

Competition and Markets Authority (CMA)  
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12 May 2025

By email: [mergerremediesreview@cma.gov.uk](mailto:mergerremediesreview@cma.gov.uk)

Dear colleagues,

## **Re: Review of merger remedies approach**

Thank you for the opportunity to respond to the call for evidence on the review of merger remedies approach.

We note that the primary purpose of the Merger Remedies Review is to ensure that the CMA's merger remedies process reflect the core 4P principles of pace, process, predictability and proportionality.

Pennon Group, as a leading water and wastewater services provider, has relevant recent experience with the merger remedies approach. We have worked constructively with colleagues at the CMA and Ofwat for Phase One clearances on the acquisitions of Bristol and SES Water, since the Merger Remedies Process was last updated in 2018, and previously on the 2015 acquisition of Bournemouth Water. These mergers have been beneficial for customers and the sector.

Mergers have historically generated significant benefits across the water sector. These include improvements in operational efficiency, leading to cost savings and enhanced service quality for customers. Mergers drive economic growth by creating more robust and resilient companies that are better positioned to invest in infrastructure and innovation. Additionally, mergers can attract investment by creating more financially stable entities that are appealing to investors.

### **Theme 1 – the CMA's approach to remedies**

We recognise the need for comparators, as they play a crucial role in regulatory assessments and benchmarking performance. The focus on maintaining a sufficient number of comparators should not overshadow the broader benefits that mergers can bring. Rather, the regulatory approach should support beneficial consolidations while safeguarding against any negative impacts on competition and customer outcomes.

In competitive markets, the primary objective is to promote efficiency, and it is essential to ensure that the regulatory framework does not inadvertently create counter-incentives. Currently the merger assessment process is designed to identify the greatest possible detriment – however unlikely - and by definition will always conclude there to be a greater detriment when an efficient company acquires another relative to when an inefficient company does so, when the former is economically more desirable and leads to greater overall sector improvements.

In the cases of Bristol Water and SES Water, we agreed with both the CMA and Ofwat that separate wholesale price controls would be put in place in order to maintain the current number of wholesale water comparators, addressing any potential detriment, whilst allowing the benefits of the mergers to be realised.

However, it is important to note that even with fewer companies, effective comparisons can still be made, as evidenced by the energy sector. We would welcome a wider consideration of comparative benchmarking in the future.

## Theme 2 - Customer Benefits

Mergers can generate significant benefits for customers. Europe Economics<sup>1</sup> note that mergers in the UK water sector have led to significant operational efficiencies: cost savings and enhanced service quality for customers. This is also our own experience.

Our customers have directly benefited from economies of scale, spreading fixed costs over a larger base and reducing per-unit costs, and the removal of the small company premium. We have returned benefits to customers through our WaterShare+ scheme. For example, in 2022, after the acquisition of Bristol Water, through WaterShare+ we returned c.£20m merger benefits to customers - ahead of any regulatory mechanisms – with customers receiving £13 as a reduction on their bill or as a share in the Pennon Group. A similar issuance will be a benefit from the more recent SES Water merger.

In our experience, merger benefits extend beyond direct customer advantages to include equity benefits, such as reducing the financial risk associated with highly geared companies. Customers have benefited significantly from being part of a larger group with sustainable financing – we have successfully addressed the unsustainably-high gearing levels and financial resilience issues in both Bristol Water and SES Water, thereby reducing the financial risks faced by customers. Yet these benefits are not expressly considered by the CMA or Ofwat.

We have also provided access to greater capital and enabled a substantial increase in investment, ensuring improved service quality and infrastructure development. A notable example is Bournemouth Water, where landmark investment to upgrade two water treatment works is currently underway. This involves £200m investment to upgrade the Alderney and Knapp Mill water treatment works with state-of-the-art ceramic membrane technology, which will sustainably produce the highest quality water for now and the future. As a smaller, standalone entity, Bournemouth Water had limited financial resources and borrowing capacity. Given this, and the regulatory regime, these upgrades would not have been affordable without the merger, highlighting the financial benefits of being part of a larger group. Absent the merger, Bournemouth Water would have faced difficulties in securing the necessary funding and managing the financial risks associated with such a large-scale project.

Additionally, mergers facilitate the sharing of best practices across the group, leading to improved operational standards and innovation. This collaborative approach ensures that all parts of the group benefit from the collective expertise and experience, driving continuous improvement and efficiency.

Furthermore, our WaterShare+ scheme has provided a strong customer voice in our operations. By involving customers directly, we ensure that their interests are at the forefront of our decision-making processes. This engagement has fostered greater transparency and is key to rebuilding trust between the company and its customers.

These benefits highlight how mergers—and thus customers—have benefited from being part of the larger Pennon Group. The combination of improved access to capital, economies of scale, risk diversification, enhanced investment capacity, loss of the small company premium, lower gearing, operational efficiencies, sharing of best practices, and a strong customer voice has positioned the newly acquired companies as more robust and resilient. We would welcome a greater recognition of all of these benefits in the methodology.

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<sup>1</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2015/11/rpt\\_com20151021mergers.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2015/11/rpt_com20151021mergers.pdf)

### Theme 3 – running an efficient process

While the CMA decides the merits of each merger and whether mergers between water companies should proceed, Ofwat provides an opinion on whether a merger is likely to prejudice its ability to make comparisons, and to what extent relevant customer benefits outweigh any identified prejudice. An important part of the process is therefore how Ofwat proposes to conduct its assessments in the future, as it looks to assess any potential prejudice and customer benefits, and any relevant Undertakings in Lieu (UILs).

Overall, we are supportive of the CMA's objective in updating its approach, codifying practical experience of water mergers since 2015, and streamlining the current guidance, especially as the sector looks to navigate the future challenges the sector may face. We welcome the steps to a fast-track process, having seen the benefit of that in the recent SES Water merger. And we continue to advocate for a flexible approach whereby mergers that are demonstrably beneficial to customers and the sector are allowed to proceed, whilst maintaining the ability for regulation to be effective.

We believe that a more flexible approach to future mergers will greatly benefit the water sector. It is important to recognise that the traditional focus on vertically integrated companies may not always be the most effective strategy. Instead, there should be an openness to merging different parts of the value chain. This flexibility would support innovation and allow companies to optimise their operations in ways that best serve their strategic goals and their customers.

For example, allowing mergers between companies that operate in different segments of the water supply chain could lead to more specialised and efficient operations. This could include mergers between companies focused on water resources, water distribution, or wastewater management at the catchment level. By enabling such mergers, the sector can benefit from the combined expertise and resources of these companies, leading to improved service quality and operational efficiency.

Furthermore, a flexible approach would encourage companies to explore new and innovative solutions to the challenges facing the water sector. This could include the adoption of advanced technologies, the development of new business models, and the implementation of sustainable practices. By fostering an environment that supports innovation, the regulatory framework can help drive continuous improvement and ensure that the sector remains resilient and adaptable to future challenges.

In conclusion, we advocate for a regulatory approach that allows for flexibility in the types of mergers that are permitted. This will enable the water sector to fully realise the potential benefits of mergers, including enhanced financial resilience, improved operational efficiency, and greater innovation. We believe that such an approach will ultimately lead to better outcomes for customers and the sector.

I hope this response is helpful in shaping the revised CMA Mergers Remedy Guidance, and we would be very happy to discuss any points raised in this response in more detail.

Yours faithfully

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