

ME.6946.21 – Phase 1 Undertakings in Lieu of a Reference

31 December 2021

Acquisition by Pennon Group plc of Bristol Water Holdings UK Limited

Undertakings given by Pennon Group plc to the Competition and Markets Authority pursuant to section 33D of the Water Industry Act 1991, as amended by the Water Act 2014

Whereas:

- (a) On 3 June 2021, Pennon Group plc (“**Pennon**” and together with its subsidiaries, but excluding Bristol Water Holdings UK Limited (“**BWHUK**”) and its subsidiaries (“**Bristol Water**”)) acquired 100% of the share capital of BWHUK (the “**Transaction**”);
- (b) Under section 32(b), section 33, and section 33A of the Water Industry Act 1991 (as amended by the Water Act 2014) (“**WIA91**”), the Competition and Markets Authority (“**CMA**”) has a duty to refer for a Phase 2 investigation where it believes that it is or may be the case that a merger of two or more water enterprises has taken place, unless it appears to the CMA that the turnover test in section 33(1) is not met, or if the CMA believes that:
 - (i) the merger has not prejudiced, and is not likely to prejudice the Water Services Regulation Authority’s (“**Ofwat’s**”) ability, in carrying out its functions, to make comparisons between water enterprises; or
 - (ii) the merger has prejudiced or is likely to prejudice Ofwat’s ability to make comparisons between water enterprises, but the prejudice is outweighed by relevant customer benefits relating to the merger;
- (c) Under section 33D of the WIA91, the CMA may, instead of making such a reference and for the purpose of remedying, mitigating or preventing the prejudicial effect on Ofwat’s ability, in carrying out its functions, to make comparisons between water enterprises, which the Transaction has had, may have had or may be likely to have, accept undertakings to take such action as it considers appropriate, from such of the parties concerned, as it considers appropriate. In particular, the CMA shall have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the prejudicial effect on Ofwat’s ability, in carrying out its functions, to make comparisons between water enterprises;
- (d) As set out in the CMA’s decision of 22 December 2021 (the “**Decision**”), the CMA believes that, in the absence of appropriate undertakings, it would be under a duty to refer the Transaction for a Phase 2 investigation;
- (e) The CMA considers that the undertakings given below by Pennon are appropriate to remedy, mitigate or prevent the prejudicial effect on Ofwat’s ability, in carrying out its functions, to make comparisons between water enterprises, which the Transaction has had, may have had or may be likely to have, as specified in the Decision;
- (f) The CMA made an Initial Enforcement Order on 15 June 2021 and a Variation Order on 5 November 2021 applying to Pennon, BWHUK and Bristol Water¹ in respect of the Transaction pursuant to section 72(2) of the Enterprise Act 2002 for the purposes of preventing pre-emptive action. Part 3 of the Enterprise Act 2002 (subject to modifications), including the CMA’s power to make an initial enforcement order under section 72(2), applies

¹ Including the Bristol Wessex Billing Services Limited and the Water 2 Business Limited joint ventures.

to mergers between water enterprises and references under section 32 of the WIA91 pursuant to regulation 2 and 17 of the Water Mergers (Modification of Enactments) Regulations 2004 (SI 2004/3202, as amended); and

- (g) Pursuant to section 72(6)(b) of the Enterprise Act 2002, the Initial Enforcement Order and the Variation Order cease to be in force on the acceptance by the CMA of the undertakings given below by Pennon.

Now therefore Pennon hereby gives to the CMA the following undertakings for the purpose of remedying, mitigating or preventing the prejudicial effect on Ofwat's ability, in carrying out its functions, to make comparisons between water enterprises, which the Transaction has had, may have had or may be likely to have.

1 Effective Date of the Undertakings

- 1.1** These undertakings shall take effect from the date that, having been signed by Pennon, they are accepted by the CMA.

2 Undertakings

- 2.1** Save as may otherwise be agreed or set by Ofwat, Pennon undertakes to ensure compliance with the PR19 determinations for SWW in respect of the SWW region and for BRL in respect of the BRL region until 31 March 2025, and Pennon acknowledges and agrees to the removal of the small company premium (which is currently part of the BRL PR19 determination) and to share half of the merger-specific cost efficiencies with all customers of SWW and BRL in the period to 31 March 2025, including by using the SWW WaterShare+ mechanism (which is currently part of the SWW PR19 determination).

