

# Completed acquisition by Castle Water Holdings Limited of Invicta Water Limited

## Decision on relevant merger situation and substantial lessening of competition

ME/6757/18

The CMA's decision on reference under section 22(1) of the Enterprise Act 2002 given on 12 September 2018. Full text of the decision published on 23 October 2018.

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

### SUMMARY

1. On 1 July 2018, Castle Water Holdings Limited (**Castle**), parent company of Castle Water Limited (**Castle Water**), acquired Invicta Water Limited (**Invicta Water**) (the **Merger**). Castle, including Castle Water, and Invicta Water are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of Castle and Invicta Water is an enterprise; that these enterprises have ceased to be distinct as a result of the Merger; and that the share of supply test is met. The four-month period for a decision has not yet expired. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.
3. The Parties overlap in the supply of water and sewerage retail services to non-household customers (**NHH customers**) (ie small and medium sized enterprises (**SMEs**), larger use customers and multi-site customers) in England. In particular, the Parties are the incumbent providers of retail services in South East Water Limited's (**SEWL**) supply area and Thames Water Utilities Limited's (**Thames Water**) supply area due to their having

taken over the customer book of, or being affiliated with, the incumbent monopoly wholesale operators active there.

4. Competition in the supply of water and sewerage retail services to NHH customers in England began on 1 April 2017 (**Market Opening**). Before this date only larger users had been able to choose their retail supplier.
5. On a cautious basis, the CMA assessed the impact of the Merger in the supply of water and sewerage retail services to SME customers, focussing on the areas where Thames Water is the appointed wholesale sewerage company and SEWL is the appointed wholesale water company, ie where the Parties overlap as the incumbent retailers (the **Overlap Area**).<sup>1</sup>
6. The CMA tested whether the Parties have a significant incumbency advantage in the supply of water and sewerage retail services to SME customers in the Overlap Area, and whether they are closer competitors than other suppliers in this area. However, the CMA found that there are several credible alternative suppliers of water and sewerage retail services to SME customers in the Overlap Area.
7. The CMA also found that there is sufficient competition remaining with respect to other customer segments and on a broader geographic basis, including England.<sup>2</sup>
8. For these reasons, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects.
9. The Merger will therefore **not be referred** under section 22(1) of the Enterprise Act 2002 (the **Act**).

## ASSESSMENT

### Background

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

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<sup>1</sup> This is an area broadly around Maidenhead, Basingstoke and Aldershot in eastern Berkshire and northern Hampshire, and a few small areas to the south east of London.

<sup>2</sup> Invicta Water has no customers in Scotland or Wales.

supply areas. NHH customers include businesses, charities and public sector organisations.

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.<sup>3</sup>
12. At present, there are two types of regional monopoly wholesalers in the UK:
  - (a) Water and sewerage companies (**WASCs**) hold Instruments of Appointment under the Water Industry Act 1991 which allow them to provide wholesale water and sewerage services; and
  - (b) Water only companies (**WOCs**) hold Instruments of Appointment for wholesale water services only. All of their customers receive sewerage services from a WASC.
13. Retail water and/or sewerage services comprise meter reading, billing and collective payment from customers. From 1 April 2017, competition in the supply of retail water and sewerage services was extended to all NHH customers in England (Market Opening). As such, retail water and/or sewerage services can now be provided to NHH customers in any supply area by any business holding a water and sewerage supply licence (**WSSL**).<sup>4</sup> Currently, around 35 retail companies hold WSSLs, actively supplying retail water and/or sewerage services to NHH customers in England.<sup>5</sup>

## Parties

14. Castle<sup>6</sup> is the parent company of Castle Water. Castle Water is a supplier of retail water and sewerage services to NHH customers throughout the UK. It holds a WSSL in England, granted by Ofwat, and is also a licensed provider of water and sewerage services in Scotland, licensed by the Water Industry Commission for Scotland. In 2017, Castle Water acquired the NHH retail activities of Thames Water.<sup>7</sup> Thames Water is a WASC, which provides wholesale sewerage services in some of SEWL's supply area, namely in the area around Maidenhead, Basingstoke and Aldershot in eastern Berkshire

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<sup>3</sup> 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](#).

