

DEROGATION LETTER

IN RESPECT OF INITIAL ENFORCEMENT ORDERS ISSUED PURSUANT TO SECTION 72(2) ENTERPRISE ACT 2002

Consent under section 72(3C) of the Enterprise Act 2002 to certain actions for the purposes of the Initial Enforcement Order made by the Competition and Markets Authority ('CMA') on 8 January 2024

ACQUISITION BY PENNON GROUP PLC OF SUMISHO OSAKA GAS WATER UK LIMITED

We refer to your emails dated 14 December 2023, 15 December 2023, and 3 January 2024 requesting that the CMA consents to a derogation to the Initial Enforcement Order of 8 January 2024 (the '**Initial Order**'). The terms defined in the Initial Order and any directions issued under the Initial Order have the same meaning in this letter.

Under the Initial Order, save with the written consent of the CMA, Pennon and the Target are required to hold separate the Target business from the Pennon business and refrain from taking any action which might prejudice a reference under section 22 of the Act or impede the taking of any remedial action following such a reference.

After due consideration of your request for a derogation from the Initial Order, based on the information received from you and in the particular circumstances of this case, Pennon and the Target may carry out the following actions, in respect of the specific paragraphs:

1. Paragraphs 5(c), 5(i), and 5(j) of the Initial Order

Pennon submits that it anticipates needing to fill certain vacant Pennon management positions which have been created [✂] in the ordinary course of Pennon's business and not in contemplation of the transaction. The management positions that Pennon submits that it is likely to fill during the hold separate period are listed at Annex 1 (together, the '**Pennon Management Positions**').

Pennon therefore requests a derogation from paragraphs 5(c), 5(i), and 5(j) of the Initial Order to fill in the Pennon Management Positions.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation will not result in any integration between the Target business and the Pennon business;

- b) none of the Pennon Management Positions will be filled by employees or officers of the Target without prior written consent from the CMA;
- c) Pennon will notify the CMA prior to each appointment of an individual to a Pennon Management Position in its periodic compliance statements;
- d) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- e) no other organisation changes will be made to the Pennon business as a result of the proposed changes.

2. Paragraphs 5(c) and 5(i) of the Initial Order

Pennon submits that it is in the process of recruiting a new Chair of the Board of Directors, following the announcement by the incumbent Chair of her intention to step down at the close of Pennon's Annual General Meeting in 2024, scheduled for 25 July 2024. Pennon submits that the recruitment process was initiated prior to, and is unrelated to, the transaction.

Pennon therefore requests derogation from paragraphs 5(c) and 5(i) of the Initial Order to permit Pennon to appoint a new Chair of the Board of Directors during the hold separate period.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) such appointment will not result in any integration between the businesses of the Target and Pennon;
- b) the new Chair of the Board of Directors will have the necessary skills and experience to assume the role, and the new Chair of the Board of Directors will not be appointed without the CMA's prior written consent (which can be given via email);
- c) Pennon shall not appoint any employee or officer of the Target to the position of Chair of the Board of Directors without the CMA's prior written consent; and
- d) no other organisation changes or key staff changes will be made to the Pennon business as a result of the proposed change.

3. Paragraphs 5(a) and 5(l) of the Initial Order

Pennon submits that it must exercise financial oversight of the Target in order to ensure that it is being maintained as a going concern, in addition to enabling Pennon

to discharge its mandatory corporate governance obligations as a premium listed company during the hold-separate period.

Pennon therefore requests a derogation from paragraphs 5(a) and 5(l) of the Initial Order to permit [X] (Pennon's Group General Counsel and Company Secretary) (the '**Designated Person**') to exercise Pennon's majority shareholder rights in SOGWUK on behalf of Pennon, and to receive such information as may be needed to enable the Designated Person to exercise such rights, in respect of the Reserved Matters (as defined in Annex 2) (the '**Delegation of Authority**').

The CMA agrees to Pennon's request for a derogation on the basis that:

- a) the Delegation of Authority is necessary to maintain the Target business as a going concern, and to enable Pennon to discharge its mandatory corporate governance obligations as a premium listed company during the hold separate period;
- b) any information provided to Pennon in connection to the Reserved Matters will not be more than strictly necessary to allow the Designated Person to exercise Pennon's majority shareholder rights on behalf of Pennon;
- c) the Delegation of Authority provided to Pennon for the purposes of reviewing the Reserved Matters is granted only to the Designated Person;
- d) the Designated Person is not engaged in a commercial or strategic role within the Pennon business;
- e) the identity of the Designated Person cannot be changed except through written consent by the CMA (which can be given via email);
- f) the thresholds for the level of expenditure that classifies as a Reserved Matter can be amended by the CMA via email if the CMA reaches a view that they are leading to frequent reporting which unnecessarily compromises the Target business' independence;
- g) the Designated Person must not consult with any other individual in the Pennon business in taking decisions on the Reserved Matters, and will sign a non-disclosure agreement in a form agreed with the CMA, which:
 - a. covers the treatment of any commercially sensitive information they receive as a result of the Delegation of Authority; and
 - b. ensures that any Target business information accessed for the purposes of the Delegation of Authority would only be used for decisions on Reserved Matters, and not for any other business purposes.

- h) the Designated Person must not communicate with employees of the Target business except in response to requests for approval of the Reserved Matters;
- i) Pennon will notify the CMA of any requests for shareholder approval made by SOGWUK in respect of the Reserved Matters and will be provided with a summary of the information shared with Pennon;
- j) in the event of a proposed veto, the Designated Person is required to explain their reasoning, and Pennon will share this reasoning with the CMA at least one working day in advance of the proposed veto being exercised;
- k) should remedial action be required by the CMA in relation to the Target business, any records or copies (electronic or otherwise) of business secrets, know-how, commercially-sensitive information, intellectual property or any other information of a confidential or proprietary nature, wherever they may be held, that were received from the Target business for the purposes of this derogation will be returned to the Target business and any copies destroyed, except to the extent that record retention is required by law or regulation;
- l) all electronic files and emails exchanged in this context will be password protected, adequately ring-fenced, and only accessible to the Designated Individual; and
- m) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

4. Paragraphs 5(a) and 5(l) of the Initial Order

Pennon submits that Sutton and East Surrey Water Plc ('**SESW**') holds an appointment as a water undertaker under section 6 of the Water Industry Act 1991, and that Condition P of the conditions of appointment requires SESW to procure from its ultimate controller a legally-enforceable undertaking in the terms described in that condition. Pennon submits that this includes procuring that the ultimate controller will:

- (a) provide, and procure that each of its subsidiaries will provide, all such information as may be necessary to enable SESW to comply with the requirements of the conditions of its appointment;
- (b) refrain, and procure that each of its subsidiaries will refrain from, any action which would or may cause SESW to breach any of its obligations under the Water Industry Act 1991 or the conditions of its appointment; and
- (c) procure the appointment to SESW's board of directors of not less than three non-executive directors, who shall be persons of standing with relevant

experience and who shall collectively have connections with and knowledge of the areas within which SESW provides water services and an understanding of the interests of its customers and how these can be respected and protected.

Pennon therefore requests a derogation from paragraphs 5(a) and 5(l) of the Initial Order to permit it to enter into the ultimate controller undertaking required to be given by it upon becoming ultimate controller of SESW upon signing.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation is strictly necessary to ensure that SESW can meet its obligations under the Water Industry Act 1991;
- b) no confidential or commercially sensitive information is exchanged between SESW and Pennon pursuant to this derogation, without prior written consent from the CMA;
- c) there will be no change to SESW's board of directors pursuant to this derogation, without prior written consent from the CMA (which can be given via email);
- d) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- e) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

5. Paragraphs 5(a) and 5(l) of the Initial Order

Pennon submits that the consideration for the transaction will be subject to post-completion adjustment for [REDACTED]. Pennon submits that there will therefore need to be liaison between Pennon and the Target in order to monitor whether any [REDACTED] has occurred, and if it has, to be able to make corresponding claims [REDACTED].

Pennon therefore requests a derogation from paragraph 5(a) and 5(l) of the Initial Order to allow the Target business to share certain financial information (**the Financial Information**) with [REDACTED] (Pennon's Corporate Development Director) and [REDACTED] (Group Financial Controller) (together **the Financial Information Authorised Individuals**) to ensure Pennon's compliance with the [REDACTED].

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation is strictly necessary to ensure Pennon complies with [REDACTED];
- b) the Financial Information is shared only to the extent necessary for Pennon to assess whether any [REDACTED];

- c) the Financial Information is shared only with the Financial Information Authorised Individuals, and these Financial Information Authorised Individuals are not directly engaged in, nor responsible for making commercial or strategic decisions with regards to Pennon's business;
- d) the identity of the Financial Information Authorised Individual(s) cannot be changed except through written consent by the CMA (which can be given via email);
- e) the Financial Information Authorised Individuals will enter into non-disclosure agreements in a form agreed with the CMA, with a view to preventing the Financial Information from being shared with any unauthorised Pennon individuals;
- f) should remedial action be required by the CMA in relation to the Target business, any records or copies (electronic or otherwise) of business secrets, know-how, commercially-sensitive information, intellectual property or any other information of a confidential or proprietary nature, wherever they may be held, that were received from the Target business for the purposes of this derogation will be returned to the Target business and any copies destroyed, except to the extent that record retention is required by law or regulation;
- g) all electronic files and emails exchanged in this context will be password protected, adequately ring-fenced, and only accessible to the Financial Information Authorised Individuals; and
- h) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

6. Paragraphs 5(a) and 5(l) of the Initial Order

Pennon submits that there are certain SPA terms governing the transaction that will require continued liaison and information exchanges between Pennon and the Target business to monitor situations that may give rise to any warranty claims under the SPA.

Pennon further submits that this information is essential to ensure that Pennon's investment is protected, and that Pennon is able to comply with its relevant financial and reporting obligations, as warranty claims and any subsequent changes to the value of the Target may give rise to financial and other reporting requirements.

Pennon therefore requests a derogation from paragraphs 5(a) and 5(l) of the Initial Order to permit the Target to provide information that is necessary for Pennon to verify

the accuracy of warranties given by the sellers under the SPA governing the transaction, such that Pennon can monitor situations which may give rise to any warranty claim, and subsequently make any such claims against the sellers.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation is strictly necessary for Pennon to comply with its relevant financial and reporting obligations;
- b) the information provided by the Target under this derogation is shared only to the extent necessary for Pennon to verify the accuracy of warranties given by the sellers under the SPA governing the transaction, such that Pennon can monitor situations which may give rise to any warranty claim, and subsequently make any such claims against the sellers;
- c) the information provided by the Target under this derogation will be limited to [X] (Pennon's Group General Counsel and Company Secretary) and [X] (Pennon's Deputy General Counsel) (together **the Warranty Authorised Individuals**);
- d) the information provided by the Target under this derogation is shared only with the Warranty Authorised Individuals, and these Warranty Authorised Individuals are not directly engaged in, nor responsible for making commercial or strategic decisions with regards to Pennon's business;
- e) the identity of the Warranty Authorised Individual(s) cannot be changed except through written consent by the CMA (which can be given via email);
- f) the Warranty Authorised Individuals will enter into non-disclosure agreements in a form agreed with the CMA, with a view to preventing the information provided by the Target under this derogation from being shared with any unauthorised Pennon individuals;
- g) should remedial action be required by the CMA in relation to the Target business, any records or copies (electronic or otherwise) of business secrets, know-how, commercially-sensitive information, intellectual property or any other information of a confidential or proprietary nature, wherever they may be held, that were received from the Target business for the purposes of this derogation will be returned to the Target business and any copies destroyed, except to the extent that record retention is required by law or regulation;
- h) all electronic files and emails exchanged in this context will be password protected, adequately ring-fenced, and only accessible to the Warranty Authorised Individuals; and

- i) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

7. Paragraphs 5(a), 5(f), and 5(l) of the Initial Order

Pennon submits that the Target presently has [REDACTED]. In particular, Pennon submits that:

(a) [REDACTED]; and

(b) [REDACTED].

Pennon submits [REDACTED]. Pennon further submits however [REDACTED].

Pennon therefore requests a derogation from paragraphs 5(a), 5(f) and 5(l) of the Initial Order to permit it to hire certain individuals who can provide certain critical management services to the Target (the '**Management Services**') to ensure that it has [REDACTED] in place and that Pennon is able to discharge its mandatory corporate governance obligations as a premium listed company during the hold separate period.

The CMA consents to Pennon's request for a derogation on the basis that:

- (a) the Target presently has [REDACTED], and this derogation is strictly necessary to ensure that the Target [REDACTED];
- (b) the individuals hired pursuant to this derogation will be appointed by the Target directly and will be independent from Pennon, and these individuals will not be hired without prior written consent from the CMA (which can be given via email);
- (c) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- (d) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

8. Paragraphs 5(a), 5(g), and 5(l) of the Initial Order

Pennon submits that as part of its obligation to maintain the Target as a going concern, it must ensure that the Target has adequate insurance cover during the hold-separate period. Pennon therefore submits that the most efficient means of securing insurance for the Target with effect from completion of the transaction is for Pennon to acquire new policies for, and/or extend the benefit of certain existing Pennon group insurance policies to, the Target. Specifically, Pennon requests that it be permitted to procure the following insurance coverage for the Target:

(a) [REDACTED]; and

(b) [REDACTED]

(together **the Insurance Cover**).

Pennon therefore requests a derogation from paragraphs 5(a), 5(g), and 5(l) of the Initial Order to permit it to procure the Insurance Cover for the Target.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation will not result in Pennon having any influence over the commercial or strategic direction of the Target;
- b) the provision of the Insurance Cover to the Target will not be difficult or costly to reverse;
- c) any information provided to Pennon by the Target business in connection with the insurance procurement process is limited to that which is strictly necessary to secure the Insurance Cover for the benefit of the Target business;
- d) such information would be shared only with [REDACTED] (Pennon's Group Director Risk and Assurance) and [REDACTED] (Pennon's Group Insurance Manager) (together the **Insurance Authorised Individuals**) who are representatives of Pennon and are not directly engaged in, nor responsible for making commercial or strategic decisions with regards to the Pennon business. The identity of the Insurance Authorised Individuals cannot be changed except through written consent by the CMA (which can be given via email);
- e) the Insurance Authorised Individuals must enter into non-disclosure agreements in a form agreed with the CMA, with a view to preventing any information received from the Target business in connection with the insurance process from being shared with any part of Pennon's wider business;
- f) should remedial action be required by the CMA in relation to the Target business, any records or copies (electronic or otherwise) of business secrets, know-how, commercially-sensitive information, intellectual property or any other information of a confidential or proprietary nature, wherever they may be held, that were received from the Target business for the purposes of this derogation will be returned to the Target business and any copies destroyed, except to the extent that record retention is required by law or regulation;
- g) all electronic files and emails exchanged in this context will be password protected, adequately ring-fenced, and only accessible to the Insurance Authorised Individuals;

- h) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- i) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

9. Paragraphs 5(a) and 5(l) of the Initial Order

Pennon submits that the due diligence process it conducted in connection with the Transaction has revealed that the Target has received correspondence from [REDACTED] requesting information in connection with [REDACTED]. Pennon submits that it must effectively engage with [REDACTED] further about this [REDACTED].

Pennon therefore requests a derogation from paragraphs 5(a) and 5(l) of the IEO to enable it to:

- (a) exchange relevant information [REDACTED]; and
- (b) engage with [REDACTED] regarding the matters in paragraph (a) above.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) this derogation is strictly necessary for Pennon to effectively engage with [REDACTED] on [REDACTED];
- b) this derogation will not result in Pennon having any influence over the commercial or strategic direction of the Target;
- c) any information provided to Pennon by the Target business in connection with this derogation is limited to that which is strictly necessary for Pennon to effectively engage with [REDACTED] on [REDACTED];
- d) such information would be shared only with [REDACTED] ([REDACTED]), [REDACTED] ([REDACTED]) and [REDACTED] ([REDACTED]) (together the [REDACTED]) who are representatives of Pennon and are not directly engaged in, nor responsible for making commercial or strategic decisions with regards to the Pennon business. The identity of the [REDACTED] Authorised Individuals cannot be changed except through written consent by the CMA (which can be given via email);
- e) the [REDACTED] Authorised Individuals must enter into non-disclosure agreements in a form agreed with the CMA, with a view to preventing any information received from the Target business in connection with this derogation from being shared with any part of Pennon's wider business;

- f) should remedial action be required by the CMA in relation to the Target business, any records or copies (electronic or otherwise) of business secrets, know-how, commercially-sensitive information, intellectual property or any other information of a confidential or proprietary nature, wherever they may be held, that were received from the Target business for the purposes of this derogation will be returned to the Target business and any copies destroyed, except to the extent that record retention is required by law or regulation;
- g) all electronic files and emails exchanged in this context will be password protected, adequately ring-fenced, and only accessible to the [X] Authorised Individuals;
- h) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- i) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

10. Paragraphs 5(a), 5(c), and 5(l) of the Initial Order

Pennon submits that it must be able to monitor whether SESW's board is conducting the Target business in a manner consistent with Pennon's own governance practices and obligations as a premium listed company, and to that end to ensure that there is sufficient expertise available to the board in matters of corporate governance.