- 2.2** Pennon undertakes and confirms that it will ensure that SWW and BRL (or any successor Merged Business) provide separate historical and forecast cost and cost driver information and any other reporting of information with respect to each of the SWW Wholesale Water Activities and the BRL Wholesale Water Activities and do such other things as Ofwat may reasonably require to allow for the maintenance of robust separate price controls with separate revenue controls and revenue limits for SWW Wholesale Water Activities and BRL Wholesale Water Activities from 1 April 2025, and to comply and be consistent with the requirements of Ofwat's price review process and methodology from time to time.

- 2.3** Pennon acknowledges and agrees that Ofwat will maintain separate price controls for the SWW Wholesale Water Activities and the BRL Wholesale Water Activities. The undertaking at paragraph 2.2 above, which Pennon accepts will underpin Ofwat's ability to maintain separate price controls for the SWW Wholesale Water Activities and the BRL Wholesale Water Activities, will be subject to the following exceptions:

- 2.3.1** consistent outcome delivery incentive rates ("**ODIs**", or their equivalent in future price controls) and cost sharing rates (or their equivalent in future price controls) will apply to each of SWW Wholesale Water Activities and BRL Wholesale Water Activities, save to the extent there are material reasons for differences between the SWW region and the BRL region;

- 2.3.2** consistent performance commitments ("**PCs**", or their equivalent in future price controls) will apply to each of SWW Wholesale Water Activities and BRL Wholesale Water Activities, save to the extent there are material reasons for differences between the SWW region and the BRL region. Over time, Pennon aims to achieve

performance commitment levels (or their equivalent in future price controls) that are consistent across the Merged Business as soon as reasonably possible, however, at the outset, the performance commitment levels will be specific to each of the BRL region and the SWW region unless there are compelling reasons to the contrary.

- 2.4** The exceptions in paragraph 2.3 and any additional exceptions that Ofwat deems appropriate either as part of any licence modification process or as part of the development of Ofwat's price review methodology and final determinations from time to time, may not compromise the provision of robust separate historical and forecast cost and cost driver information and any other required information and Ofwat's reasonable requirements with respect to BRL Wholesale Water Activities in order that Ofwat may set robust separate price controls for SWW Wholesale Water Activities and BRL Wholesale Water Activities.
- 2.5** Pennon undertakes that it will ensure that SWW and BRL (or any successor Merged Business) will provide historical and forecast cost and cost driver information and any other reporting of information to allow Ofwat to set a combined retail price control for the SWW and BRL regions from 1 April 2025.
- 2.6** In reporting costs for the separate price controls in annual performance reports, Pennon undertakes that it will ensure that SWW and BRL (or any successor Merged Business) will comply with the accounting guidance published by Ofwat from time to time, including RAG 2 'Guideline for classification of costs across the price controls' (or any successor guidance) and summarise the basis of the allocation of costs in the annual performance report as currently required by Ofwat's Regulatory Accounting Guidance (or any successor guidance).
- 2.7** For the avoidance of doubt, these undertakings are offered by Pennon to the CMA pursuant to section 33D of the Water Industry Act 1991 and accordingly do not bind any third parties to the Transaction

3 Compliance

- 3.1** Pennon acknowledges that Ofwat will be involved in monitoring Pennon's compliance with these undertakings and may provide recommendations or opinions to the CMA on compliance issues.
- 3.2** Pennon shall comply promptly with such written directions as the CMA may from time to time give:
- (a) to take such steps as may be specified or described in the directions for the purpose of carrying out or securing compliance with these undertakings; or
 - (b) to do or refrain from doing anything so specified or described which it might be required by these undertakings to do or to refrain from doing.
- 3.3** Pennon shall co-operate fully with the CMA and/or Ofwat when the CMA and/or Ofwat is:
- (a) monitoring compliance with the provisions of these undertakings; and
 - (b) investigating potential breaches of the provisions of these undertakings.
- 3.4** Pennon shall procure that any member of the same Group of Interconnected Bodies Corporate as Pennon complies with these undertakings as if it had given them and actions and omissions of the members of the same Group of Interconnected Bodies Corporate as Pennon shall be attributed to Pennon for the purposes of these undertakings.

