

Completed Acquisition by Pennon Group Plc of Sumisho Osaka Gas Water UK Limited (now Sutton and East Surrey Group Holdings Limited)

SUMMARY

1. The Competition and Markets Authority (**CMA**) has found that there is a realistic prospect that the acquisition by Pennon Group Plc (**Pennon**) of Sumisho Osaka Gas Water UK Limited (**SOGWUK**) has prejudiced or will prejudice Ofwat's ability to make comparisons between water enterprises.
2. On 10 January 2024, Pennon acquired SOGWUK. Following the Merger, SOGWUK's name was changed to Sutton and East Surrey Group Holdings Limited (**SESGHL**). SESGHL's subsidiaries include Sutton and East Surrey Water plc (**SES**). The CMA refers to this acquisition as the **Merger**. Pennon and SESGHL are together referred to as the **Parties** and, for statements relating to the future, the **Merged Entity**.
3. The Parties have until 13 May 2024 to offer undertakings in lieu of a reference (**UILs**) to the CMA that will remedy the prejudice identified. If no such undertaking is offered, then the CMA will refer the Merger pursuant to section 32 of the Water Industry Act 1991 (**WIA91**), as amended by The Water Act 2014.

Who are the businesses and what products/services do they provide?

4. Pennon and SES are water utility companies, and each provide water services to household and non-household customers in England.
5. Pennon operates as a water and sewerage undertaker in the Southwest of England through South West Water. It also operates as a water undertaker in the Bournemouth and Bristol regions, through Bournemouth Water and Bristol Water respectively.
6. SES operates as a water undertaker in parts of Surrey, Kent, West Sussex and South London, providing wholesale and retail household water services.

Why did the CMA review this merger?

7. The supply of water and sewerage services to household customers is a regulated market in England and Wales characterised by suppliers that hold regional monopolies within set sub-national regions. The market is regulated by Ofwat.
8. Mergers between water enterprises are subject to a separate review process to the normal regime under the Enterprise Act 2002. The review of water mergers is conducted by the CMA pursuant to the provisions of the WIA91.
9. Under the WIA91, as amended by the Water Act 2014, if the CMA believes that it is or may be the case that a completed Merger is a merger of two or more water enterprises (water merger), it is under a duty to refer the Merger to a phase 2 investigation unless the CMA believes that:
 - (a) the turnover of the water enterprise being taken over, and that of at least one of the water enterprises already belonging to the person making the takeover, is greater than £10 million; or
 - (b) 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
 - (c) 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 (**RCBs**) relating to the Merger.
10. The CMA considers that both Pennon and SES are water enterprises and that, as a result of the Merger, have ceased to be distinct. Accordingly, a water merger has taken place. The CMA also believes that the relevant turnover of both Pennon and SES is greater than £10 million.

What evidence has the CMA looked at?

11. The CMA has taken into account submissions made by Pennon, including modelling undertaken by its economic advisors Oxera (**Oxera**), Ofwat's opinion on the Merger, and third-party views of the Merger.

What did the evidence tell the CMA about the impact of the Merger on Ofwat's ability to regulate the water market?

12. Ofwat uses comparisons to perform a number of functions, including during its periodic price reviews for setting revenue allowances and service quality requirements, and between price reviews for monitoring and enforcement and setting best practice.

13. Based on the evidence received by the CMA, the CMA has found that the Merger has prejudiced or would be likely to prejudice Ofwat's ability, in carrying out its functions, to make comparisons between water enterprises. In particular;
- (a) the Merger is likely to lead to a loss of precision for Ofwat's wholesale cost models at both a company level and at an industry level;
 - (b) the Merger may have a detrimental impact on Ofwat's ability to set the industry cost allowance by removing a high or low performing company from Ofwat's benchmarks;
 - (c) the Merger could lead to the loss of a company with important characteristics in residential retail, for example in relation to average bill size and deprivation score and this could prejudice Ofwat's ability to regulate the cost of residential retail activities;
 - (d) the loss of SES as an independent comparator could adversely impact Ofwat's ability to use performance commitments and outcome delivery incentives as part of its comparative regulation of the market; and
 - (e) there is insufficient evidence to conclude at Phase 1 that RCBs would outweigh the adverse impacts of the Merger.

What happens next?

14. The CMA is considering whether to accept undertakings under section 33D of the WIA91. The Parties have until 13 May 2024 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to section 32 of the WIA91, as amended by The Water Act 2014.