<sup>4</sup> In a minority of cases, the WSSL retail authorisation is limited to self-supply.

<sup>5</sup> <https://www.ofwat.gov.uk/regulated-companies/ofwat-industry-overview/licences>.

<sup>6</sup> Registered in BVI and tax domiciled in the UK.

<sup>7</sup> Thames Water (a WASC) has a statutory monopoly for the wholesale supply of water and sewerage services in the Thames Water supply area, ie London and the Thames Valley (excluding, amongst others, SEWL's supply area where SEWL is the WOC).

and northern Hampshire, and a few small areas to the south east of London. The turnover of Castle Water for the financial year ended 31 March 2018 was approximately £[REDACTED] million.

15. Invicta Water is a supplier of retail water and sewerage services to NHH customers in England. It holds a WSSL, granted by Ofwat. Prior to the Merger, Invicta Water was 100% owned by the Swan Group, which is a wholly owned subsidiary of HDF (UK) Holdings Ltd, the (indirect) parent company of SEWL.<sup>8</sup> SEWL has a statutory monopoly for the wholesale supply of water services in the SEWL supply area.<sup>9</sup> On 1 May 2018, Invicta Water acquired SEWL's NHH retail customers of water and sewerage services. The turnover of Invicta Water in the financial year ended 31 March 2018 was approximately £164,000. However, the annualised turnover attributable to SEWL's NHH retail business, which was transferred to Invicta Water, for the financial year ending 31 March 2018 was approximately £[REDACTED] million.
16. The CMA refers to the area where Thames Water is the appointed wholesale sewerage company and SEWL is the appointed wholesale water company, ie the area where the Parties overlap as incumbent retailers, as the **Overlap Area**.

## Transaction

17. On 1 July 2018, Castle acquired the entire issued share capital of Invicta Water.

## Procedure

18. The CMA's mergers intelligence function identified this transaction as warranting an investigation.<sup>10</sup>

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<sup>8</sup> The ultimate owners of HDF (UK) Holdings Ltd are Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, RBS Pension Trustee Ltd as trustee for the Royal Bank of Scotland Group Pension Fund and three entities of the Desjardins co-operative financial group based in Quebec (Regime de rentes du Mouvement Desjardins, Desjardins Financial Security Life Assurance Company and Certas Home and Auto Insurance Company).

<sup>9</sup> SEWL (a WOC) has a statutory monopoly for the wholesale supply of water services in the SEWL supply area, ie parts of Hampshire, Berkshire, Surrey, Sussex and Kent.

<sup>10</sup> See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, paragraphs 6.9-6.19 and 6.59-60.

## Jurisdiction

19. On the basis of the evidence available, the CMA believes that each of Castle and Invicta Water is an enterprise.<sup>11</sup> While no employees, and very little branding, were transferred as part of the Merger, the sale of Invicta Water comprised the customer records and contracts associated with SEWL's water and sewerage NHH retail business. The transfer of these assets is typically indicative of an enterprise being transferred, in particular for a retail service business.<sup>12,13</sup> The CMA believes that, in the circumstances of the supply of retail water and sewerage services to NHH customers, the transfer of customer contracts and records creates the economic continuity which would enable Castle to carry on the Invicta Water business.
20. As a result of the Merger, these enterprises have ceased to be distinct.
21. The Parties overlap in, amongst other things, the supply of retail water services in the SEWL wholesale supply area,<sup>14</sup> with a combined share of over 90% (increment 0.7%).<sup>15</sup> The CMA therefore believes that the share of supply test in section 23 of the Act is met.
22. The Merger completed on 1 July 2018 and was brought to the CMA's attention on this day. The four-month deadline for a decision under section 24 of the Act is 1 November 2018.
23. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.
24. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 25 July 2018. The statutory 40 working day deadline for a decision is 19 September 2018.

