

COMPLETED ACQUISITION BY PENNON GROUP PLC OF BRISTOL WATER HOLDINGS UK LIMITED

Notice under paragraph 2(1) of Schedule 10 to the Enterprise Act 2002 (the Act) – consultation on proposed undertakings in lieu of reference pursuant to section 73 of the Act.

ME/6946/21

INTRODUCTION

1. On 3 June 2021, Pennon Group plc (**Pennon**) acquired the entire share capital of Bristol Water Holdings UK Limited and its subsidiaries, including Bristol Water plc (**Bristol Water**) (the **Merger**). Pennon and Bristol Water are together referred to as the **Parties** or, for statements referring to the future, the **Merged Entity**.
2. Pennon (through its subsidiary South West Water Limited) and Bristol Water are water utility companies, and each provide water services to household customers in England and Wales. The supply of water and sewerage services to household customers is a regulated market which in England and Wales is characterised by regional suppliers who hold regional monopolies within set sub-national regions. The market is regulated by Ofwat, which carries out this role using a system of comparative regulation between the water enterprises¹ and their sub-national regions.
3. On 22 December 2021, the Competition and Markets Authority (CMA) decided under section 32 of the Water Industry Act (WIA91) that it is or may be the case that a merger of two or more water enterprises had taken place. Following its review of the Merger, the CMA found that the Merger has prejudiced, or is likely to prejudice, the ability of Ofwat in carrying out its functions by virtue of the WIA91, to make comparisons between water enterprises (the **Reference Decision**).
4. On 31 December 2021, Pennon offered undertakings to the CMA for the purposes of section 33D of the WIA91.²
5. On 10 January 2022, the CMA gave notice to Pennon, pursuant to section 73A(2)(b) of the Act, that it considers that there are reasonable grounds for believing that the undertakings offered, or a modified version of them, might be accepted by the CMA

¹ Defined under section 35(1) of the WIA91 as an enterprise carried on by a water undertaker or sewerage undertaker appointed under section 6 of the WIA91

² Pennon offered revised undertakings on 9 January 2022 and again on 10 January 2022. These revised undertakings were made in response to comments made by the CMA and Ofwat, and to correct some minor elements of the text of the proposed undertakings.

under section 33D of the WIA91 and that it is considering Pennon's offer (the **UIL Provisional Acceptance Decision**).

THE UNDERTAKINGS OFFERED

6. As set out in the Reference Decision, the CMA found that the Merger has prejudiced, or is likely to prejudice, the ability of Ofwat in carrying out its functions by virtue of the WIA91.
7. As set out in the UIL Provisional Acceptance Decision, to address the prejudice identified by the CMA Pennon have offered undertakings to provide separate reporting information for South West Water and Bristol Water—comprising primarily of separate historical and forecast cost and cost driver information—which will enable Ofwat to maintain separate wholesale water price controls, with separate revenue controls and revenue limits, for South West Water wholesale water activities and Bristol Water wholesale water activities from 1 April 2025; Pennon also acknowledges and agrees that Ofwat will maintain separate price controls for the South West Water wholesale water activities and Bristol Water wholesale water activities (the **Proposed Undertakings**),³ and considers that the Proposed Undertakings 'will allow Pennon to realise the benefits of the Merger but continue to provide Ofwat with the information that it needs for the maintenance of separate price controls...which in turn enables the continuation of the existing comparisons between water enterprises in these areas'.⁴

CMA ASSESSMENT

8. The CMA currently considers that, subject to responses to the consultation required by Schedule 10 of the Act, the Proposed Undertakings will resolve the prejudice identified in the Reference Decision in a clear-cut manner, ie the CMA currently does not have material doubts about the overall effectiveness of the Proposed Undertakings or concerns about their implementation.⁵
9. This is because the agreement by Pennon for separate wholesale price controls, and to undertake to provide relevant information to allow for the maintenance of

³ Pennon notes that there may be exceptions to separate price controls as regards outcome delivery incentive rates (ODIs), cost sharing rates, and performance commitments (PCs), which will be consistent across Pennon's water businesses, save to the extent there are material reasons for differences between the South West Water region and the Bristol Water region. Pennon notes that it aims to achieve consistent PC levels over time but that at the outset, PC levels will be specific to the South West Water region and Bristol Water region unless there are compelling reasons to the contrary.

⁴ Pennon Remedies Form of 31 December 2021, paragraph 12. In addition, Pennon has committed to realising and sharing with consumers certain anticipated benefits of the merger ahead of Ofwat's next price determination period beginning in April 2025. These commitments include removing the small company premium in the Bristol region, and sharing efficiency benefits realized from the merger, including through Pennon's WaterShare+ scheme ahead of this.

