

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 email of 9 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) and 5(i) of the Initial Order

Pennon submits that upon completion of the transaction, the individuals listed in column 2 of Table 1, each of whom is a nominee of the sellers, will resign their positions as directors and/or company secretary of the Target (the '**Target Board Seller Nominees**').

As a result, Pennon submits that the Target board may become inquorate and/or otherwise unable to comply with its governance obligations. Accordingly, Pennon proposes to fill the relevant board or company secretary positions with the individuals shown in column 3 of Table 1 (the '**Target Board Proposed Appointees**').

Table 1: Target Board Seller Nominees and Target Board Proposed Appointees

(1) Target Group entity	(2) Target Board Seller Nominees	(3) Target Board Proposed Appointees
Sumisho Osaka Gas Water UK Limited (08369318)	[REDACTED] ([REDACTED])	[REDACTED] ([REDACTED])
	[REDACTED] ([REDACTED])	[REDACTED] ([REDACTED])
	[REDACTED] ([REDACTED])	[REDACTED] ([REDACTED])
	[REDACTED] ([REDACTED])	N/A
	[REDACTED] ([REDACTED])	N/A

Pennon submits that the Target Board Proposed Appointees are all directors and/or employees of the Target business. In particular, Pennon submits that:

- (a) [REDACTED];
- (b) [REDACTED]; and
- (c) [REDACTED].

Pennon therefore requests a derogation from paragraphs 5(c) and 5(i) of the Initial Order to allow: (i) the resignation of the Target Board Seller Nominees; and (ii) the appointment of the Target Board Proposed Appointees to the positions shown in column 3 of Table 1.

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 Target Board Proposed Appointees is an employee or officer of the Pennon business;
- (c) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business; and
- (d) no other organisation changes will be made to the Target business as a result of the proposed changes.

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

Pennon submits that upon completion of the transaction, the individuals listed in column 2 of Table 2, each of whom is a nominee of the sellers, (the '**Target Subsidiary**

Seller Nominees') will resign their positions as directors of the Target subsidiaries shown in column 1 of Table 2 (the '**Target Subsidiaries**').

As a result, Pennon submits, the boards of certain Target Subsidiaries may become inquorate and/or otherwise unable to comply with their governance obligations. Where this is the case, Pennon proposes to fill the relevant boards with the individuals shown in column 3 of Table 2 (the '**Target Subsidiary Interim Appointees**') on a temporary basis.

Table 2: Target Subsidiary Seller Nominees and Target Subsidiary Interim Appointees

(1) Target Subsidiary	(2) Target Subsidiary Seller Nominees	(3) Target Subsidiary Interim Appointees
East Surrey Holdings Limited (02660370)	[X] ([X])	N/A
	[X] ([X])	
	[X] ([X])	
	[X] ([X])	
Sutton and East Surrey Water Plc (02447875)	[X] ([X])	N/A
	[X] ([X])	
Sutton and East Surrey Water Services Limited (02446416)	[X] ([X])	[X] ([X])
	[X] ([X])	[X] ([X])
SES Business Water Limited (10167930)	[X] ([X])	[X] ([X])
	N/A	[X] ([X])
SES Home Services Limited (10167931)	[X] ([X])	[X] ([X])
	N/A	[X] ([X])

Pennon submits that each of Sutton and East Surrey Water Services Limited, SES Business Water Limited and SES Home Services is involved in non-regulated aspects of the Target business. Pennon further submits that, as a result of licence conditions imposed by Ofwat on statutory water undertakers who also operate as licensed non-

household suppliers,¹ Pennon is under a duty to manage conflicts of interest, *inter alia* by avoiding giving undue preference to its own (or discriminating against third-party) licensed non-household suppliers, avoiding the misuse of commercially-sensitive information received from the latter and ensuring proper charge-back of staff costs where staff are permitted to “cross-work” in the regulated and non-regulated parts of the business. As part of Pennon’s work to ensure compliance with these requirements, Pennon’s submits its policy is [X].

[X], Pennon requests that the CMA permits their appointment only for an interim period, during which time Pennon would identify suitable candidates to serve as directors of the Target Subsidiaries for the remainder of the period during which the Initial Order is in force. Pennon submits that it has not been possible to identify such candidates in the period prior to completion of the transaction given its limited access to Target Subsidiary employees and management, and the confidentiality of the transaction.

Pennon therefore requests a derogation from paragraphs 5(c) and 5(i) of the Initial Order to allow: (i) the resignation of the Target Subsidiary Seller Nominees; and (ii) the appointment of the Target Subsidiary Interim Appointees to the positions shown in column 3 of Table 2.

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 Target Subsidiary Interim Appointees is an employee or officer of the Pennon business;
- (c) this derogation will not result in any disruption to, or impact the viability of the Pennon business or the Target business;
- (d) as soon as possible, and not later than 20 working days following the IEO commencement date, Pennon will submit a further derogation request to the CMA addressing the resignation of the Target Subsidiary Interim Appointees and the appointment of new directors of the Target Subsidiaries who, Pennon envisages, would remain as directors for as long as the Initial Order remains in force; and

¹ Pennon submits that these are licence condition R, which has been inserted into the licences of all statutory water undertakers, and general licence condition 7 for all licensed NHH retailers. Ofwat has also issued Regulated Accounting Guideline 5.07, which governs transfer pricing arrangements.

(e) no other organisation changes will be made to the Target business as a result of the proposed changes.

Yours sincerely,

Richard Flanagan

Director

Mergers

9 January 2024