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<sup>11</sup> The CMA believes that the special merger regime set out in the Water Industry Act 1991 (as amended) does not apply in this case. For both Parties, the relevant NHH water and sewerage retail businesses are carried on by subsidiaries holding WSSLs. The CMA therefore believes that the NHH water and sewerage retail enterprises ceasing to be distinct cannot be characterised as water enterprises. See further the [CMA's guidance on the procedure and assessment of water and sewerage mergers](#) (CMA49), November 2015.

<sup>12</sup> [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2).

<sup>13</sup> Castle submitted that one of the rationales for the Merger was that the acquisition represented a higher return and lower risk route to increase customers than incremental growth through individual customer acquisition.

<sup>14</sup> The SEWL supply area comprises parts of Hampshire, Berkshire, Surrey, Sussex and Kent. The population of these counties is in the region of 6 million. The population falling within the SEWL supply area will be smaller but is significant. The CMA therefore considers this supply area to constitute a substantial part of the UK.

<sup>15</sup> Based on data supplied by Market Operator Services Limited (**MOSL**).

## Counterfactual

25. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For completed mergers the CMA generally adopts the pre-merger 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, 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.<sup>16</sup>
26. In the present case, the CMA found no evidence supporting a different counterfactual, and Castle and third parties have not put forward arguments in this respect. Therefore, the CMA believes the pre-Merger conditions of competition to be the relevant counterfactual.

## Frame of reference

### *Product scope*

27. 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 merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>17</sup>
28. The Parties overlap in the supply of retail water and sewerage services to NHH customers.

### *Product scope*

29. For the purposes of determining the appropriate product frame of reference, the CMA has considered:

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<sup>16</sup> [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).

<sup>17</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

- (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*

- 30. Castle submitted that the relevant frame of reference should encompass both water and sewerage retail services to NHH customers.
- 31. Retail water services and retail sewerage services are not demand-side substitutes.
- 32. However, the CMA found that these services are supplied by the same firms to broadly the same customers using the same assets.<sup>18</sup> Evidence from third parties supported this view. Third parties, including Ofwat, told the CMA that many customers generally prefer a single water and sewerage bill; and, from a supply-side perspective, there is little difficulty for a retail supplier of one service to begin to offer the other service. Ofwat noted that almost all retailers have been granted both water and sewerage WSSLs.
- 33. Evidence provided by MOSL on the switching of retail customers to other suppliers showed that the vast majority of switchers (around 89%) have chosen to switch to a single retailer.<sup>19</sup> On the other hand only 6% switched water or sewerage as an individual service, indicating that NHH customers generally prefer a single supplier for both retail services.
- 34. On the basis of this evidence, the CMA believes it appropriate to assess the impact of the Merger in a frame of reference for both water and sewerage retail services.

#### *Customer segmentation*

- 35. 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.<sup>20</sup>

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<sup>18</sup> [Merger Assessment Guidelines](#), paragraph 5.2.17.

<sup>19</sup> [www.mosl.co.uk/market-performance/details/30/switching-behaviours](http://www.mosl.co.uk/market-performance/details/30/switching-behaviours) (as at 1 September 2018).

<sup>20</sup> [Merger Assessment Guidelines](#), paragraphs 5.2.28 – 5.2.30.

36. 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, in the present case, it would be appropriate to identify separate frames of reference according to customer type.
37. As in previous decisions,<sup>21</sup> while noting 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.

*Castle's submissions*

38. Castle submitted that it is not necessary for the CMA to distinguish between different customer types for the following reasons:
- (a) All retailers supply all NHH customers. No retailer in the UK is currently servicing only one customer segment.
  - (b) All customers have the same ability to switch provider regardless of their size.
  - (c) There is no material difference between customer segments in the services they require, or in their contractual terms with suppliers.
  - (d) Switching activity is not sufficiently different between customer segments to warrant different analysis. Data published by MOSL in its CEO Annual Market Review Year One 2017/18,<sup>22</sup> which monitored switching activity within customer segments, indicates that micro businesses (M1-M2) switch at a lower rate than other customer segments, but both larger SMEs (M3-M7) and large customers (M8-M9) exhibit similar levels of switching (at circa 9% and 11% respectively across Q3 and Q4).

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<sup>21</sup> [Severn Trent Group Plc / United Utilities Group Plc \(ME/6575/15\)](#) (**Severn Trent/United Utilities**), [Pennon Group Plc / South Staffordshire Plc \(ME/6657/16\)](#) (**Pennon/ South Staffordshire**) and [Anglian Water Group Ltd / Northumbrian Water Group Ltd \(ME/6692/17\)](#) (**Anglian/Northumbrian**).

<sup>22</sup> [MOSL CEO Annual Market Review 2017/2018](#).



### *Third party views and MOSL switching data*

39. Responses from third parties, including Ofwat, indicated that smaller NHH customers (ie SMEs) may have less incentive to switch and, if they do consider switching, less incentive to undertake a thorough comparison of alternative providers than larger customers.
40. These views were supported by evidence provided by Ofwat and MOSL. MOSL's segment data showed that switching rates broadly increase with customer usage.<sup>23</sup> SME customers (for the purposes of this case assumed as being categories M5<sup>24</sup> and below) typically had lower switching rates after Market Opening than larger customers (M6 and above). Similarly, Ofwat's State of the Market Report found that around 3% of SMEs and microbusinesses had switched or renegotiated their contract in the first year after Market Opening compared with 11% of larger customers.<sup>25</sup>
41. In addition to these 'demand-side' differences between SMEs and larger customers, the CMA noted that differences in total bill size could lead to 'supply-side' differences, in particular for SMEs with relatively high customer acquisition costs or costs to serve.

### *Conclusion on customer segmentation*

42. Based on the evidence outlined above, 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 customers distinct from larger customers.
43. 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.
44. In any event, the CMA did not consider it necessary to conclude on the precise scope of the product frame of reference given that, as set out below, no competition concerns arise on any plausible basis.
45. In relation to larger customers, given the relatively higher switching rates for larger customers, the Parties' low shares of supply and the number and range of alternative suppliers, the CMA found no plausible competition concerns

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<sup>23</sup> [MOSL CEO Annual Market Review 2017/2018](#), page 7.

<sup>24</sup> For a definition of the MOSL segments, cf. [MOSL CEO Annual Market Review 2017/2018](#), page 8. The CMA notes that considering categories M1-M5 as a proxy for SME customers could be over inclusive as: (i) the categorisations do not distinguish between multi-site and single site customers; (ii) the level of water usage in categories M4 and M5 may be on the higher end of typical SME usage.

<sup>25</sup> Ofwat [State of the Market Report](#), page 32.

arising from the Merger for these customers.<sup>26</sup> This frame of reference is therefore not discussed further in this decision.

### *Conclusion on product scope*

46. For the reasons set out above, 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 customers.

### **Geographic scope**

47. As in *Severn Trent/United Utilities, Pennon/South Staffordshire and Anglian/Northumbrian*, 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 locally or across the whole of England.
48. As described in the Background section, in most supply areas there is a single large, incumbent retailer of water and sewerage services which is (or was) associated with the wholesaler monopoly supplier of these services in that area. However, in areas where there is both a WOC and a WASC, there are typically two large, incumbent retailers, one with predominantly water customers and the other with predominantly sewerage customers.<sup>27, 28</sup> This is the case for the Parties in the Overlap Area.
49. For the purposes of determining the relevant geographic frame of reference, the CMA has considered the extent to which incumbency features in areas where there are two incumbents could lead to different conditions of retail supply compared with a broader region over which the suppliers might also compete. In particular, the CMA has considered whether: (i) from a demand-side perspective, SMEs may be more willing to choose between the two

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<sup>26</sup> Based on MOSL data, the CMA estimates that Castle Water's share of supply for England is around 19% in the supply of water and sewerage retail services to NHH customers and the Merger would result in a small increase in its national share of around 2%. The CMA also found that there are several other large competitors remaining. While these shares encompass all customer segments, the evidence available to the CMA did not indicate that these would vary significantly for SME customers or any other segment.