- 3.5** Where any Affiliate of Pennon is not a member of the same Group of Interconnected Bodies Corporate as Pennon, Pennon shall use its best endeavours to procure that any such Affiliate shall comply with these undertakings as if it had given them.
- 3.6** At every price review, as part of Pennon's routine assurance reporting, Pennon shall provide to the CMA and Ofwat an assurance statement from the Board of Pennon that it has complied with the provisions of these undertakings.
- 3.7** In circumstances where the CMA and/or Ofwat has serious concerns about Pennon's compliance with these undertakings:
- 3.7.1** The CMA may, if it considers it appropriate following consultation with Ofwat, require Pennon to appoint or instruct an external auditor (at Pennon's expense and to be approved by the CMA) to review Pennon's compliance with these undertakings and make recommendations to ensure effective future compliance;
 - 3.7.2** Pennon shall promptly agree on the scope of any audit required under paragraph 3.7.1, including a reasonable and prompt deadline for receiving a final audit report, and shall appoint an auditor no later than 20 working days after the CMA formally requires Pennon to do so;
 - 3.7.3** The auditor will have the power to discuss any relevant matters with Ofwat and/or the CMA and shall deliver its final report to both Ofwat and the CMA;
 - 3.7.4** Pennon shall implement the recommendations of any audit carried out under paragraph 3.7.1 in a timely manner so as to allow Ofwat to set robust separate wholesale price controls (including, if necessary, by re-submitting appropriate sections of its business plan);
 - 3.7.5** To the extent the CMA exercises its right to require Pennon to appoint an auditor under paragraph 3.7.1, the CMA may at its discretion require Pennon to appoint or instruct a different external auditor than any auditor engaged by Pennon for other purposes.

4 Provision of Information

- 4.1** Pennon shall furnish promptly to the CMA such information as the CMA considers necessary in relation to or in connection with the implementation and/or enforcement of and/or the compliance with these undertakings, including for the avoidance of doubt, any Confidential Information. The CMA may share such information with Ofwat to the extent it deems appropriate following consultation with Pennon.

5 Extension of Time Limits

- 5.1** The CMA may, in response to a written request from Pennon or Ofwat, or otherwise at its own discretion, grant an extension to any time period referred to in these undertakings.

6 Service

- 6.1** Pennon hereby authorises Linklaters LLP, whose address for service is One Silk Street, London, EC2Y 8HQ, to accept service on its behalf of all documents connected with these undertakings (including any document of any kind which falls to be served on or sent to Pennon, or any of its Subsidiaries in connection with any proceedings in Courts in the UK, orders, requests, notifications or other communications connected with these undertakings).

- 6.2** Unless Pennon informs the CMA in writing that Linklaters LLP has ceased to have authority to accept and acknowledge service on its or any of its Subsidiaries' behalf, any document, order, request, notification or other communication shall be validly served on Pennon if it is served on Linklaters LLP; and service shall be deemed to have been acknowledged by Pennon if it is acknowledged by Linklaters LLP or such other nominee.
- 6.3** The above has effect irrespective of whether, as between Pennon and Linklaters LLP or other nominees, Linklaters LLP or other nominees has or continues to have any authority to accept and acknowledge service on Pennon's or any of its respective Subsidiaries' behalf.
- 6.4** No failure or mistake by Linklaters LLP or other nominees (including a failure to notify Pennon of the service of any document, order, request, notification or other communication) shall invalidate any action taken in respect of these undertakings including any proceedings or judgment.
- 6.5** Any communication from Pennon to the CMA under these undertakings shall be addressed to Manager, Market and Mergers Remedies Monitoring, Competition and Markets Authority, The Cabot, 25 Cabot Square, London, E14 4QZ, or by email to RemediesMonitoringTeam@cma.gov.uk, or such other postal or email address as the CMA may direct in writing.

7 Effect of Invalidity

- 7.1** Should any provision of these undertakings be contrary to law or invalid for any reason, Pennon undertakes to continue to observe the remaining provisions.

8 Governing Law

- 8.1** Pennon recognises and acknowledges that these undertakings shall be governed and construed in all respects in accordance with English law.
- 8.2** In the event that a dispute arises concerning these undertakings, Pennon undertakes to submit to the courts of England and Wales.

9 Term and termination

- 9.1** Pennon recognises and acknowledges that these undertakings shall be in force until such time as they are varied, released or superseded under the Water Industry Act 1991.
- 9.2** Pennon recognises and acknowledges that the variation, release or supersession of these undertakings shall not affect the validity and enforceability of any rights or obligations that arose prior to such variation, release or supersession.

10 Review or variation

- 10.1** Upon request from Pennon or Ofwat or on the CMA's own initiative, the CMA shall consider whether, by reason of any material change of circumstances, the undertakings are no longer appropriate and need to be varied, superseded or released. For the avoidance of doubt, such change of circumstances could include a change in the regulatory framework leading to a material change to the way in which Ofwat sets price controls by reference to comparisons between water undertakers in the future.

11 Interpretation

11.1 The Interpretation Act 1978 shall apply to these undertakings as it does to Acts of Parliament.

11.2 References in these undertakings to any English law term for any legal status, interest, concept or thing shall in respect of any jurisdiction other than England and Wales be deemed to include what most nearly approximates in that jurisdiction to the English law term.

