

ME/7083/23 – Phase 1 Undertakings in Lieu of a Reference

Acquisition by Pennon Group plc of Sumisho Osaka Gas Water 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

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.

Whereas:

- (a) On 10 January 2024 Pennon acquired 100% of the issued and to be issued share capital of SOGWUK (the “**Transaction**”), the subsidiaries of which include SES;
- (b) Under section 32(b) of the Water Industry Act 1991 (as amended by the Water Act 2014) (“**WIA91**”), the 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:
 - (i) the turnover of the water enterprise being taken over or of each of the water enterprises already belonging to the person making the takeover, would not exceed £10 million (pursuant to section 33(1) of the WIA91); or
 - (ii) the merger has not prejudiced, and is not likely to prejudice, Ofwat’s ability, in carrying out its statutory functions, to make comparisons between water enterprises (pursuant to section 33A(2)(a) of the WIA91); or
 - (iii) the merger has prejudiced or is likely to prejudice Ofwat’s ability to make comparisons between water enterprises in the carrying out of its statutory functions, but the prejudice in question is outweighed by relevant customer benefits relating to the merger (pursuant to section 33A(2)(b) of the WIA91);
- (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 3 May 2024 (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 8 January 2024 and a Variation Order on 26 January 2024 applying to Pennon and SOGWUK 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 to mergers between water enterprises and references under section 32 of the WIA91 pursuant to regulation 2 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** Nothing in these undertakings shall have the effect of varying, superseding or releasing any of the undertakings given by Pennon and accepted by the CMA on 7 March 2022 in connection with the CMA's review of Pennon's completed acquisition of Bristol Water Holdings UK Limited (the "**Bristol Water Undertakings**"). Further, and for the avoidance of doubt, Pennon acknowledges that these undertakings will continue to apply notwithstanding any subsequent modification to the Instruments of Appointment of SBB and/or SES.
- 2.2** Pennon shall ensure that SBB and SES (or any Successor Entity) shall comply with the prevailing price controls to which each is subject.
- 2.3** Pennon undertakes to share half of the forecast merger-specific cost efficiencies, with a minimum to be shared of £[~~8~~], with all customers of SBB and SES as soon as reasonably practicable and no later than 31 March 2030, which would be undertaken via Pennon's WaterShare+ Scheme.
- 2.4** Pennon undertakes that, in respect of SES' request to apply a 'small company premium' as part of its PR24 business plan submission, in the event that Ofwat does apply a 'small company premium' for SES at PR24 in the draft or final determination:
- 2.4.1** Pennon shall waive such request to the extent that a final PR24 determination has not been issued in respect of SES as of the effective date of these undertakings; or
- 2.4.2** to the extent that a final PR24 determination has been issued in respect of SES that incorporates a small company premium allowance, Pennon shall seek Ofwat's consent to the disapplication of such allowance for the remainder of the PR24 period.
- 2.5** Pennon undertakes and confirms that it will ensure that SBB and SES (or any Successor Entity) provide Ofwat with such separate historical and forecast cost, cost driver and performance information and any other reporting of information with respect to each of the SWB Wholesale Water Activities, the BRL Wholesale Water Activities and the SES Wholesale Water Activities as may be required by Ofwat for the proper exercise of its regulatory functions including for the maintenance of separate price controls for each of the SWB Wholesale Water Activities, the BRL Wholesale Water Activities and the SES Wholesale Water Activities and to comply and be

consistent with the requirements of Ofwat's price review process and methodology from time to time.

- 2.6** Pennon confirms that SBB and SES (or any Successor Entity) will provide separate historical and forecast cost, cost driver and performance information and any other reporting of information with respect to each of the SWB Retail Activities, BRL Retail Activities and SES Retail Activities as may be required by Ofwat for the proper exercise of its regulatory functions, including to set a combined retail price control for the SBB and SES regions.
- 2.7** Pennon confirms that when reporting actual or forecast costs to Ofwat, SBB and SES (or any Successor Entity) will allocate costs to the appropriate SWB Wholesale Water Activities, BRL Wholesale Water Activities and SES Wholesale Water Activities and SWB Retail Activities, BRL Retail Activities and SES Retail Activities using a method consistent with the Regulatory Accounting Guidelines save as otherwise agreed with Ofwat from time to time. When submitting any historical or forecast cost or cost driver information to Ofwat, Pennon undertakes to submit an accompanying assurance report from an Independent Auditor containing a specific statement confirming that costs have been allocated across SBB and SES in accordance with the Regulatory Accounting Guidelines (subject to such alternative approach as agreed with Ofwat).
- 2.8** Pennon undertakes that the SES region will be represented at the WaterShare+ Customer Advisory Panel.