<sup>27</sup> Some wholesalers have sold their customer book rather than set up an associated retailer. For example, as noted above, Thames Water sold its customer book to Castle.

<sup>28</sup> Prior to Market Opening, in supply areas where the wholesale supplier of water was different to the wholesale supplier of sewerage (as in the SEWL supply area), the WASC and WOC would typically enter into joint billing arrangements for retail services, whereby either the WASC or WOC would send one bill to customers. However, the Parties stated that there have never been any joint billing arrangements in place between Castle Water and SEWL (including in the Overlap Area), each customer in the Overlap Area was prior to the Merger dealing with two retailers, one for water and one for sewerage.

incumbent providers in the Overlap Area; and (ii) from a supply-side perspective, the incumbents may benefit from significant advantages due to being established as the default retail suppliers in the area, which other suppliers may not be able to overcome.

50. The CMA has considered evidence from the MOSL data on switching since Market Opening, the Parties' submissions and third party views.

#### *MOSL data*

51. The CMA considered data provided by MOSL on the number of customer switches between retail suppliers in England in the period 1 April 2017 to 31 May 2018. The data did not distinguish different customer groups. The data showed that:
- (a) Switching rates are generally higher in areas with more than one incumbent retailer; and
  - (b) Switching to an overlapping incumbent is generally significantly higher than switching to a non-overlapping alternative supplier.
52. The CMA believes that this data indicates that there are potentially significant demand and supply-side differences between the Overlap Area, where the Parties are both incumbent retail suppliers, and a broader region in which they also compete.

#### *Castle's submissions*

53. Castle submitted that the geographic scope for the CMA's assessment should be national, encompassing England and Scotland together. It submitted that the retail supply of water and sewerage services is a national activity, as evidenced in the MOSL CEO Annual Market Review. Castle submitted that this data shows that:
- (a) There are a large number of national players, operating across all wholesale areas, whose presence and geographic reach is increasing.
  - (b) Retail services, including billing and debt collection, can be provided on a national basis, irrespective of the location of the retailer.
  - (c) Although some aspects of retail services such as meter reading activities and sales may require a local presence, these can be easily outsourced to local agents.

54. However, the CMA found some evidence in the Parties' pre-Merger internal documents which indicated a focus on local supply. In particular, Invicta Water's pre-Merger business plan<sup>29</sup> stated that it intended [REDACTED].

#### *Third party views*

55. Evidence from third parties indicated that incumbents in overlap areas compete to attract customers who want a single water and sewerage retail services provider. Third parties indicated that there can be scale and other cost advantages for incumbent suppliers with regard to SME customers. In particular, third party retailers noted that customer acquisition costs can be higher in areas where they do not have a strong existing presence. The CMA notes that this could lead to local variation in margins and therefore a competitive strategy which varies locally. A number of incumbent retailers confirmed that their strategy to acquire customers varied to some extent across the UK depending on the extent to which they had a pre-existing or geographically proximate customer base.
56. One third party provided its own analysis of switching data which supported the trends indicated by the MOSL data outlined above.

#### *Conclusion on geographic frame of reference*

57. On the basis of the evidence set out above, in particular the MOSL switching data and some indication of supply-side differences leading to differences in the conditions of competition, and on a cautious basis, the CMA has assessed the impact of the Merger in the supply of water and sewerage retail services to SMEs both in the Overlap Area.
58. 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.
59. The CMA notes that no concerns would arise on a broader frame of reference ie across England. The Parties have a limited share of supply, the increment arising from the Merger is small, and there is sufficient competition remaining post-Merger to constrain the Parties in the supply of water and sewerage

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<sup>29</sup> [REDACTED].

retail services to SME customers.<sup>30</sup> This frame of reference is therefore not discussed further in this decision.

### *Conclusion on frame of reference*

60. As set out above, the CMA has assessed the impact of the Merger in the supply of water and sewerage retail services to SME customers in the Overlap Area. However, given that no concerns arise on any basis, the CMA has not found it necessary to conclude on either the product or geographic frame of reference.

## **Competitive assessment**

### ***Horizontal unilateral effects***

61. 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.<sup>31</sup> Horizontal unilateral effects are more likely when the merger parties are close competitors.
62. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the supply of water and sewerage retail services to SME customers in the Overlap Area. 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***

63. As a consequence of their historic incumbent positions, as described above, the two Parties currently both serve the vast majority of customers in the Overlap Area. However, these high shares of supply are not a consequence of successful competition but of past regulatory constraints. Therefore, they

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<sup>30</sup> Based on MOSL data, the CMA estimates that Castle Water's share of supply in England is around 19% in the supply of water and sewerage retail service to NHH customers and the Merger would result in a small increase in its national share of around 2%. The CMA also found that there are several other large competitors remaining. While these shares encompass all customer segments, the evidence available to the CMA did not indicate that shares would vary significantly for SME customers or any other segment.

<sup>31</sup> [Merger Assessment Guidelines](#), from paragraphs 5.4.1.

are not a meaningful indicator of the Parties' competitive strength or interaction in the area.

64. For this reason, the CMA has focused in its analysis on other indicators of the extent of the competitive constraint between the Parties and with other suppliers, including shares of switching.

### ***Closeness of competition between the Parties***

65. Pre-Merger, including for a period prior to Market Opening, the Parties' customers in the Overlap Area received separate bills for water services and sewerage services from each of the Parties. Following Market Opening, these customers have been free to choose a new supplier for either water or sewerage retail services, or for both services, including the Parties.
66. The CMA has considered whether, absent the Merger, given each of the Parties was the historic incumbent retailer of either water or sewerage services in the Overlap Area, the Parties were particularly close competitors for the retail supply of water and sewerage services for SME customers in this area. 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 one of the Parties when switching to a single supplier of retail services than to a new supplier.
67. The CMA has considered (i) the Parties' submissions; (ii) evidence on switching based on MOSL data and the Parties' data; and (iii) third party views.

### ***Castle submissions***

68. Castle submitted that the switching data indicates that the Parties are not particularly close competitors as:
- (a) Of [redacted] customer switches (by supply points (**SPIDs**<sup>32</sup>)) for water services in the SEWL supply area since Market Opening, only [redacted] ([less than 10]%) were from one of the Parties to the other.
  - (b) Of the gross total of [redacted] water customers Invicta Water lost since Market Opening, only [redacted] ([less than 10]%) switched to Castle Water.
  - (c) Of [redacted] customer switches for wastewater services in the SEWL area since Market Opening, the majority of switches ([more than 60]%) were

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<sup>32</sup> Supply Point Identification.

between Castle Water or Invicta Water and a third party retailer or self-supply.

69. Castle also said that it posed a weak constraint on Invicta Water [REDACTED].

#### *Switching data*

70. The CMA used MOSL data and data submitted by the Parties to estimate shares of switching.<sup>33</sup> MOSL data is limited to wholesale supply areas so it could not be used to assess competition specifically in the Overlap Area.

71. Based on MOSL data, the CMA estimated that:

(a) In the SEWL supply area, where Invicta Water is the incumbent water retailer: Castle Water and Invicta Water had a share of customers switching in their water supply service of [5-10]% and [0-5]% respectively;<sup>34</sup>

(b) In the Thames Water supply area, where Castle Water can be regarded as the incumbent sewerage retailer: Castle Water and Invicta Water had a share of customers switching in their sewerage services of [0-5]% and [5-10]% respectively.

