clarify information requirements.

⁷ For more information please see [to be confirmed: reference to Defra's SI].

⁸ For example, [Greene King/Spirit Pub Company \(ME/6501/14, 29 May 2015\)](#) and [Inter City Railways/InterCity East Coast rail franchise \(ME/6506/14, 6 March 2015\)](#).

Annex A: List of respondents

1. Written consultation responses were received from the following:
 - Consumer Council for Water
 - Office for Gas and Electricity Markets (Ofgem)
 - Seven Trent Water
 - South East Water
 - South Staffordshire Water plc
 - Sutton and East Surrey Water
 - Thames Water