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, alongside the submission to Ofwat of its business plan, 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;
 - 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 Slaughter and May, whose address for service is One Bunhill Row, London EC1Y 8YY, 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 Slaughter and May 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 Slaughter and May, and service shall be deemed to have been acknowledged by Pennon if it is acknowledged by Slaughter and May or such other nominee.
- 6.3** The above has effect irrespective of whether, as between Pennon and Slaughter and May or other nominees, Slaughter and May 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 Slaughter and May 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 such other person or 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 region**” means the area for which Bristol Water Plc was the water undertaker as at the effective date of the Bristol Water Undertakings;

“**BRL Retail Activities**” means Residential Retail activities in the BRL region, or any other such definition of residential retail water activities in the BRL region, in accordance with Ofwat’s price review methodology at any given time;

“**Bristol Water Undertakings**” has the meaning given to it in paragraph 2.1;

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

- (i) Water Resources activities in the BRL region; and
- (ii) Water Network Plus activities in the BRL region

or any other such definition of wholesale water activities in the BRL region, in accordance with Ofwat’s price review methodology at any given time;

“**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;

“**Decision**” has the meaning given to it in Recital (d);

“**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;

“**Independent Auditor**” means an accountancy firm and/or technical auditor appointed by Pennon to prepare a report assessing the allocation of costs between SBB and SES in any historical or forecast cost or cost driver information to be submitted to Ofwat, as such appointment may be varied from time to time;

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

“**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 registration number 02366640;

“**PR24**” means the price and service review undertaken, and due to be concluded, by Ofwat in 2024, to take effect during the period from 1 April 2025 to 31 March 2030;

“**PR24 determination**” means a price and service review final determination in place for the period starting from 1 April 2025, including for the avoidance of doubt any redetermination issued by the CMA;

“**Regulatory Accounting Guidelines**” means Ofwat’s prevailing Regulatory Accounting Guidelines;

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

“SBB region” means the area for which SBB is appointed to be the water or water and sewerage undertaker under the WIA91 as at the effective date of these undertakings, or as may be varied by Ofwat from time to time, although, for the avoidance of doubt, not including the SES region;

“SES” means Sutton and East Surrey Water plc, whose registered office is at 66-74 London Road, Redhill, Surrey, RH1 1LJ with registration number 02447875;

“SES region” means the area for which SES is appointed to be the water undertaker under the WIA91 as at the effective date of these undertakings, or as may be varied by Ofwat from time to time;

“SES Retail Activities” means Residential Retail activities in the SES region (or as otherwise defined by Ofwat in the future), or any other such definition of residential retail water activities in the SES region, in accordance with Ofwat’s price review methodology at any given time;

“SES Wholesale Water Activities” means:

- (i) Water Resources activities in the SES region (or as otherwise defined by Ofwat in the future); and
- (ii) Water Network Plus activities in the SES region (or as otherwise defined by Ofwat in the future),

or any other such definition of wholesale water activities in the SES region, in accordance with Ofwat’s price review methodology at any given time;

“SOGWUK” means Sutton and East Surrey Group Holdings Limited, previously Sumisho Osaka Gas Water UK Limited, whose registered office is at 66-74 London Road, Redhill, England, RH1 1LJ with registration number 08369318;

“Successor Entity” means any entity or entities carrying on a relevant activity for the purposes of these undertakings which, as at the date of these undertakings, is carried out by SBB or SES;

“SWB Retail Activities” means Residential Retail activities in the SBB region (or as otherwise defined by Ofwat in the future), or any other such definition of residential retail water activities in the SBB region, in accordance with Ofwat’s price review methodology at any given time, but excluding BRL Retail Activities unless stated to the contrary;

“SWB Wholesale Water Activities” means:

- (i) Water Resources activities in the SBB region (or as otherwise defined by Ofwat in the future); and
- (ii) Water Network Plus activities in the SBB region (or as otherwise defined by Ofwat in the future),

or any other such definition of wholesale water activities in the SBB region, in accordance with Ofwat’s price review methodology at any given time, but excluding BRL Wholesale Water Activities unless stated to the contrary;

“Transaction” has the meaning given to it in Recital (a);

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

“WaterShare+ Customer Advisory Panel” means South West Water’s independent customer panel or any successor panel providing challenge on in-period performance and preparation of regulatory business plans;

“WaterShare+ Scheme” means the scheme implemented by Pennon (or any successor scheme(s) with similar effect) to facilitate financial returns to household customers of Pennon group companies in the form of bill reductions or issuance of shares in Pennon; and

“WIA91” has the meaning given to it in Recital (b).

11.5 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:

Signed by Pennon Group plc on 11 June 2024 and accepted by the CMA on 14 June 2024.