

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

Decision on acceptance of undertakings in lieu of reference

ME/7083/23

The Competition and Markets Authority’s decision to accept undertakings in lieu of reference under section 73(2) of the Enterprise Act 2002 given on 14 June 2024. Full text of the decision published on 24 June 2024.

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

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1. 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 there is a realistic prospect 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 3 May 2024, Pennon offered undertakings to the CMA for the purposes of section 33D of the WIA91. On 14 May, the CMA gave notice to Pennon, pursuant to section 73A(2)(b) of the Enterprise Act 2002 (the **Act**), 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 Pennon's offer (the **UIL Provisional Acceptance Decision**).
4. The text of the Reference Decision and the UILs Provisional Acceptance Decision are available on the CMA webpages.¹

2. THE UNDERTAKINGS OFFERED

5. As set out in the Reference Decision, the CMA found a realistic prospect that the Merger has prejudiced, or is likely to prejudice, the ability of Ofwat in carrying out its functions by virtue of the WIA91.
6. To address the prejudice identified by the CMA, Pennon has offered to provide separate reporting information for SES from the rest of Pennon's water businesses post-Merger (the **UILs**). As part of the UILs, Pennon will maintain the existing separate reporting for Bristol Water under the previous UILs agreed with the CMA.² The UILs will enable Ofwat to maintain a separate wholesale water price

¹ See <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>

² See [Pennon/Bristol UILs](#).

control for SES, and the flexibility to maintain separate or combined performance targets and incentives.^{3,4}

3. CONSULTATION

7. On 21 May 2024, pursuant to paragraph 2(1) of Schedule 10 to the Act, the CMA published the UILs, inviting interested parties to give their views on the UILs. The relevant text from the consultation is set out at Annex 1 of this decision.⁵ For the reasons set out in the consultation, the CMA’s preliminary view was that the UILs would resolve the prejudice identified in the Reference Decision in a clear-cut manner, ie without giving rise to material doubts about the overall effectiveness of the UILs or concerns about their implementation.⁶
8. The CMA received three submissions during the consultation period. These were all supportive of the UILs, in particular the requirement to maintain separate cost and performance information. One third party mentioned that in addition to enabling Ofwat to set challenging targets, the UILs would enable consumers to see the performance improvements made by their water provider.
9. While supporting the UILs overall, one third party suggested that the CMA could consider two changes to the UILs. These were (1) the inclusion of an additional “catch all” clause aimed at preventing any action that could reduce Ofwat’s ability to compare the efficiency of water companies in future, and (2) lowering the threshold above which Ofwat or the CMA can appoint an external auditor to assess Pennon’s compliance with the UILs.⁷
10. The CMA has carefully assessed the points raised during the consultation and based on the available evidence and the advice of Ofwat, considers that the existing UILs, without the suggested changes, are already sufficient to address the detriment identified in the Reference Decision.
 - (a) The CMA considers that an additional “catch-all” clause is not necessary to address the detriment identified in the Reference Decision. Clause 2.5 of the UILs requires Pennon to provide separate reporting (with respect to each of the SWB Wholesale Water Activities, the BRL Wholesale Water Activities

³ 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.

⁴ See also the UIL Provisional Acceptance Decision and Consultation Notice on <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>.

⁵ The full consultation text was published on <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>. Some of the links contained in footnotes of Annex 1 (9,12 and 16) have been updated from the text that was published on 21 May 2024.

⁶ [Merger remedies, \(CMA87\), December 2018](#), Chapter 3, in particular paragraphs 3.27, 3.28 and 3.30.

⁷ The UILs state that if the CMA or Ofwat have serious concerns with Pennon’s compliance with the UILs, they can appoint an external auditor to review Pennon’s compliance with the UILs and make recommendations to ensure effective future compliance. The third party suggested that this threshold could be lowered from ‘serious concerns’ to ‘concerns’.

and the SES Wholesale Water Activities) of any other information as may be required by Ofwat for the proper exercise of its regulatory functions, enabling Ofwat to compare the efficiency and performance of water companies in the future.

- (b) The CMA considers that it would be disproportionate to lower the threshold for appointing an external auditor. Where Ofwat and/or the CMA have concerns (rather than serious concerns) around compliance, the CMA considers it more proportionate to allow Pennon the opportunity to address those concerns without the need for an external audit.

11. The CMA sought views from Ofwat on the third-party submissions, and their view is in line with our conclusions (ie that no changes were required in light of the representations received). These third-party submissions therefore did not cause the CMA to change its preliminary view that the UILs would be acceptable (and the CMA has not otherwise become aware of any information that might cause a change in this view).
12. The CMA therefore considers that the UILs offered by Pennon are clear-cut and appropriate to remedy, mitigate or prevent the concerns identified in the Reference Decision.

DECISION

13. For the reasons set out above, the CMA considers that the UILs provided by Pennon are as comprehensive a solution as is reasonable and practicable and remedy, mitigate or prevent the prejudice identified in the Reference Decision and any adverse effects resulting from it. The CMA has therefore decided to accept the UILs offered by Pennon pursuant to section 33D of the WIA91. The Merger will therefore not be referred for a phase 2 investigation.
14. The UILs, which have been signed by Pennon and will be published on the CMA webpages, will come into effect from the date of this decision.