⁵ [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance \(OFT1122\)](#), December 2010, Chapter 5 (in particular paragraphs 5.7–5.8 and 5.11). This guidance was adopted by the CMA (see Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2), January 2014, Annex D).

robust separate controls, will enable Ofwat to continue to make comparisons between these water enterprises even after the Merger. In addition, the CMA also considers that the Proposed Undertakings would be capable of ready implementation, in particular because the Proposed Undertakings will essentially require the Merged Entity to continue to report and provide information, which is already currently provided independently for each of South West Water and Bristol Water.

10. In its Phase 1 decision the CMA found that there is a prospect of the Merger having a detriment to Ofwat's ability to assess wholesale water costs. The CMA considers that retaining separate information on the wholesale water activities of South West Water and Bristol Water, along with the other commitments offered by Pennon including maintenance of separate price controls,⁶ will address the detriment identified in the Reference Decision.

Opinion of Ofwat

11. As noted at paragraph [2] above, Ofwat is the regulator for the water sector in England and Wales. Ofwat has a set of primary and secondary duties⁷ and functions. One of the functions is to set price limits every five years, determining the maximum companies can charge customers for water and wastewater services. Ofwat also monitors the performance of the water companies to ensure that they deliver the required services and improvements in quality.
12. A water merger could affect Ofwat's ability to make comparisons in a number of ways across each of these functions. The regional monopolisation of the market drives the need for Ofwat's comparative approach to regulating the sector.
13. The CMA consulted with Ofwat on the nature of the undertakings submitted by Pennon, including requesting, receiving, and considering an opinion on the effect of the undertakings pursuant to section 33D(6) of the WIA91.
14. Ofwat confirmed to the CMA that it considers that the Proposed Undertakings, offered to the CMA by Pennon on 10 January 2022, as outlined at paragraph 7

⁶ In Ofwat's Final Opinion on Pennon's UIL offer, submitted to the CMA on 24 January 2022, Ofwat noted that it considers that 'separate reporting on its own would not be sufficient' to address the prejudice identified by the CMA, and that separate controls 'would create a meaningfully stronger incentive on company management to have robust cost allocation and cost apportionment in place from the outset' of the Merger. Ofwat further considers that separate reporting without separate price controls would 'require [Ofwat] to design a new process to gather information, including because the current reporting approach would not allow us to request information on forecast costs. This would be resource intensive and entail risks to the consistency of [Ofwat's] approach to information gathering across the water sector'.

⁷ Ofwat's duties for most of its work as the economic regulator of the water sector are laid down in sections 2 and 3 of the WIA91 as amended. These duties include, among others, to: further the consumer objective to protect the interests of consumers; secure that water companies properly carry out their statutory functions; secure that water companies can (in particular through securing reasonable returns on their capital) finance the proper carrying out of their statutory functions; further the resilience objective to secure the long-term resilience of water companies' water supply and wastewater systems; and to secure they take steps to enable them in the long term to meet the need for water supplies and wastewater services; promote economy and efficiency by water companies in their work; and contribute to the achievement of sustainable development (see [Our duties - Ofwat](#)).

above, are capable of addressing the prejudice identified by the CMA in the Reference Decision.⁸

Proposed decision and next steps

15. For the reasons set out above, the CMA considers that the Proposed Undertakings are, in the circumstances of this case, appropriate to remedy, mitigate or prevent any loss in Ofwat's ability to make comparisons between water enterprises that may arise following the Merger and form as comprehensive a solution to these concerns as is reasonable and practicable.
16. The CMA therefore gives notice that it proposes to accept the Proposed Undertakings in lieu of a reference of the Merger for a phase 2 investigation. The text of the proposed undertaking is available on the CMA web pages.⁹
17. Before reaching a decision as to whether to accept the Proposed Undertakings, the CMA invites interested parties to make their views known to it. The CMA will have regard to any representations made in response to this consultation and may make modifications to the Proposed Undertakings as a result. If the CMA considers that any representation necessitates any material change to the Proposed Undertakings, the CMA will give notice of the proposed modifications and publish a further consultation.¹⁰
18. Representations should be made in writing to the CMA and be addressed to:

James McGarrachan
Mergers Group
Competition and Markets Authority
The Cabot
25 Cabot Square
London
E14 4QZ

Email: james.mcgarrachan@cma.gov.uk

Telephone: 0131 515 2201

Deadline for comments: 28 February 2022

⁸ Ofwat's Final Opinion on Pennon's UIL offer, submitted to the CMA on 24 January 2022.

⁹ See <https://www.gov.uk/cma-cases/pennon-group-plc-slash-bristol-water-holdings-uk-limited-merger-inquiry>

¹⁰ Under paragraph 2(4) of Schedule 10 to the Act.