

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

Decision that undertakings might be accepted

ME/7083/23

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

INTRODUCTION

1. On 10 January 2024, Pennon Group Plc (**Pennon**) acquired Sumisho Osaka Gas Water UK Limited (**SOGWUK**) (the **Merger**). 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**). Pennon and SOGWUK are together referred to as the **Parties**, and, for statements relating to the future, the **Merged Entity**.
2. On 3 May 2024, the Competition and Markets Authority (**CMA**) decided that it is or may be the case that a merger of two or more water enterprises has taken place, and that the Merger has prejudiced, or is likely to prejudice, the ability of Ofwat in carrying out its functions by virtue of the Water Industry Act 1991 (**WIA91**), to make comparisons between water enterprises (the **Reference Decision**).
3. On the date of the Reference Decision, the CMA gave notice pursuant to section 34ZA(1)(b) of the Enterprise Act 2002¹ (the **Act**) to the Parties of the Reference Decision. However, the CMA did not refer the Merger for a phase 2 investigation pursuant to section 32 of the WIA91 on the date of the SLC Decision in order to

¹ References to the Enterprise Act 2002 in this decision include any modifications having effect as a result of the Water Mergers (Modification of Enactments) Regulations SI 2004/3202, as amended.

allow the Parties the opportunity to offer undertakings to the CMA in lieu of such reference (**UILs**) for the purposes of section 33D of the WIA91.

4. Pursuant to section 73A(1) of the Act, if a party wishes to offer undertakings for the purposes of section 33D of the WIA91, it must do so within the five working day period specified in section 73A(1)(a) of the Act. Accordingly, on 3 May 2024, Pennon offered undertakings to the CMA for the purposes of section 33D of the WIA91.
5. The CMA has consulted with Ofwat on the nature of the undertakings submitted by Pennon, including requesting, receiving, and considering a draft opinion on Pennon's UIL offer.²
6. The CMA now gives notice, pursuant to section 73A(2)(b) of the Act, to Pennon 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 under section 33D of the WIA91 and that it is considering the offer.

THE UNDERTAKINGS OFFERED

7. Under section 33D of the WIA91, the CMA may, instead of making a reference, and for the purpose of remedying, mitigating or preventing the prejudicial effect on Ofwat's ability, in carrying out its functions by virtue of the WIA91, to make comparisons between water enterprises that the Merger has had, may have had or may be likely to have, accept from the merger parties concerned as it considers appropriate undertakings to take such action as it considers appropriate.
8. Pennon, through its subsidiary South West Water Limited, and SES both provide water services to household customers in England. The supply of water 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 enterprises and their sub-national regions.
9. The Reference Decision found that there is a realistic prospect that the Merger has prejudiced or will prejudice Ofwat's ability to make comparisons between water enterprises.
10. To address the prejudice, Pennon has offered to provide separate reporting information for SES from the rest of Pennon's water businesses post-Merger, whilst maintaining the existing separate reporting for Bristol Water under the

² Ofwat's draft opinion on Pennon's UIL offer was submitted to the CMA on 8 May 2024.

previous UILs.³ This information includes separate historical and forecast cost and cost driver information, and separate performance information (the **Proposed Undertakings**). The Proposed Undertakings would enable Ofwat to maintain a separate wholesale water price control for SES, and the flexibility to maintain separate or combined performance targets and incentives.^{4,5}

THE CMA'S PROVISIONAL VIEWS

11. The CMA considers that undertakings in lieu of a reference are appropriate when they are clear-cut and capable of ready implementation. For UILs in water mergers, the CMA's starting point is to seek an outcome that will restore Ofwat's ability to make comparisons between water enterprises to a level similar to that which existed pre-merger.
12. The CMA believes that the Proposed Undertakings, or a modified version of them, might be acceptable as a suitable remedy to the prejudice identified by the CMA in its Reference Decision. This prejudice arises due to SES, which is currently a separate comparator, becoming a combined comparator with the rest of Pennon's water businesses.⁶ As such, the CMA considers that the Proposed Undertakings, which commit to maintaining separate cost and performance information, will likely mitigate any loss in Ofwat's ability to make comparisons between water enterprises that may arise following the Merger.
13. The CMA also currently believes that the Proposed Undertakings are capable of amounting to a sufficiently clear-cut and effective resolution of the CMA's concerns and that the Proposed Undertakings are capable of ready implementation. In particular this is because they will require the Merged Entity to continue to report and provide information that is already currently provided independently.
14. For these reasons, the CMA currently thinks that there are reasonable grounds for believing that the Proposed Undertakings, or a modified version of them, might be accepted by the CMA under section 33D of the WIA91.
15. The CMA's decision on whether ultimately to accept the Proposed Undertakings or refer the Merger for a phase 2 investigation will be informed by, among other things, third party views on whether the Proposed Undertakings are suitable to address the concerns identified by the CMA.

³ See [Pennon/Bristol UILs](#).

⁴ While the Proposed Undertakings commit to Pennon providing separate retail data for SES, it would not be subject to separate retail price controls.

⁵ Pennon has also committed to sharing half of the forecast cost efficiencies of the Merger with customers via its WaterShare+ Scheme, and in the event that Ofwat applies a small company premium to the cost of capital allowance for SES at PR24 (the price and service review undertaken, and due to be concluded, by Ofwat in 2024) in its draft or final determinations, to waive SES's request or seek Ofwat's consent to the disapplication of the allowance.

⁶ Other than for the Bristol region, which is a separate comparator.

CONSULTATION PROCESS

16. Full details of the undertakings offered will be published in due course when the CMA consults on the undertakings offered as required by Schedule 10 of the Act.⁷

DECISION

17. The CMA therefore considers that there are reasonable grounds for believing that the Proposed Undertakings offered by the Parties, or a modified version of them, might be accepted by the CMA under section 33D of the WIA91. The CMA now has until 16 July 2024 pursuant to section 73A(3) of the Act to decide whether to accept the undertakings, with the possibility to extend this timeframe pursuant to section 73A(4) of the Act to 11 September 2024 if it considers that there are special reasons for doing so. If no undertakings are accepted, the CMA will refer the Merger for a phase 2 investigation pursuant to section 32 of the WIA91.

Joel Bamford
Executive Director, Mergers
Competition and Markets Authority
14 May 2024

⁷ [CMA87](#), paragraph 4.27–4.28.