11.3 In these undertakings the word “including” shall mean including without limitation or prejudice to the generality of any description, definition, term or phrase preceding that word and the word “include” and its derivatives shall be construed accordingly.

11.4 For the purposes of these undertakings:

“**Affiliate**” a person is an affiliate of another person if they or their respective enterprises would be regarded as being under common control for the purposes of section 26 of the Enterprise Act 2002;

“**BRL**” means Bristol Water plc, whose registered office is at Bridgwater Road, Bristol, BS13 7AT with company number 02662226;

“**BRL region**” means the area for which BRL is appointed to be the water undertaker under the WIA91 as at 31 December 2021, as may be varied by Ofwat from time to time;

“**BRL Wholesale Water Activities**” means:

- (i) Water Resources Activities in the BRL region (as defined in BRL's Instrument of Appointment as at 31 December 2021); and
- (ii) Network Plus Water Activities in the BRL region (as defined in BRL's Instrument of Appointment as at 31 December 2021),

or any other definition or split of wholesale water activities for the BRL region, in accordance with Ofwat's price review methodology at any given time (or as otherwise defined in the future).

“**business**” has the meaning given by section 129(1) and (3) of the Enterprise Act 2002;

“**BWHUK**” means Bristol Water Holdings UK Limited, whose registered office is at Bridgwater Road, Bristol, BS13 7AT with company number 04789566;

“**CMA**” means the Competition and Markets Authority or any successor body;

“**Confidential Information**” means any business secrets, know-how, commercially sensitive information, intellectual property or any other information of a confidential or proprietary nature;

“**Control**” shall be construed in accordance with section 26 of the Enterprise Act 2002, and in the case of a body corporate, a person shall be deemed to Control it if he holds, or has an interest in, shares of that body corporate amounting to 10 per cent or more of its issued share capital or carrying an entitlement to vote at meetings of that body corporate of 10 per cent or more of the total number of votes which may be cast at such meetings;

“**Decision**” means the CMA's decision under section 32(b) of the Water Industry Act 1991 dated 22 December 2021 in connection with the Transaction;

“**enterprise**” has the meaning given in section 129(1) of the Enterprise Act 2002;

“Group of Interconnected Bodies Corporate” has the meaning given in section 129(2) of the Enterprise Act 2002; references to a Group of Interconnected Bodies Corporate shall be to the Group of Interconnected Bodies Corporate as constituted from time to time;

“Instrument of Appointment” means an appointment as a water and/or sewerage undertaker under the WIA91;

“Interest” includes shares, an interest in shares and any other interest carrying an entitlement to vote at shareholders’ meetings but does not include a contract to acquire shares in the future; and for this purpose “an interest in shares” includes an entitlement by a person other than the registered holder, to exercise any right conferred by the holding of these shares or an entitlement to Control the exercise of such right;

“Merged Business” means the combined Bristol Water and South West Water business;

“Merged Licence” means the licence of SWW as may be amended to incorporate the BRL region pursuant to Sections 8 and 13 of the WIA91 and subject to any necessary consultation required to bring such modification into effect;

“Ofwat” means the Water Services Regulation Authority or any successor body;

“Pennon” means Pennon Group plc, whose registered office is at Peninsula House, Rydon Lane, Exeter, EX2 7HR with company number 02366640;

“PR19 determinations” means the price and service review final determinations that are in place for the period starting from 1 April 2020, including for the avoidance of doubt the CMA's PR19 redetermination for BRL in respect of the BRL region;

“Subsidiary” shall be construed in accordance with section 1159 of the Companies Act 2006 (as amended), unless otherwise stated;

“SWW” means South West Water Limited, whose registered office is at Peninsula House, Rydon Lane, Exeter, EX2 7HR with company number 02366665;

“SWW region” means the area for which SWW is appointed to be the water and sewerage undertaker under the WIA91 as at 31 December 2021, as may be varied by Ofwat from time to time, although for the avoidance of doubt this shall not include the BRL region;

“SWW Wholesale Water Activities” means:

- (i) Water Resources Activities in the SWW region (as defined in SWW's Instrument of Appointment as at 31 December 2021); and
- (ii) Network Plus Water Activities in the SWW region (as defined in SWW's Instrument of Appointment as at 31 December 2021),

or any other definition or split of wholesale water activities for the SWW region, in accordance with Ofwat's price review methodology at any given time;

“UK” means the United Kingdom of Great Britain and Northern Ireland;

“WIA91” means the Water Industry Act 1991 as amended; and

unless the context requires otherwise, the singular shall include the plural and vice versa.

For and on behalf of Pennon Group plc:

Signature:

Name:

Title:

Date:

Date accepted by the CMA: