

Anticipated non-household retail water and sewerage services joint venture between Severn Trent Plc and United Utilities Group Plc

Decision on relevant merger situation and substantial lessening of competition

ME/6575/15

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 3 May 2016. Full text of the decision published on 27 May 2016.

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.

SUMMARY

1. Severn Trent Plc (**ST**) and United Utilities Group Plc (**UU**) have agreed to form a new 50/50 joint venture company through which they will combine their respective non-household (**NHH**) retail water and sewerage businesses (the **Merger**). ST and UU are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that enterprises will cease to be distinct as a result of the Merger, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties have explained that the Merger is being entered into in preparation for the opening of the English NHH retail water and sewerage sector to full competition from April 2017.¹ Therefore, currently, the Parties are both active in supplying a range of NHH customers within their regulated regional monopolies but do not, with very limited exception in relation to

¹ These reforms do not extend to Wales.

certain customers, compete to supply retail water and sewerage services to NHH customers.

4. The Scottish NHH retail sector has been open to full competition since 2008. Therefore, the Parties currently compete in the supply of retail water and sewerage services to NHH customers in Scotland.
5. Given upcoming reform, the CMA has assessed the effects of the Merger in England relative to what may have happened absent the Merger following the opening of the English NHH retail sector. It has assessed the effects of the Merger in Scotland relative to the existing conditions of competition.
6. The Parties overlap in the supply of retail water and sewerage services to a range of non-household (**NHH**) customers (small and medium sized enterprises (**SMEs**), large user customers and multi-site customers) in both England and Scotland. The CMA has therefore assessed the impact of the Merger in the supply of retail water and sewerage services to SMEs, large user customers and multi-site customers separately.
7. The CMA considered a wide range of evidence in assessing the competitive constraint on the Parties post-Merger, including: (i) shares of supply; (ii) the Parties' submissions and internal documents; and (iii) views of third parties, including sectoral regulators Ofwat and the Water Industry Commission Scotland (**WICS**).
8. With regard to England:
 - (a) The CMA considered current shares of supply to be of limited relevance as ahead of reform in April 2017 they are not reflective of competition for the supply of retail water and sewerage services.
 - (b) The evidence from third parties and internal documents indicated that the Parties have the potential to be close competitors, but not uniquely close.
 - (c) A significant number of other suppliers indicated that they would be active in targeting all types of NHH customers after reform in April 2017 in England.
 - (d) The majority of third parties, including Ofwat, were not concerned by the Merger.
9. With regard to Scotland, the Parties have a combined market share of around 9-10%, with one large competitor and many other smaller competitors remaining after the Merger. Third parties and the Parties' internal documents identified a number of effective alternative suppliers.

10. The CMA believes that these constraints, taken together, are sufficient to ensure that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects.
11. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Background

Water and sewerage sector in England and Wales

12. Water and sewerage services in England and Wales are generally supplied by vertically integrated regional monopoly operators, which are responsible for wholesale and retail supply of water and/or sewerage services to household (**HH**) and NHH customers in their respective regions (**Supply Areas**). In this context:
 - (a) Wholesale services, comprise water abstraction, treatment and delivery and wastewater collection, treatment and disposal.
 - (b) Retail services comprise meter reading, billing and collecting payment from customers.
 - (c) NHH customers include businesses, charities and public sector organisations.
13. The conduct of these regional operators in their respective Supply Areas is regulated by Ofwat (the economic regulator for the water sector in England and Wales) via licences. In particular, these licences limit the prices that regional operators can charge different customer groups. Ofwat periodically reviews where the limits should be set using a process of 'comparative competition', which broadly disallows any costs companies incur inefficiently, relative to other operators.
14. At present the following groups of suppliers operate in England and Wales under this regime:
 - (a) Ten companies holding Instruments of Appointment (**Licences**) as regional monopoly water and sewerage companies (**WASCs**) under the Water Industry Act 1991 (**WIA91**).

- (b) Nine companies holding Licences to provide water only services (**WoCs**) pursuant to WIA91. All of their customers receive sewerage services from one of the WASCs.
- (c) Six companies that applied for and received new 'inset' appointments to serve defined areas within a WASC or WoC area (entailing a variation to the appointment(s) of the relevant WASC or WoC).
15. Competition between water and sewerage suppliers in England and Wales is therefore limited.
16. Currently only NHH customers using at least 5 mega-litres² (**ML**) per annum in England or 50ML per annum in Wales can choose their retail water services provider. These customers can choose between 12 different suppliers operating under a water supply licence (**WSLs**) pursuant to section 17A WIA91 (**WSL Licence**).³ 10 of these WSLs are in the same corporate group as a WASCs. However, until April 2016 they were unable to compete for customers located in the area of the WASC with which they were associated. The Parties explained that only a small proportion of eligible customers (less than 1%) have switched to WSLs prior to April 2016.
17. The Water Act 2014 (**WA14**) created a framework to extend retail water and sewerage competition to all NHH customers in England⁴ from April 2017 (**Market Opening**).
18. The paragraphs that follow provide some further background on: (i) the reform introduced by the WA14; and (ii) pricing and tariffs for NHH retail customers.
19. Please see the map in Annex 1, which shows the supply areas in the UK, including the Parties areas.

Reform in England

20. As part of Market Opening, Defra and Ofwat are introducing the following key reforms:
- (a) From April 2017, abolishing the 5 ML limit in England so that all NHH customers can switch supplier;

² A mega-litre is equal to 1 million litres.

³ The WSL Licence allows WSLs to use the supply system of a WASC or a WoC to supply retail water (but not sewerage) services to customers in the Supply Area of a WASC or WoC.

⁴ The changes will apply to customers served by licenced operators that operate in England. This means that a small number of customers based in England but served by operators mainly based in Wales, such as Dwr Cymru, will not be eligible to change supplier from April 2017 unless their usage levels exceed 50ML a year.

(b) Enable WASCs to transfer their NHH customers to third parties (known as **Retail Exit**). WASCs can apply for permission to do this from 3 October 2016.

21. Broadly, the market is being designed and developed via the Open Water programme by Defra, Ofwat and Market Operator Systems Limited, a private company owned by market participants.
22. The Open Water programme is co-ordinating the development of the framework, systems and key documents (codes, processes and agreements) that are necessary for an effective market. As part of this process, a market operator will be established to administer these codes, processes and agreements.

Default tariffs – pricing for NHH retail customers

23. As noted above, there are currently restrictions on the prices charged by suppliers in their Supply Areas.
24. The NHH retail price controls are called default tariff caps. These operate by limiting the average revenue that can be recovered by suppliers for specific customer types.⁵ Each supplier then publishes annually a 'scheme of charges' which set out default tariffs that will allow it to recover this revenue from each customer type without exceeding the average revenue per customer group allowance in the price control.
25. After Market Opening, in order to protect customers, default tariffs will continue to restrain the prices offered to customers who do not switch. Customers will be free to accept prices above this if they wish (eg for value added services).
26. Ofwat is currently consulting on the price review for 2017-2020. It is due to reach a final decision by 16 December 2016.

Water and sewerage sector in Scotland

27. Prior to 2008, the structure of water and sewerage services in Scotland was broadly similar to the current system in England and Wales, with little or no competition for customers.

⁵ This is based on: (i) the average cost per customer varying according to a regional allocation of cost; (ii) net margin limits, which were set at 2.5% in the 2015-2020 price review; (iii) wholesale revenues; and (iv) customer numbers.

28. However, in 2008 the NHH retail sector in Scotland was liberalised and opened to competition following the enactment of the Water Services etc. (Scotland) Act 2005.
29. Scottish Water remains the monopoly provider of wholesale water and sewerage services in Scotland. However, entrants are able to apply for a water services licence, sewerage services licence, or both under section 6 of the Water Service etc. (Scotland) Act 2005 to enable them to supply retail services to NHH customers.
30. There are now 22 retail suppliers operating in Scotland and all have a licence to provide both water and sewerage retail services. Nine of these companies are in the same corporate group as English WASCs, including the Parties' WASCs.

Parties

31. ST is a FTSE 100 company listed on the London Stock Exchange and holding company for:
 - (a) Severn Trent Water Limited (**ST WASC**), one of the 10 English/Welsh WASCs.
 - (b) Severn Trent Select Limited (**ST WSL**), a WSL operating in England and Scotland.
32. The turnover attributable to NHH retail activities of ST in the financial year ending 31 March 2015 was [X] million in the UK.
33. UU is a FTSE 100 company listed on the London Stock Exchange and holding company for:
 - (a) United Utilities Water Limited (**UU WASC**), one of the 10 English/Welsh WASCs.
 - (b) United Utilities Water Sales Ltd (**UU WSL**), a WSL operating in England and Scotland.
34. The turnover attributable to NHH retail activities of UU in the financial year ending 31 March 2015 was [X] million in the UK.

Transaction

35. ST and UU propose to form a new 50/50 joint venture company (**JVCO**) through which they will combine their respective NHH retail water and sewerage businesses.

36. The Parties have explained that the transaction will be structured in two steps: an internal restructuring stage and a completion stage. They have also explained that a number of transitional arrangements will be needed until Market Opening.

First stage

37. In the first stage, ST WASC and UU WASC will transfer their NHH retail activities to the respective ST and UU WSLs. The Scottish NHH retail activities of ST and UU will also be transferred to the WSLs.
38. These internal transfers will comprise all the assets currently used to perform the Parties' NHH retail businesses, including:
- (a) Goodwill;
 - (b) Benefit of WASC customer relationships (including the right to receive revenue);
 - (c) Benefit of all other contracts until assignment/novation is possible;
 - (d) IP rights and IT systems – including UU's Mecoms CRM system; and
 - (e) Relevant staff under TUPE.

Second stage

39. At the second stage, the JVCO will acquire 100% of the shares of ST WSL and UU WSL in return for the issue of shares in JVCO to ST and UU, such that ST and UU will each hold a 50% interest in JVCO.

Transitional arrangements pending Retail Exit

40. Until Retail Exit, ST and UU WASCs retain statutory and Licence obligations towards NHH retail customers served in their respective Supply Areas. As such, on completion, the customer relationships cannot be transferred to the JVCO (via the WSLs) outright.
41. The Parties have explained that the transfer and the ongoing relationship between JVCO and the WASCs in respect of these NHH retail customers will therefore be governed by a transitional agreement.
42. Under this agreement, ahead of Retail Exit, each of the two WASCs will hold the benefit of their NHH retail customer relationships on simple trust for each

of the relevant WSLs and correspondingly the JVCO. However, the WASC customer relationships will not be transferred outright until Retail Exit.

43. The JVCO will supply NHH retail services to the ST and UU WASC customers but will be required to carry on this business in a manner compliant with the WASCs' statutory and Licence obligations. In this context, the WASCs will be granted certain monitoring and enforcement rights, including the right to perform the relevant obligations instead of the JVCO to the extent required in order to meet its statutory and Licence obligations (step-in rights).
44. Ofwat has consented to UU WASC granting JVCO a loan required for the Merger to be completed on the basis of these arrangements.⁶

Jurisdiction

45. Under the Act the CMA has a general duty to review and obtain information related to mergers. Where the CMA believes that it is or may be the case that a merger qualifies as a relevant merger situation and has resulted, or may be expected to result, in an SLC, it has a duty to refer it for an in-depth phase 2 investigation (**the general merger regime**).
46. Mergers of two or more water enterprises are an exception to this regime. In certain circumstances, the merger of two or more water enterprises is subject to a special merger regime which has been in place since the water industry was privatised in 1989 (**the special water merger regime**) under the WIA91. Under this regime, the CMA's assessment is not focused on determining whether there is a realistic prospect of an SLC but rather on whether a merger between two or more water or sewerage enterprises would prejudice Ofwat's ability to make comparisons for the purpose of carrying out its statutory functions (such as setting price controls on regulated water enterprises and other regulatory functions). This involves a different type of assessment to the one envisaged under the general merger regime.⁷
47. Accordingly, for the purposes of the current assessment, the CMA has had to determine whether: (i) there is a relevant merger situation (as defined by the Act); and (ii) whether that involves two or more water enterprises (as defined by WIA91) such that the Merger should be considered under the special water merger regime rather than the general merger regime.

⁶ See *Statement of Reasons: The granting of consent for United Utilities Water Limited to make loans to an associated company*.

⁷ See the *CMA's guidance on the procedure and assessment of water and sewerage mergers* (CMA49), November 2015.

Relevant merger situation

48. Section 23 of the Act provides that in the case of anticipated transactions a relevant merger situation is created if:
- (a) there are arrangements in progress or in contemplation which, if carried into effect, will lead to enterprises ceasing to be distinct; and
 - (b) either the share of supply test or the turnover test specified in that section of the Act is satisfied.

Enterprises ceasing to be distinct

Enterprises

49. In the context of the transitional arrangements operating until Retail Exit, the CMA considered whether the activities transferred to the JVCO amounted to enterprises rather than just outsourcing arrangements to supply NHH retail services.
50. As noted in the CMA's guidance, outsourcing arrangements involving ongoing supply arrangements will not generally result in enterprises ceasing to be distinct, but may do so where, for example, they involve the permanent (or long-term) transfer of assets, rights and/or employees to the outsourcing service supplier and where those may be used to supply services other than to the original owner/employer. The guidance states that the CMA will assess whether, overall, the assets, rights and employees transferred to the outsourcing service supplier are such as to constitute an enterprise under the principles set out above.⁸
51. On the basis of the evidence available, the CMA believes that the assets, rights and employees which will be transferred to the JVCO by the Parties are such as to constitute enterprises for the following reasons:
- (a) The assets and employees include all the assets and employees required to run the NHH retail businesses (see paragraph 38);
 - (b) The rights of the JVCO with respect to the NHH retail business reflect a level of operational and commercial control (as well as associated risk) beyond that which would be expected under an outsourcing arrangement. In particular:

⁸ See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D, paragraph 4.9.

- (i) The JVCO will have independent responsibility for determining the strategic direction of the business (in relation to commercial strategy, management, marketing arrangements, and branding);⁹
 - (ii) The JVCO will take on both the risks and the rewards of the NHH retail business in that it will be accountable for all the charges levied (including wholesale charges which may not be recouped from customers) and it will retain all the profits, after payment of the wholesale charges;
 - (iii) The JVCO will have as much discretion as to pricing and other dimensions of competition (quality, responsiveness and service levels) as the WASCs do under their Licence and statutory obligations;
 - (iv) The provisions allowing the WASCs to step-in and perform the JVCO's obligations to the extent required to fulfil its Licence and statutory obligations do not amount to the WASCs giving regular directions on the management of the NHH retail businesses.
- (c) All of the relevant assets and rights are being transferred to the JVCO on a permanent basis.

Ceasing to be distinct

- 52. Under s26 of the Act, enterprises will 'cease to be distinct' if they are brought under common ownership or control. S26 of the Act allows for a number of types of control, including the ability materially to influence the policy of a person (material influence).
- 53. As described above, each Party will acquire a 50% interest in the JVCO comprising each of the Parties' NHH retail enterprises, which would indicate that the Parties would acquire common ownership and control over the combined enterprises.
- 54. On the basis of the arrangements described at paragraphs 40 to 44 above, the CMA nonetheless considered whether the transitional arrangements in respect of the WASCs' Licencing and statutory obligations were such as to preclude the Parties' acquiring at least material influence via the JVCO.
- 55. However, further to the above, the CMA believes that the WASC's transitional rights in respect of their Licence and statutory obligations do not preclude the

⁹ As recognised in the joint venture agreement and draft JVCO business plan.

Parties acquiring at least material influence in the NHH retail enterprise being contributed by the other. In this context, the CMA notes in particular that the JVCO will have a significant degree of discretion on the operational and commercial management of the business.

56. Therefore, the CMA believes that the NHH retail enterprises of ST and UU will cease to be distinct from each other and the Parties together will enjoy common ownership and control of the combined enterprise. Each Party will acquire, at least, material influence in the NHH retail business being contributed by the other.

Turnover test

57. The UK turnover of each of the NHH retail businesses contributed to JVCO and ceasing to be distinct exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.

Nature of the enterprises and appropriate merger regime

58. As noted in the CMA's guidance, to establish if the transaction will result or has resulted in a merger of two or more water enterprises the CMA must determine if the merger parties are water enterprises. Both parties (or where the merger is between more than two parties, at least two of those parties) must be water enterprises for the special water merger regime to apply.¹⁰ Section 35(1) of WIA91 explains that a water enterprise is an enterprise carried on by a company appointed under section 6 of WIA91 to be a WASC.
59. On the basis of the evidence set out in paragraph 51(b) above regarding the autonomy of the JVCO's conduct, the CMA believes that the NHH retail enterprises ceasing to be distinct cannot be described as water enterprises. This is also consistent with Ofwat's view of the transaction which notes that: "*The [JVCO] will have its own management and operate independently of the [WASCs] wholesale businesses.*"¹¹
60. The CMA also notes that the Merger is taking place in the context of Market Opening, where the NHH retail activities in question will no longer be the subject of regulation by Ofwat under 'comparative competition' but actual competition. As such, a comparative assessment under the special merger

¹⁰ See the [CMA's guidance on the procedure and assessment of water and sewerage mergers](#), paragraph 2.9 onwards.

¹¹ See [Statement of Reasons: The granting of consent for United Utilities Water Limited to make loans to an associated company](#).

regime would not focus on the key issues at stake, which general merger control rules would be more appropriate to identify.

61. Therefore the CMA believes that the general merger regime applies in this case.

Conclusion on Jurisdiction

62. Accordingly, on the basis of the considerations outlined above, the CMA believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation for consideration under the general merger regime.
63. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 4 March 2016 and the statutory 40 working day deadline for a decision is therefore 3 May 2016.

Counterfactual

64. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.¹²
65. In this case, the CMA has considered the role of two factors in determining the appropriate counterfactual:
- (a) The effects of Market Opening on the nature of competition on the supply of NHH retail water and sewerage services in England.
 - (b) Evidence of prospective mergers taking place between potential NHH water and sewerage retailers (parallel transactions).¹³

¹² [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#)).

¹³ [Merger Assessment Guidelines](#), paragraph 4.3.25.

Market Opening

66. The Parties submitted that the counterfactual should take into account the upcoming regulatory change in the English NHH retail sector as the prevailing conditions of competition will not exist beyond April 2017. The Parties submitted that the CMA should evaluate the Merger with reference to a counterfactual of competition in the supply of NHH retail water and sewerage services across England and Scotland as:
- (a) Prior to April 2017, under the prevailing conditions of competition the Parties are only competing to the limited extent permitted for larger NHH customers in England and Wales;
 - (b) Market Opening is intended to create a single NHH retail market in England and Scotland.

England

67. The CMA agrees with the Parties that the prevailing conditions of competition will not exist beyond April 2017 and believes that the evidence available suggests that there is a realistic prospect of a more competitive counterfactual in relation to NHH retail supply in England at that time. In particular, while, as noted at paragraphs 20 to 26 above, there are still some uncertainties about some aspects of market operation after April 2017, the potential for competition for NHH water and sewerage customers in England will increase significantly at this time.
68. The CMA also notes that the Parties' submissions and internal documents,¹⁴ and submissions from third parties responding to the CMA's investigation, indicate that, absent the Merger, the Parties' WASCs would not have exited from NHH retail supply and would have competed.¹
69. Therefore, the CMA has assessed the effects of the Merger in England against a counterfactual where, in the absence of the Merger, the Parties would have been competing in an 'open' NHH retail sector in England, as is intended post-April 2017.¹⁵ The CMA has considered the impact of changes in market conditions from Market Opening in its competitive assessment.¹⁶ In

¹⁴ For example, ST Board Strategy Day Presentation, 21 November 2014, UU Board Strategy Day Business Retail Paper, 28 October 2014.

¹⁵ In this context, the CMA notes that under the WSL regime described at paragraphs 16, the Parties are already able to compete with respect to certain larger customers in England. However, given that competition between the Parties on this basis to date appears to have been relatively limited (UU currently has no WSL customers and no third party raised any concerns about current competition between the Parties in England) and that Market Opening would have increased the scope for competition between the Parties absent the Merger, the CMA has not found it necessary to assess the limited existing competition between the Parties in England separately.

¹⁶ [Merger Assessment Guidelines](#), paragraph 4.3.2.

particular, the CMA has considered the extent to which the Parties would have been close competitors absent the Merger and the extent to which other NHH retail suppliers will remain or emerge in the context of Market Opening.

Scotland

70. The CMA notes that one of the intentions of reform in England is to create a combined English and Scottish NHH retail market.
71. However, the CMA has found no evidence to suggest that there is a realistic prospect of a more competitive counterfactual in Scotland than the prevailing conditions of competition. The CMA notes that both the Parties already compete actively in Scotland.
72. Therefore, the CMA has, in accordance with its general approach, assessed the impact of the Merger in Scotland against the prevailing conditions of competition.

Parallel transactions

73. The CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (ie a parallel transaction¹⁷). To the extent that these parallel transactions are not too speculative, the CMA will typically consider whether the statutory test would be met if the parallel transaction were to proceed and also consider whether the statutory test would be met if the parallel transaction were not to proceed.¹⁸
74. In parallel to this Merger, the CMA has reason to believe that, as of 1 April 2017, Castle Water, a Scottish retailer, will be responsible for supplying NHH retail services to the customers of Portsmouth Water (an English WoC);¹⁹ and the CMA has also received confidential information regarding preliminary discussions involving another transaction.
75. Given these transactions, the CMA assessed the Merger against both a counterfactual where these parallel transactions did not go ahead and against a counterfactual where they did proceed.

¹⁷ See the [Merger Assessment Guidelines](#) at footnote 46, which explains that a parallel transaction is considered as part of the counterfactual on the basis that it would occur whether or not the merger takes place. In this context, a parallel transaction is one which is either anticipated or which has been completed but remains subject to the possibility of being unwound as a result of intervention by the CMA under the Act.

¹⁸ See the [Merger Assessment Guidelines](#) at paragraphs 4.3.25 *et seq.*

¹⁹ [Portsmouth water press release](#).

76. As set out below, the CMA believes that there is no realistic prospect of an SLC under either alternative.

Frame of reference

77. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.²⁰
78. The Parties overlap in the supply of water and sewerage retail services to a range of NHH customers in England and Scotland.
79. The Parties submitted that the relevant market is the provision of water and sewerage retail services to all NHH customers in England and Scotland.
80. As part of its assessment of the relevant frame of reference and its assessment of the Merger more generally, the CMA sought and considered views from the Parties and a large number of third parties, including: (i) the Parties' customers; (ii) potential competitors, including current English WASCs and WOCs and retailers active in Scotland; (iii) intermediaries active in the sector; (iv) OFWAT; and (v) WICS.
81. Further to the counterfactual discussion above, the CMA believes that the frame of reference in England should be considered in the context of the scope of competition envisaged after Market Opening in April 2017, whereas the frame of reference in Scotland should be considered in the context of existing competition.
82. Due to the prospective nature of the assessment in England, the CMA has considered it appropriate to place more weight on the responses from informed authorities, such as Ofwat and WICS, and from suppliers and NHH customers with experience of the Scottish sector, than on the responses from English NHH customers. This is because most customers operating only in England do not yet have any experience of water and sewerage choice.
83. The CMA also notes that, because this assessment is taking place at a relatively early stage in the development of the NHH retail water and

²⁰ [Merger Assessment Guidelines](#), paragraph 5.2.2.

sewerage sector, while it has reached its conclusions on the appropriate frame of reference on the basis of the evidence available at this time, future reviews may give rise to different or new considerations.

Product scope

84. Based on the Parties' submissions and evidence received in the course of its investigation, the CMA considered two main issues in assessing the appropriate product frame of reference:
- (a) Whether water and sewerage services should be considered together or separately; and
 - (b) Whether supply of NHH retail water and sewerage services should be segmented according to different customer types.

Water and sewerage retail services

85. The Parties submitted that retail water and sewerage services should be considered together as:
- (a) Almost all customers in England will, post-Market Opening, want to purchase their water and sewerage services from the same supplier and the same retail assets are used to supply both;
 - (b) Evidence from NHH retail sector reform in Scotland provides strong evidence that water and sewerage retail services should be considered together. In particular, no company in Scotland is currently offering only one of the services; and
 - (c) While the current English water and sewerage sector comprises a number of WOCs which only offer water services, many of these WOCs have agreements in place with the relevant sewerage services provider to bill their customers for sewerage, which highlights the attractiveness to customers of offering the services together.
86. The evidence received from third parties confirmed that the appropriate frame of reference should include the supply of both water and sewerage retail services. In particular:
- (a) Third parties indicated that the vast majority of customers would wish to purchase their water and sewerage services from the same retailer;

- (b) Most suppliers said either that they already supplied both services or that they planned to do so, with many indicating that it would be a severe disadvantage not to do so;
- (c) A limited number of water and sewerage suppliers noted that there could be an element of specialisation for some sewerage users who required significant services relating to trade effluent and that some retailers could specialise to supply this. However, these respondents also highlighted that retailers would be able to supply retail services to both water and sewerage services and that it is likely that even customers with specific requirements would wish to purchase them together;
- (d) No third party raised concerns about the Merger specifically with reference to only one of either water or sewerage retail services; and
- (e) Experience from Scotland suggests that customers have been purchasing the services together and that retailers are offering both.

87. Therefore, on the basis of the evidence set out above, the CMA has assessed the effects of the Merger on the supply of retail water and sewerage services.

Customer segmentation

88. The CMA may sometimes define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers, and require a separate analysis. This may happen when, for example, suppliers can target higher prices at customers willing to pay more, or when competition for customers differs significantly between different customer groups. In some cases the prices customers pay will vary because they are buying different products.
89. In determining whether there are separate customer groups, the key question is whether some customers could get better terms for the same requirements.
90. In assessing the breadth of relevant markets defined by customer groups, the CMA may consider a range of factors, including whether customers have different preferences or have access to different sets of suppliers.²¹
91. NHH users of water and sewerage services range from small retail outlets using relatively small amounts of water to much larger users sometimes operating at a number of sites. The CMA therefore considered whether it

²¹ [Merger Assessment Guidelines](#), paragraphs 5.2.28 – 5.2.30.

would be appropriate to segment the assessment of these customers according to their type.

92. The CMA considered evidence: (i) from the Parties; (ii) from third parties; and (iii) relating to the NHH retail sector in Scotland.

Parties' submissions

93. The Parties submitted that it would not be necessary to distinguish between different customer types for the purposes of the CMA's assessment as, while there may be some differences between customers in the current market, these differences were not sufficient to merit further segmentation. In particular, the Parties noted that:
- (a) Evidence from customer research conducted by the Parties suggests that SMEs and larger users would both have similar levels of switching once customers were able to choose supplier, and that all retailers would be able to supply both groups;²²
 - (b) Evidence from NHH retail competition in Scotland indicates that all retailers are offering services to all customers; and
 - (c) There is no material difference in the supply needed for larger users and SMEs, other than that larger users may be more likely to require a dedicated account manager.
94. Nonetheless, the Parties recognised that, based on their observations of their current customers, requirements among NHH water and sewerage customers, may differ:
- (a) Between larger users (either on the basis of volume or number of sites) and smaller users such as SMEs; and
 - (b) Within larger users, between customers with a significant number of sites (multi-site customers) and customers with fewer sites (large users).
95. In this context, the Parties acknowledged that different strategies might be needed to win different types of customers:
- (a) Larger customers may place a higher value on value added services, such as leak detection, and be more likely to tender for providers;

²² ST, JN2923 NHH Awareness Research, October 2015.

- (b) Smaller customers may place a higher value on price and clear and simple billing. Customer research evidence also suggested that smaller customers may require higher discounts to switch.²³
96. Therefore, to the extent that customers could be segmented, the Parties proposed that customers could be classified into three broad categories based on usage, comprising:
- (a) SMEs;
 - (b) Large users;
 - (c) Multi-site customers.²⁴
97. Internal documents from the Parties show that they have consistently used these groupings when conducting research and in developing strategies. [✂]
98. Overall, the evidence submitted by the Parties indicated that some segmentation along the broad SME, large user and multi-site categories may be appropriate.

Third party views

99. Third party responses also suggested that there would be some differences between different categories of NHH water and sewerage customer in their requirements from retail providers. Third parties said that these differences in requirements might lead to differences in how competition works for these different categories. Third parties broadly supported the customer groupings proposed by the Parties. In particular, third parties said that:
- (a) SMEs may be less likely to switch than larger users and would require higher discounts to be induced to switch;
 - (b) SMEs may also be less interested in value-added services, with customers more likely to switch on price. In this context, third parties highlighted the examples in Scotland where suppliers had focussed on winning smaller customers with a simple offering and low prices;

²³ ST, JN2923 NHH Awareness Research, October 2015

²⁴ There is no definition of 'SME', 'large' user, or 'multi-site' customer in relation to the GB water sector. Therefore, [✂] the Parties have defined: (i) an 'SME' as a customer with water usage of less than 5ML per annum and fewer than 25 sites; (ii) a 'large' user as a customer with water usage of at least 5ML per annum and fewer than 25 sites, and (iii) a 'multi-site' customer as a customer with 25 or more sites.

- (c) Larger customers may generally be more interested in switching for lower percentage discounts than smaller customers, given their higher absolute spend, and would be more likely to use tender processes;
- (d) Multi-site customers also usually face a higher absolute spend than SMEs and are likely to wish to consolidate to fewer suppliers; and
- (e) Some third parties noted that some suppliers in Scotland, including the Parties, had focused their activities on different customer groups.

Evidence from Scotland

100. Evidence from Scotland is also supportive of customer segmentation. In particular:
- (a) Shares of supply for Scotland by each of the customer groups identified at paragraph 96 below show that there are significant differences between suppliers across customer groups, with some retailers clearly targeting some groups of customers more than others. For example, Clear Business Water has a much higher share in the SME segment than in the other customer categories.
 - (b) The margins earned by the Parties differ across different customer groups in Scotland, [REDACTED]

Conclusions on customer segmentation

101. On the basis of the evidence set out above, the CMA believes that it is appropriate to segment the frame of reference by customer type.
102. The CMA notes that the evidence suggests that there is a high degree of differentiation between different types of water and sewerage customer, which makes it difficult to define precisely categories which describe all of the ways in which customers differ.
103. However, for the purposes of this assessment, the CMA believes it is appropriate to assess the impact of the Merger in the supply of retail water and sewerage services to each of the SME, large user and multi-site customer segments defined above (see footnote 24). These categories are supported by the Parties, most third parties and evidence from Scotland. The CMA has, nonetheless, considered evidence of the impact of the Merger on any narrower customer segments in its competitive assessment.

Conclusion on product scope

104. For the reasons set out above, the CMA has considered the impact of the Merger in the following product frames of reference:
- (a) The supply of retail water and sewerage services to SME customers;
 - (b) The supply of retail water and sewerage services to large user customers;
 - (c) The supply of retail water and sewerage services to multi-site customers.

Geographic scope

105. Further to the counterfactual considerations above, the CMA has assessed the appropriate geographic scope of the frame of reference for:
- (a) England after Market Opening in April 2017;
 - (b) Scotland currently.

England post-Market Opening

106. Based on the Parties' submissions and the evidence received from third parties in the course of its investigation, the CMA considered two main issues in assessing the appropriate geographic scope for England post-Market Opening:
- (a) Whether it is appropriate to consider competition regionally or across the whole of England; and
 - (b) Whether it is appropriate to consider competition across both England and Scotland together.
107. As noted above, the CMA considers that NHH customers can be segmented into three groups: SMEs, large users and multi-site. Since the majority of evidence on geographic scope is relevant to all three, the evidence is presented together.

Regional or England

Parties' views

108. The Parties submitted that the geographic scope for the CMA's assessment should be national, encompassing England and Scotland together.

109. The Parties explained that, although some aspects of retail services such as meter reading activities and sales may require a local presence, this does not impact on the question of geographic scope as such activities can be easily outsourced to local agents.

Third party views

110. Third parties generally supported a national geographic scope, encompassing both England and Scotland. More specifically:

(a) Ofwat submitted that retail services such as billing and debt management can be provided on a national basis, and that this had been demonstrated in other sectors, such as energy.

(b) Customers across all categories demonstrated a willingness to be served by a supplier in a different part of the UK, even if they thought that some of their requirements may require a local presence. In particular, for certain customer types, such as multi-site customers, the option of having a single national supplier was a clear advantage arising from sectoral reform.

111. However, some suppliers noted that supply in England post-April 2017 may display some regional features as a result of two supply-side factors:

(a) The cost to serve for suppliers varying by geographic area; and

(b) Differences in the net margins available across incumbent regional areas.

112. The CMA considered each of these specific issues.

- *Geographic variation in cost to serve*

113. Some third parties noted that the cost to serve for suppliers may vary by geographic area, due to differences in the cost of meter reading as a result of the economies of density²⁵ in providing these services or the need to have account managers near to customers.

114. However, the evidence from the majority of third parties indicates that there are unlikely to be significant differences in the cost to serve across regions, or between customer groups, such that the geographic scope should be regional. In particular:

²⁵ Economies of density state that the cost of serving a group of customers would be lower the closer those customers are to each other.

- (a) Most suppliers submitted that retail water and sewerage services is, in effect, a national activity. Suppliers noted that Scotland operates as one market, with only some remote geographic areas being slightly more costly to serve for suppliers;
- (b) Meter readers confirmed that they would be able to provide outsourced services to suppliers not already active in a certain region;
- (c) Meter readers said that there may be some geographic variation in cost based on a particular meter reader's presence in an area (economies of density), however, in general, they did not indicate that this would present a material enough difference to affect competition between water and sewerage service suppliers on a geographic basis;²⁶
- (d) Ofwat also confirmed the availability of outsourced options for meter reading and said that new entrants would be able to access services from competitive providers as well from the incumbent retailer.
- (e) A number of suppliers confirmed that they were in discussions regarding metering provision in areas in which they were not currently active.²⁷

- *Regulatory issues and net margins*

115. As explained in paragraphs 23 to 26 above, the default tariffs which will apply to English NHH customers in a particular water and sewerage supply area will take non-household retail costs and a net margin and add these to the wholesale costs. Some suppliers submitted that, in a number of areas, the retail costs are not correctly specified. They noted that the effect of this might be that the actual profit that can be achieved in an area will vary, with some regions being unattractive for new 'non-incumbent' suppliers.
116. In response to these concerns, Ofwat told the CMA that it considered the cost allocation methodologies and net margins to be conducive to national competition. In particular, it pointed the CMA to a 2013 report by Ernst and Young²⁸ which, on the whole, supported the cost allocations in the sector as

²⁶ Some competitors suggested that meter reading costs would be more significant for SME customers as the reading itself was a fixed cost and therefore would be a higher proportion of the overall bill for smaller customers. However, it was suggested by other competitors that larger customers would have their meters read more regularly and that meter reading would therefore be a more important issue for those customers.

²⁷ Suppliers also noted that in some instances customers may be able to read their own meters and automatic meter reading was becoming more prevalent.

²⁸ [Targeted Review of Accounting Separation Cost Allocations](#), Report of findings, Ernst & Young, 28 May 2013.

broadly appropriate. Further, in a recent consultation response, Ofwat reaffirmed its view that the cost allocations were broadly appropriate.²⁹

117. The CMA notes that it is difficult to determine how competition will develop after Market Opening in England. However, the CMA notes that, for the purposes of its assessment of the impact of the Merger, including for determining the appropriate geographic frame of reference, the CMA is not attempting to assess how effective Market Opening may be at stimulating competition generally. Rather, the CMA has considered the implications of Market Opening to the extent they are relevant to determining the competitive constraints which may be faced by the Parties and whether these are sufficient to prevent a realistic prospect of an SLC arising from the Merger.

Conclusion on regional or England

118. On the basis of the evidence set out above, and in particular the submissions provided by Ofwat, the CMA believes that the Merger should be assessed against a geographic frame of reference comprising the whole of England. Nonetheless, the CMA has considered any scope for regional variation in competition in its competitive assessment.

England and Scotland

119. As noted above, the Parties submitted that the geographic scope for the CMA's assessment of the Merger in the context of Market Opening should encompass both England and Scotland together. The Parties submitted that:
- (a) Post-April 2017, the NHH retail sector in both England and Scotland will be open to competition and retailers based in Scotland will impose a competitive constraint on retailers based in England, and vice versa.
 - (b) There is already some evidence that retail suppliers have started to operate in a common English-Scottish market:
 - (i) Nine English water companies have entered the Scottish NHH retail market;
 - (ii) Scottish Water's affiliate, Business Stream, has already entered the water NHH retail market in England and has stated publicly that it has plans to expand its presence after full market opening in 2017; and

²⁹ [Draft statement of method and data table requirements - Review of non-household retail price controls](#), Ofwat, March 2016.

- (iii) Independent new entrants in Scotland, such as Castle Water, have publicly stated that they will enter the market in England and are committing expenditure to do so. Indeed, Castle Water has recently assumed responsibility for Portsmouth Water's NHH retail customers.
 - (c) Market reforms will enable cross-border arrangements with Scotland. This means there will be a streamlined application process for potential water and sewerage service suppliers wishing to enter the market, and will ultimately mean that customers operating across England and Scotland will experience a seamless market.
120. A number of third parties, including Ofwat, agreed with this position. In particular, Ofwat noted:
- (a) Evidence of Scottish retailers which were preparing or which had already entered supply in England;
 - (b) While there were legal and regulatory differences between England and Scotland, the Open Water programme was seeking to align these where possible to promote inter-operability across jurisdictions.

Conclusion on England and Scotland

121. The CMA notes that it is difficult to predict the extent to which the English and Scottish NHH retail sectors will integrate after Market Opening but that, at least initially, some significant differences will exist in the nature of competition due to regulatory differences.
122. Therefore, the CMA believes that, on a cautious basis, it is appropriate to assess the impact of the Merger on the supply of NHH retail water and sewerage services in England only, recognising that some water and sewerage retailers currently active in Scotland may impose some competitive constraint on the Parties in England. However, given that the CMA has found no concerns on this basis it has not been necessary for the CMA to conclude on this aspect of the geographic frame of reference.

Scotland

123. Evidence from third parties was consistent in indicating that the appropriate geographic frame of reference for Scotland under the prevailing conditions of competition should comprise the whole of Scotland. In particular, all retailers were able to offer services to all customers across Scotland, although the costs to serve more remote customers were higher.

Conclusion on frame of reference

124. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:
- (a) The supply of retail water and sewerage services to SME customers in England;
 - (b) The supply of retail water and sewerage services to large user customers in England;
 - (c) The supply of retail water and sewerage services to multi-site customers in England;
 - (d) The supply of retail water and sewerage services to SME customers in Scotland;
 - (e) The supply of retail water and sewerage services to large user customers in Scotland;
 - (f) The supply of retail water and sewerage services to multi-site customers in Scotland.

Competitive assessment

Horizontal unilateral effects

125. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.³⁰ Horizontal unilateral effects are more likely when the merger parties are close competitors.
126. The CMA has assessed whether the Merger may be expected to result in an SLC in relation to unilateral horizontal effects in the:
- (a) supply of retail water and sewerage services to SME, large-user and multi-site customers in England after Market Opening in April 2017;

³⁰ [Merger Assessment Guidelines](#), from paragraph 5.4.1.

(b) supply of retail water and sewerage services to SME, large-user and multi-site customers in Scotland under prevailing conditions of competition.³¹

127. The Parties submitted that there was no realistic prospect of an SLC as a result of the Merger as:

(a) The Parties' shares of supply are not above 40%, even on a very conservative view whereby the frame of reference is limited to England and it is assumed that there is no reduction in the Parties' shares as a result of Market Opening.

(b) The Merger would only reduce the number of potential competitors from nine to eight, even considering only English WASCs as potential competing suppliers.

(c) Competition for NHH retail water and sewerage services after Market Opening will be strong and will comprise all English and Scottish suppliers.

128. The CMA considered these submissions alongside the evidence provided by the Parties in their internal documents and a range of third party views.

Supply of NHH retail services in England

Shares of supply

129. The Parties submitted evidence on their current shares of supply based on publicly available data across all customer segments and for water and sewerage retail services separately. Table 1 shows the shares of supply by revenue.³²

³¹ For ease of reference, the CMA has referred to the **supply of NHH retail services** as opposed to the supply of retail water and sewerage services to SME, large-user and multi-site customers below.

³² The Parties submitted that, whilst shares of supply could feasibly be measured on a number of bases for NHH customers, the number of customers would be the most appropriate metric. This is because revenue figures have the potential to be distorted by wholesale costs, which will vary by region and which make up a substantial part of the revenue collected by firms. With regard to margins, the Parties argued that the nature of the allowed net margin for retail companies, namely that it allows a set margin as a proportion of wholesale costs, will vary across companies based purely on wholesale costs. The CMA notes the Parties arguments regarding the potential for wholesale costs to distort market size, although notes that customer numbers will not capture the size of customers and could therefore also distort shares of supply. The CMA notes that the shares of the Parties are higher on a revenue basis and therefore used these as a starting point on a cautious basis.

Table 1 - Shares of supply for England by revenue for different customer segments³³

	SME	Large	Multi-site
Severn Trent	[10-20]%	[10-20]%	[10-20]%
United Utilities	[10-20]%	[10-20]%	[10-20]%
Combined	[30-40]%	[30-40]%	[30-40]%
Thames Water	[10-20]%	[10-20]%	[10-20]%
Yorkshire Water	[5-10]%	[5-10]%	[5-10]%
Anglian Water	[5-10]%	[5-10]%	[5-10]%
Southern Water	[5-10]%	[5-10]%	[5-10]%
Northumbrian Water	[5-10]%	[5-10]%	[5-10]%
South West (incl. Bournemouth)	[5-10]%	[5-10]%	[5-10]%
Wessex Water	[5-10]%	[5-10]%	[5-10]%
Affinity Water	[5-10]%	[5-10]%	[5-10]%
South East Water	[5-10]%	[5-10]%	[5-10]%
South Staffs Water	[5-10]%	[5-10]%	[5-10]%
Bristol Water	[5-10]%	[5-10]%	[5-10]%
Portsmouth Water	[5-10]%	[5-10]%	[5-10]%
Sutton & East Surrey Water	[5-10]%	[5-10]%	[5-10]%
Total	100%	100%	100%

Source: the Parties.

*may not sum to 100% due to rounding errors.

130. Assuming there are no significant changes prior to April 2017, the shares of supply indicate that, on both a revenue and customer number basis, the Parties would have started off post-Market Opening as two of the largest suppliers of water and sewerage retail services to NHH customers in England. The merged entity would have a share of supply larger than any of the other suppliers. However, even on the basis of the higher revenue-based shares of supply, the merged entity would have a share of supply of only around 35%, a level which would not generally raise competition concerns in a Merger.
131. However, in this case, the CMA believes that shares of supply for England are not particularly reflective of the competitive constraints that will be faced by the Parties post-Merger and has placed limited weight on them for the purposes of its assessment. This is because, as submitted by the Parties, current shares are not the result of customer preferences or the competitive strength of suppliers, but merely reflect the historic regional boundaries of the

³³ The Parties' shares of supply on the basis of customer numbers are significantly lower than those on a revenue basis, with a joint share of supply of 27% of water customers and 32% of sewerage customers. The difference could reflect the wholesale charges in the Parties' Supply Areas being larger, or the fact that the Parties' NHH customers tend to be larger customers and therefore spend more on water and sewerage services.

Supply Areas and the number and nature of the customers who happen to be located within those boundaries.

132. The Parties submitted that shares of supply therefore present a ‘worst case’ scenario absent new entry and other shifts. However, the CMA notes that the fact that shares are not reflective of competition could work in either direction. On the one hand, as the Parties submitted, the shares of supply could overstate the competitive strength of the Parties post-Merger and post-Market Opening if new suppliers were to enter. On the other hand, if the shares of supply figures include water companies with retail divisions which will not actively compete for new customers after April 2017 then the current shares of supply might overstate the constraints that such companies would play and so understate the competitive effect of the Merger.
133. The CMA has therefore considered other evidence on the competitive conditions the Parties may face after Market Opening.

Closeness of competition

134. The CMA considered whether the Parties may have been particularly close competitors after Market Opening due to:
- (a) The relative positioning of their retail service offering;³⁴
 - (b) The close geographic proximity of their existing NHH customer bases. In particular, the CMA considered whether, post Market Opening, the Parties may have particularly targeted customers close to their respective Supply Areas, and whether they may have had cost advantages over rivals when targeting customers within a short distance.
135. In reaching its conclusions on closeness of competition, the CMA considered:
- (i) evidence from the Parties’ submissions, including internal documents; and
 - (ii) evidence from third parties.³⁵

³⁴ Third parties indicated that there is some possibility for differentiation on the basis of additional services or billing innovation.

³⁵ In this context, the CMA has not considered evidence from competition between the Parties in Scotland as indicative as the CMA notes that the lack of evidence of closeness of competition between the Parties in Scotland does not imply that the Parties would not have been close competitors absent the Merger in England.

Parties' submissions and internal documents

136. The Parties' internal documents suggest that, before the Merger was agreed, both were planning to compete actively in the English water and sewerage market for all NHH customers.³⁶
137. However, the internal documents made available to the CMA do not show one of the Parties identifying the other as a uniquely strong competitor absent the Merger. In particular:
- (a) While the Parties tend to list each other as potentially strong competitors in the open market, this is alongside a list of at least four, and often more, other competitors identified on the basis of being English WASCs operating in Scotland.³⁷
 - (b) There are no references to specifically targeting the other Party or customers in similar geographic areas.
138. The CMA believes that to the extent that geographic proximity is of relevance, customers currently served by both Parties because they cross the relevant Supply Areas may be more affected as they may have been more likely to have considered the Parties' as alternative suppliers. However, evidence from the Parties indicated that only a small proportion of customers in each of the Parties' Supply Areas are currently supplied by both Parties, with only between 1.5% and 2.4% of ST and UU customers having billing addresses in the other's Supply Area. Therefore, on the basis of this evidence, the CMA believes that the scope for the Parties to compete particularly closely on the basis of geographic proximity appears limited.

Third parties

139. Third party views did not generally indicate that the Parties would have been competing particularly closely absent the Merger. In particular:
- (a) Ofwat told the CMA that it did not consider that there was any reason to believe that the Parties would have competed uniquely closely after Market Opening absent the Merger. Further, it noted that there was unlikely to be any reason for the Parties to enjoy any material cost advantage in each other's Supply Area.

³⁶ For example, ST Board Strategy Day Presentation, 21 November 2014, UU Board Strategy Day Business Retail Paper, 28 October 2014.

³⁷ For example, ST Board Strategy Day Presentation, 21 November 2014, page 2, UU Board Strategy Day Business Retail Paper, 28 October 2014.

- (b) A number of third parties noted that there may be regional elements to demand (see paragraphs 111 to 117). However, as explained above, the majority of respondents considered that suppliers would compete on a national basis and there was limited basis on which the Parties would have competed particularly strongly for customers that were closer to them. Overall, third parties did not suggest that the Parties would have competed particularly closely for customers located geographically close to them.
- (c) Several customers indicated that they would have considered both Parties as a supply option absent the Merger. However, they did not identify any specific features which would have made the offerings of the Parties unique. Overall, customer responses did not suggest that the Parties would be competing uniquely closely.

Conclusion on closeness of competition

140. On the basis of the evidence outlined above, in particular from the Parties' internal documents and third parties, the CMA believes that, while the Parties may be close competitors absent the Merger, they would not have been uniquely close competitors either due to the nature of their offering or their geographic proximity.

Competitive constraints

141. The Parties submitted that there will be a large number of competitors for all types of customer in England post-Merger. These will include the many incumbent WASCs and WOCs, as well as retailers that have been active in Scotland such as Business Stream, Castle Water and Clear Business Water, amongst others.
142. The Parties submitted that competition would be particularly intense for multi-site customers, who would have a strong desire to consolidate their numerous suppliers upon Market Opening.
143. As noted above, the CMA considers that the share of supply data only provides limited information on the competitive dynamics that will be relevant post Market Opening. Therefore, the CMA has sought to assess the competitive constraint the Parties will face by considering:
- (a) Evidence from potential suppliers on their plans for competing in England after Market Opening;

- (b) The views of third parties on the level of competitive constraint the Parties may face;
- (c) The extent to which the development of competitive constraints in Scotland may be replicated in England.

Supplier plans to compete

- 144. A number of potential suppliers, including English WASCs and retailers active in Scotland, told the CMA that there was a significant amount of uncertainty regarding how active they would be after Market Opening. This uncertainty was related to the length of time for the relevant market mechanisms to be established and how the market would develop. In some cases, companies had not reached a final decision on whether and how they would compete in the supply of NHH retail services in England.
- 145. Nonetheless, the CMA received strong confirmation (supported in a number of instances by internal business plans) from at least four suppliers that they intended to compete for new customers of all types across England. Three of these suppliers were incumbent WASCs and the other was a retailer active in Scotland. One of these suppliers specifically noted that it would target customers in the Parties' Supply Areas.
- 146. In addition to these four suppliers, four other suppliers stated strong intentions to grow in the supply of NHH retail services in England, albeit that they were not able to confirm as strongly what this would entail in terms of a specific customer strategy. These suppliers were two WASCs and two retailers currently active in Scotland. The two WASCs noted in particular their intention to compete actively for large and multi-site customers. Both of the two Scottish retailers hold significant positions in Scotland, with one being particularly focused on [redacted] according to it and other third parties.
- 147. In addition to these suppliers with specified plans or intentions, several other suppliers told the CMA that they did not intend to exit after April 2017. These suppliers could not confirm that they would be competing actively for new customers, and some indicated that acquiring new customers would not be a focus for their business, but as these suppliers would at least continue to serve NHH retail water and sewerage customers in their Supply Areas they would provide some additional constraint on the Parties.

Third party views on competitive constraint remaining

- 148. The majority of third parties raised no concerns regarding the Merger. In particular:

(a) Ofwat stated:

There are a relatively large number of potential market entrants and we regard some consolidation as inevitable and in the interests of customers as greater concentration would allow the sector to better exploit economies of scale. We have no evidence that suggests ST and UU will be particularly close competitors, but the transaction would mean the loss of an independent retailer. On a national basis the market shares associated with the proposed concentration are moderate rather than high. We also think that there is some merit in the arguments that market shares based on arrangements ahead of market opening are not representative of market forces and should not necessarily be used as a guide to market power. We have no evidence that the contiguous appointed areas of ST and UU will cause particular issues for competition as we expect the NHH retail market to encompass England and Scotland.

(b) Several customers told the CMA that the Merger would be good for competition as it would allow the Parties to lower costs and compete more aggressively.

149. Where concerns were raised by third parties, a significant proportion did not relate directly to the Merger but to other issues or uncertainties, eg more generally to market reform. Where concerns did relate to the Merger, they generally related to a reduction of competition between two of the larger English suppliers and a deterrence of new entry in the longer term as a result of the Parties being able to outmanoeuvre competitors on price. The concerns were not focussed on any particular customer segment or on water or sewerage separately.
150. Overall, third parties indicated that the Parties would face sufficient competitive constraint post-Merger.

Evidence from Scotland on additional sources of competition in England

151. The CMA notes that competition in the NHH retail sector has increased significantly in Scotland since reform in 2008 and, in particular, that non-incumbent retailers have gained increasing share. When the NHH retail sector was reformed in Scotland, Business Stream, the retail arm of the monopoly wholesaler, was the only supplier and served all NHH retail customers. There are now 22 retail suppliers operating in Scotland, nine of which are within the same corporate group as English WASCs, including the Parties.

152. This would indicate that competition from non-WASCs may also increase in England post Market Opening such that the Parties will face competitive constraints additional to those from current English WASCs.
153. However, a number of third parties highlighted differences between competitive conditions in Scotland and England, suggesting that the development of competition in Scotland may not necessarily be replicated in England. For example, third parties identified different approaches to the allowed retail margin, noting that competition in Scotland started to increase more significantly once higher margins were allowed.
154. Therefore, the CMA believes that the extent to which the experience of reform in Scotland can be used to foresee how competition will develop in England after April 2017, particularly in the short-term (eg the first two years), is unclear.
155. However, the CMA believes that it does not need to reach a firm view on this point as the evidence from other potential suppliers and third parties indicates that the Parties will face sufficient competitive constraint post-Merger.

Conclusion on horizontal unilateral effects in the supply of retail water and sewerage services in England

156. The CMA considers that there is a degree of uncertainty regarding how the supply of retail water and sewerage services may develop in England after Market Opening in April 2017.
157. However, on the basis of the evidence set out above, the CMA believes that:
 - (a) Absent the Merger, the Parties would not have been competing uniquely closely compared with their rivals; and
 - (b) There will be sufficient competition in each of the customer segments. Eight suppliers have indicated their intention to compete for NHH retail customers after Market Opening. In addition, there are many other existing suppliers which have indicated that they will at least continue to serve their existing NHH retail customers, and so exert some additional competitive constraint on the Parties.
 - (c) The CMA also notes the view of Ofwat that a significant amount of competition for NHH retail customers will emerge post Market Opening, and the comments of other third parties which support this view.
158. The CMA believes that, given the number of other suppliers which intend to compete in the supply of NHH retail services in England, the CMA's views on

the level of competition would not change in the context of the parallel transactions discussed in the counterfactual section above.

159. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of retail water and sewerage services to SME, large user and multi-site NHH customers in England after Market Opening.

Supply of NHH retail services in Scotland

Shares of supply

160. The Parties supplied the CMA with estimated shares of supply in Scotland, as shown in Table 2.³⁸

Table 2 - Shares of supply by revenue for Scotland by customer type, January 2016

	All	SME	Multi-site	Large
United Utilities	[5-10]%	[0-5]%	[5-10]%	[5-10]%
Severn Trent	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Combined	[5-10]%	[0-5]%	[10-20]%	[10-20]%
Business Stream	[70-80]%	[70-80]%	[70-80]%	[70-80]%
Clear Water Business	[5-10]%	[10-20]%	[0-5]%	[5-10]%
Aimera	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Castle	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Cobalt	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Anglian	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Thames	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Veolia	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Blue Business Water	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Yorkshire	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Commercial Water Solutions	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Northumbrian	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Everflow	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Source For Business	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Water2Business	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Real	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Total	100.0%	100.0%	100.0%	100.0%

Source: the Parties based on publicly available information.

³⁸ The figures do not include a recent win by Anglian water of a large public tender that was previously operated by Business Stream.

161. The shares of supply suggest that the Parties have an overall combined share of around 10% and that this is focussed on the multi-site and large user customer segments. With regard to multi-site customers, UU has the second largest share and ST has the fourth largest. With regard to large users, UU holds the third largest position and ST the seventh largest. However, in both of these segments there is a long list of suppliers which are active and not substantially smaller than ST.
162. The Parties have a very small combined position in relation to SMEs, with less than 1% share of supply.

Closeness of competition

163. The evidence from the Parties' competitive interaction in Scotland suggests that the Parties are not competing particularly closely in Scotland. Specifically:
- (a) Both of the Parties are relatively small players in Scotland, as evidenced by their shares of supply (see Table 2). This suggest that they are not competing particularly strongly.ⁱⁱ The shares also suggest that there are other retailers of similar or greater strength active in the supply of NHH retail services in Scotland.
 - (b) Internal documents from ST relating to the Scottish retail business suggest that it sought to replicate the success of UU in Scotland but did not indicate that ST believed it would become a close competitor to UU in Scotland.³⁹
 - (c) Only a small number of Scottish customers have switched between the Parties.
 - (d) Third parties generally considered that the Parties were both relatively small players in Scotland and did not suggest that they had been competing particularly closely relative to other competitors.

Competitive constraints

164. Third parties confirmed that there are a large number of active suppliers in Scotland. Specifically:
- (a) Multi-site/Large user customers were able to point to a number of alternative suppliers; and

³⁹ ST Scotland Rapid Retail Expansion Plan - 3 June 2014.

(b) SMEs in Scotland were able to point to many alternative suppliers active in their area. In particular, Clear Business Water and Business Stream were mentioned as credible suppliers by the majority of SMEs.

165. The Parties internal documents also suggested that they considered the competitive environment to be intense in Scotland and highlighted up to 16 suppliers with high levels of activity in Scotland, both English WASCs and other retailers.⁴⁰

Conclusion on horizontal unilateral effects in the supply of retail water and sewerage services in Scotland

166. As set out above, the Parties' shares of supply in Scotland are not at a level that would ordinarily raise competition concerns, there is evidence of a large number of competing suppliers active across the three customer segments of SMEs, large users and multi-site users in Scotland, and the Parties do not appear currently to be competing closely.

167. The CMA therefore believes that there is no realistic prospect of an SLC in the supply of water and sewerage retail services to SMEs, large users or multi-site NHH customers in Scotland.

Barriers to entry and expansion

168. The CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

169. The CMA contacted customers in England and Scotland, English suppliers, Scottish suppliers, Ofwat and WICS, meter reading suppliers and intermediaries involved in brokering retail services contracts with suppliers.

170. The majority of respondents, including Ofwat, raised no concerns regarding the Merger.

171. Some competitors, customers and intermediaries raised potential concerns. A significant proportion of these concerns were not specific to the Merger but related to the design and future evolution of the English NHH retail sector.

⁴⁰ For example: UU, 'Business Retail QBR', 16 December 2015, UU 'Business Retail, QBR, June 2014, ST 'Board Strategy day: Business and Operating Services UK', 21 November 2014, ST, 'STW Business Services Performance Report', period ending 31 March 2014, ST, 'STW Business Services Performance Report, period ending 31 October 2014.

172. Third party comments have been taken into account where appropriate in the competitive assessment above.

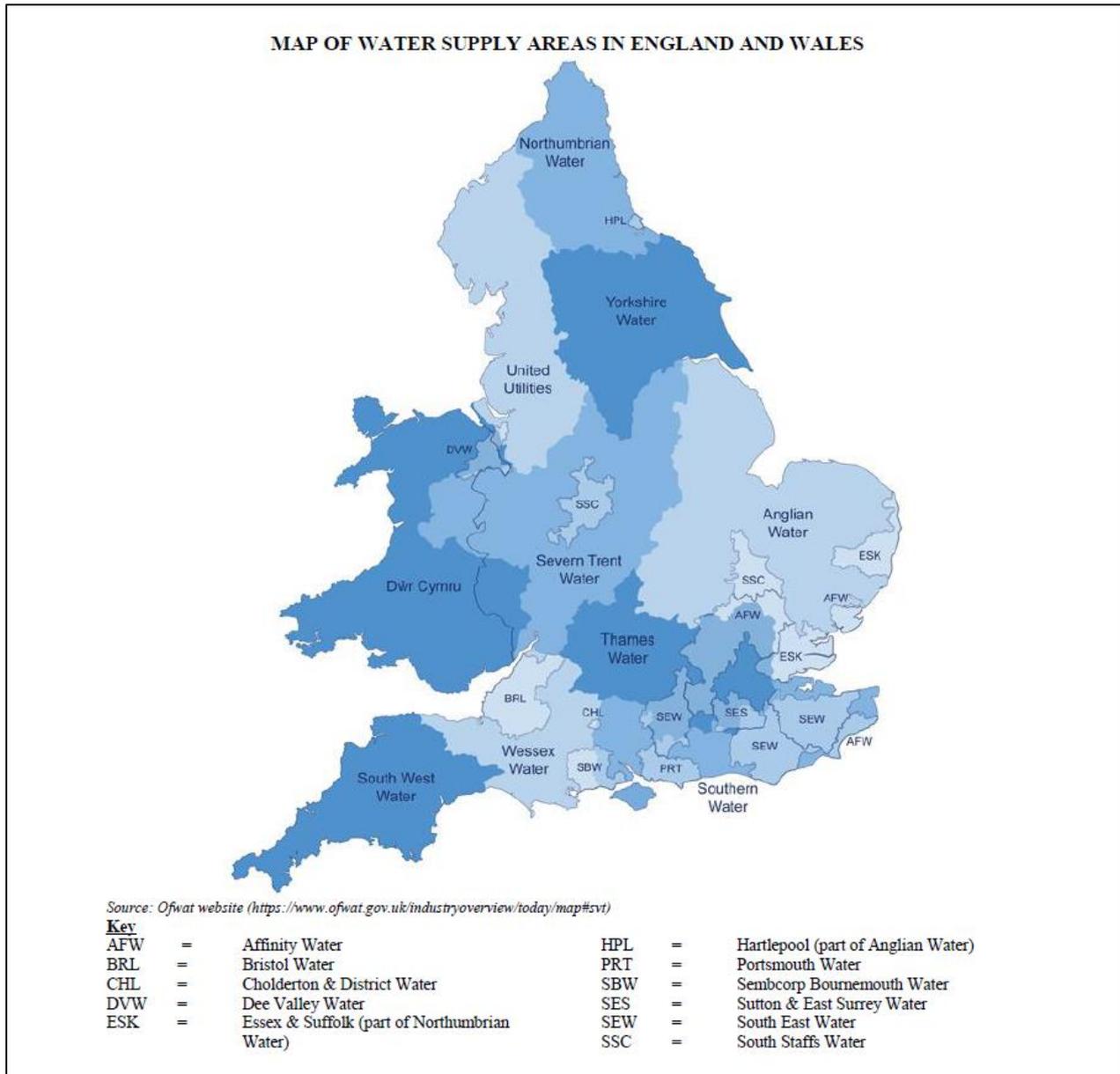
Decision

173. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom.

174. The Merger will therefore **not be referred** under section 33(1) of the Act.

Andrew Wright
Director, Mergers
Competition and Markets Authority
3 May 2016

Annex 1 – Supply areas in England and Wales



ⁱ Paragraph 68: The Parties clarified that the Parties, not the Parties' WASCs, would not have exited from NHH retail supply.

ⁱⁱ Paragraph 163(a): The CMA clarifies that the Parties 'are not competing particularly strongly **with each other**'.