72. The CMA also considered switching data provided by the Parties. On the basis of this data, the CMA estimated that Invicta Water won 64% of the sewerage SPIDs lost by Castle Water in the Overlap Area. However, due to limitations in the data set, the CMA was unable to make a similar estimate for the proportion of water SPIDs lost by Invicta Water which were won by Castle Water.

73. Overall, the CMA believes that the available switching data indicates that, while switching between the Parties across each of the SEWL and Thames Water supply areas (where there are other 'incumbent' retailers) is low, switching between the Parties within the Overlap Area where the Parties are the only incumbent suppliers is significantly higher. The data suggests that the Parties may have been close competitors pre-Merger (in particular, Invicta Water might have constrained Castle Water, [REDACTED]).

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<sup>33</sup> Shares of switching in terms of SPIDs (MOSL data up to 1 June 2018). In the MOSL data, the CMA cannot observe specifically the Overlap Area. Therefore, the shares of water switching for the water supply area of SEWL and the shares of sewerage switching in the sewerage supply area of Thames Water are presented separately. Similarly, different customer segments in each area of appointment cannot be separated out, so these figures concern the entire NHH market.

<sup>34</sup> The Parties are shown as having won a number of switches in their home areas because these figures include customers who switched more than once.

### *Third party views*

74. Third parties gave mixed views on the closeness of competition between the Parties. A majority of third parties indicated that the Parties' existing presence in the Overlap Area may make them better placed to win customers wishing to switch to a single supplier and therefore closer competitors to each other than to other suppliers. However, third parties did not suggest that there was any feature of the Parties' retail offerings which would make them particularly close alternatives. Indeed, some third parties noted a number differences in this regard.

### *CMA assessment*

75. On the basis of the evidence set out above, the CMA believes that, due to the Parties' historic incumbent relationship with each other's customers, Castle Water and Invicta Water are currently each other's closest competitors for SME customers wishing to consolidate their water and sewerage retail services in the Overlap Area than other possible suppliers of water and sewerage retail services.

### ***Competitive constraints from alternative suppliers***

76. Horizontal effects are more likely where customers have little choice of alternative supplier.
77. The CMA considered the extent to which post-Merger, the merged entity will be constrained by alternative suppliers. The CMA considered evidence from Castle's submissions, switching data, internal documents and third parties.

### *Castle submissions*

78. Castle submitted that, post-Merger, the Parties would compete in the retail supply of water and sewerage services to SMEs in the Overlap Area with a large number of competitors. The Parties said that these competitors, including Scottish Water Business Stream, Everflow, Water Plus (Severn Trent/United Utilities, Sutton and East Surrey (**SES**), Clear Business Water, Anglian Water Business and Affinity for Business, are all actively targeting customer acquisitions and a number are actively seeking SME customer acquisitions (see Third party views below). Castle said that the ability of these competitors to compete effectively in the Overlap Area was supported by switching data.



## Switching data

79. As noted above, the data provided by MOSL does not allow for analysis of switching in the Overlap Area specifically. Nevertheless, the CMA believes that switching data for the SEWL water supply area and the Thames Water supply area is a useful indicator of the competitive strength of other retailers in the Overlap Area.
80. Table 1 sets out the CMA's estimates of shares of switching in terms of SPIDs, based on MOSL data.