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

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

**NOTICE UNDER PARAGRAPH 2(1) OF SCHEDULE 10 TO THE
ENTERPRISE ACT 2002 (THE ACT) – CONSULTATION ON
PROPOSED UNDERTAKINGS IN LIEU OF REFERENCE
PURSUANT TO SECTION 73 OF THE ACT.**

ME/7083/23

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. Pennon⁸ 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.
3. 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 there is a realistic prospect 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**). The text of the Reference Decision is available on the CMA webpages.⁹
4. On 3 May 2024, Pennon offered undertakings to the CMA for the purposes of section 33D of the WIA91.
5. On 14 May, the CMA gave notice to Pennon, pursuant to section 73A(2)(b) of the Act, 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 Pennon's offer (the **UIL Provisional Acceptance Decision**).

THE UNDERTAKINGS OFFERED

6. As set out in the Reference Decision, the CMA found a realistic prospect that the Merger has prejudiced, or is likely to prejudice, the ability of Ofwat in carrying out its functions by virtue of the WIA91.
7. To address the prejudice identified by the CMA, Pennon has offered to provide separate reporting information for SES from the rest of Pennon's water businesses post-Merger (the **Proposed Undertakings**). As part of the Proposed

⁸ Through South West Water, Bournemouth Water and Bristol Water.

⁹ See <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>

Undertakings, Pennon will maintain the existing separate reporting for Bristol Water under the previous UILs agreed with the CMA.¹⁰ 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.^{11,12}

CMA ASSESSMENT

8. The CMA currently considers that, subject to responses to the consultation required by Schedule 10 of the Act, the Proposed Undertakings will resolve the prejudice identified in the Reference Decision in a clear-cut manner, ie the CMA currently does not have material doubts about the overall effectiveness of the Proposed Undertakings or concerns about their implementation.¹³ The prejudice identified by the CMA arises due to SES, which is currently a separate comparator, becoming a combined comparator with the rest of Pennon's water businesses. 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.
9. The CMA also considers that the Proposed Undertakings would be 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.

Opinion of Ofwat

10. Ofwat is the regulator for the water sector in England and Wales. Ofwat has a set of primary and secondary duties and functions. One of the functions is to set price limits every five years, determining the maximum companies can charge customers for water and wastewater services. Ofwat also monitors the performance of the water companies to ensure that they deliver the required services and improvements in quality.
11. Ofwat carries out its role using a system of comparative regulation between the water enterprises. A water merger could affect Ofwat's ability to make comparisons in a number of ways across each of these functions.

¹⁰ See [Pennon/Bristol UILs](#).

¹¹ 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.

¹² See also the UIL Provisional Acceptance Decision on <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>

¹³ Merger remedies guidance ([CMA87](#)), December 2018, paragraph 3.28.

12. The CMA consulted with Ofwat on the nature of the undertakings submitted by Pennon, including requesting, receiving, and considering an opinion on the effect of the undertakings pursuant to section 33D(6) of the WIA91.
13. Ofwat confirmed to the CMA that it considers that the Proposed Undertakings, offered to the CMA by Pennon on 3 May 2024 adequately remedy the prejudice identified by the CMA in the Reference Decision.¹⁴ In particular, Ofwat submitted that it relies heavily on comparisons in order to set appropriate revenue limits and service packages. As a result, retaining separate cost, cost driver, performance and other information for the SES area is crucial. Ofwat also submitted that it requires separate reporting on both wholesale and retail activities, that it is also necessary for it to set separate wholesale price controls across the regions, but that it is not necessary to retain separate retail price controls.¹⁵

PROPOSED DECISION AND NEXT STEPS

14. For the reasons set out above, the CMA currently considers that the Proposed Undertakings are, in the circumstances of this case, appropriate to remedy, mitigate or prevent any loss in Ofwat's ability to make comparisons between water enterprises that may arise following the Merger and form as comprehensive a solution to these concerns as is reasonable and practicable.
15. The CMA therefore gives notice that it proposes to accept the Proposed Undertakings in lieu of a reference of the Merger for a phase 2 investigation. The text of the proposed undertaking is available on the CMA web page.¹⁶
16. Before reaching a decision as to whether to accept the Proposed Undertakings, the CMA invites interested parties to make their views known to it. The CMA will have regard to any representations made in response to this consultation and may make modifications to the Proposed Undertakings as a result. If the CMA considers that any representation necessitates any material change to the Proposed Undertakings, the CMA will give notice of the proposed modifications and publish a further consultation.¹⁷
17. Representations should be made in writing to the CMA and be addressed to:

James McGarrachan
Mergers Group
Competition and Markets Authority
The Cabot

¹⁴ Ofwat states that the proposed UILs would provide it with the flexibility to maintain either different or consistent performance targets and incentives with separate price controls maintained.

¹⁵ Ofwat's Final Opinion on Pennon's UIL offer, submitted to the CMA on 14 May 2024, paragraphs 2.1 to 2.8

¹⁶ See <https://www.gov.uk/cma-cases/pennon-slash-sumisho-osaka-gas-water-uk-merger-inquiry>

¹⁷ Under paragraph 2(4) of Schedule 10 to the Act.

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Deadline for comments: 5 June 2024