Pennon therefore requests a derogation from paragraphs 5(a), 5(c) and 5(l) of the IEO to, with effect from completion, enable Pennon to nominate a third party (the '**Third-Party Observer**') to attend and observe the Target's board meetings.

The CMA consents to Pennon's request for a derogation on the basis that:

- a) the identity of the Third-Party Observer will be subject to written approval by the CMA (which can be given via email);
- b) the Third-Party Observer will be independent from the Pennon business, and once appointed, the identity of the Third-Party Observer cannot be changed except through written consent by the CMA (which can be given via email);
- c) the Third-Party Observer must enter into non-disclosure agreement in a form agreed with the CMA, with a view to preventing any information received from the Target business in connection with this derogation from being shared with any part of Pennon's business;

- d) there will be no correspondence between Pennon and the Third-Party Observer without prior written consent from the CMA (which can be given via email);
- e) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- f) this derogation will not result in any pre-emptive action which might prejudice the outcome of a reference or impede the taking of any action which may be justified by the CMA's decision on a reference.

Yours sincerely,

Richard Flanagan

Director

Mergers

9 January 2024

Annex 1 – The Pennon Management Positions

Business / Reporting Area	Role
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
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[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]

Annex 2 – the Reserved Matters

Pennon requests a Delegation of Authority derogation to exercise its majority shareholder rights in SOGWUK on behalf of Pennon, and to receive such information as may be needed to enable the Designated Person to exercise such rights, in respect of the following matters:

- (a) approval of any capital expenditure and operating expenditure, which [X] and is above a threshold of £[X];
- (b) approval of any land purchases and sales, which had not been budgeted for in the Target's pre-merger business plan and are above a threshold of £[X];
- (c) approval of the commencement, cessation or settlement of any litigation, dispute, claim or action where the amount claimed is likely to exceed £[X];
- (d) approval of entry into any customer/supplier contracts with an aggregate value of £[X] or greater;
- (e) approval of entry into [X];
- (f) approval of any resolutions and corresponding documentation to be put forward to Pennon, in its capacity as shareholder of the Target, at a general meeting;
- (g) the appointment, reappointment or removal of the [X] of the Target, following the recommendation of [X];
- (h) determining the remuneration of the non-executive directors of SESW;
- (i) approving the introduction of [X] (including [X]), material changes to the rules of [X] or the terms of [X] (including the waiver or amendment of [X] that would have the effect of [X]), or any decision by the remuneration committee of SESW to exercise its discretion to approve [X]. In particular, awards vesting at a level between [X]% and [X]% would be subject to the ability of the Designated Person to exercise a formulaic override to reduce the vesting level of the award if the Designated Person reasonably considers that the approved payments are not aligned with, or reflect, the performance of the Target or the relevant individual, and awards vesting at a level of [X]% would be subject to the ability of the Designated Person to prevent or reduce the vesting outcome of the awards; and
- (j) approving material changes to the rules of [X] or [X] (including the waiver or amendment of [X] that would have the effect of [X]) or any decision by the remuneration committee of SESW to approve payments under the annual bonus plans in respect of the financial year ended 31 March 2024 above an aggregate level of [X]% of the maximum opportunity. In particular, payments

at an aggregate level of between [X]% and [X]% of maximum would be subject to the ability of the Designated Person to exercise a formulaic override to reduce payments if the Designated Person reasonably considers that the approved payments are not aligned with, or reflect, the performance of the Target or the relevant individual, and payments at an aggregate level of [X]% of maximum would be subject to the ability of the Designated Person to prevent or reduce the level of the payments;

(together the **Reserved Matters**)

Annex 3 – [✂]

[✂]