**Table 1 Shares of switching**

	Water SPIDs in the SEWL Area	Sewerage SPIDs in the Thames Water Area
Castle Water	[5-10] %	[0-5] %
Invicta Water	[0-5] %	[5-10] %
Combined	[ <del>5</del> ] %	[ <del>5</del> ] %
Scottish Water Business Stream	[30-40] %	[5-10] %
SES	[5-10] %	[20-30] %
Affinity for Business	[0-5] %	[10-20] %
Severn Trent	[10-20] %	[10-20] %
Everflow	[10-20] %	[5-10] %
Anglian Water Business	[5-10] %	[10-20] %
Clear Business Water	[0-5] %	[5-10] %
Others	[ <del>5</del> ] %	[ <del>5</del> ] %
<b>Total</b>	100%	100%
Number of switches	[ <del>5</del> ]	[ <del>5</del> ]

81. Table 1 indicates that:
- (a) Scottish Water Business Stream, SES, Severn Trent, Everflow, and Anglian Water Business have each won more than 5% of water switches in the SEWL area between Market Opening and 1 June 2018.
  - (b) During the same period, Scottish Water Business Stream, SES, Affinity for Business, Severn Trent, Everflow, Anglian Water Business, and Clear Business Water have each won more than 5% of sewerage switches in the Thames Water area.
82. This evidence supports Castle's view that several alternative retail suppliers of water and sewerage services are actively targeting NHH customers in the broad area in which the Parties overlap. The switching data indicates that some of these competitors are winning NHH customers. The CMA has seen no evidence to indicate that competitors are being more or less successful in attracting SME customers than any other segment of NHH customer.

### *Internal documents*

83. The Parties' internal documents shortly prior to or since Market Opening (but prior to the Merger being in contemplation) provide further evidence of a significant competitive constraint from several alternative suppliers of retail services. These documents indicate that the Parties are monitoring a number of competitors in their supply areas. For example, an internal document from Castle Water indicated that it sought to respond to an SME initiative from SES. It referred to competitors more generally, stating: ' [REDACTED]'<sup>35</sup> An Invicta Water strategy document also contained a review of a range of competitor's product offerings.<sup>36</sup>

### *Third party views*

84. Responses from third parties indicated that there are several alternative suppliers of water and sewerage retail services actively pursuing SME customers across the UK, including in the Overlap Area. These suppliers include: Scottish Water Business Stream, SES, Everflow, Pennon, Water Plus (Severn Trent/United Utilities), Anglian Water Business, NWG Business, Affinity for Business, First Business, Regent Water and Clear Business Water.
85. Ofwat told the CMA that whilst it had not conducted a detailed competition assessment of the likely effects of the Merger, nevertheless, a priori, it did not have particular concerns about the Merger's impact on competition in the business retail water and waste water markets. Ofwat considered that the wider pool of retailers is likely to offer competitive constraints that would be retained following the Merger. In the context of the latter it noted that it considers that several licensed retailers are likely to be credible competitors in the Overlap Area.

### *CMA Assessment*

86. On the basis of the evidence set out above, the CMA believes that there are several credible alternative suppliers of water and sewerage retail services to SME customers in the Overlap Area.

### ***Conclusion on horizontal unilateral effects***

87. Although to date not many SME customers have switched away from their incumbent retail supplier, several alternative suppliers of water and sewerage retail services have entered the Overlap Area and are supplying NHH

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<sup>35</sup> [REDACTED]

<sup>36</sup> [REDACTED].

customers in this area. These alternative suppliers are together providing a significant competitive constraint on the Parties and, on the basis of the evidence set out above, the CMA believes that they will continue to do so. For this reason, 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 the supply of water and sewerage retail services to SME customers in the Overlap Area.

### ***Barriers to entry and expansion***

88. Entry, or the 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.<sup>37</sup>
89. In the present case, 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**

90. The CMA contacted customers and competitors of the Parties, Ofwat and MOSL.
91. The majority of respondents, including Ofwat, raised no competition concerns regarding the Merger.
92. Where concerns were raised by third parties, they were in relation to the significance of the Parties' pre-Merger positions in the Overlap Area.
93. Third party comments have been taken into account where appropriate in the competitive assessment above.

### **Decision**

94. Consequently, the CMA does not believe that it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC within a market or markets in the UK.
95. The Merger will therefore **not be referred** under section 22(1) of the Act.

**Andrew Wright**  
**Director, Mergers**  
**Competition and Markets Authority**

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<sup>37</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.

**12 September 2018**