



## Consultation on Ofwat's approach to future mergers and statement of methods

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Dear Tim,

Thank you for the invitation to comment on your proposed approach to future mergers in light of the Water Act 2014 amendments to the special merger regime. We welcome the improved transparency Ofwat has provided by setting out the criteria against which it will assess both the prejudice to the regulatory regime and the benefits to customers of a water merger.

We consider that the approach you take to mergers should allow for a diversity of investors to be maintained within the water sector and should not favour any particular type of investor, for example, Water and Sewerage Companies (WASCs).

You invite comment in three specific areas. Our responses are set out below.

### **Principles and approach to mergers**

We consider the principles listed for assessing mergers provide a sensible approach to assessing the potential impact of a water merger. As you set out in the consultation, comparators will remain important to Ofwat in allowing it to discharge its duties in the areas of setting price limits, monitoring and incentivising service quality and carrying out ongoing activities in relation to monitoring, enforcement and spreading best practice.

As each merger may permanently reduce the number of independent comparators, with the detriment to the comparative regime likely to increase for each successive merger, it is important for Ofwat to consider whether further disaggregation of vertical structures (for example separation of WASCs into separate water and sewerage companies, or splitting larger companies into smaller more responsive entities) would be beneficial to the sector. You have partially alluded to this in the potential for mergers to create customer benefits through innovative company structures and that future developments in regulation such as network plus sub limits may require more comparators.

### **Process for Phase 1 mergers**

To follow on from the successful role of customers within the price review process, we would support a role for the Customer Challenge Groups within the merger process and would anticipate them providing a third party view on the merger. In practice, we consider it may be difficult to

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obtain customer support for the means of delivering benefits to them at the pre-notification stage of the phase 1 process.

### Draft statement of methods

In the draft statement of methods you set out both the criteria and weighting you would apply for assessing the detriment to the regulatory regime from the loss of a comparator.

For criterion 2, you state that *“If a merger involves a water company which Ofwat does not use to make comparisons, for example a small water company, then we might not in practice lose an independent comparator.”* We believe this statement is contradictory to criterion 4 (the number and quality of independent observations that remain) and should be removed from your assessment.

We have previously argued that small companies deliver benefits for customers. For completeness, we reiterate these below.

- Water only companies’ (WOCs) costs are lower and this translates into lower water bills;
- The overall capital charge is lower for WOCs than WASCs, which explains half the difference in bills;
- On average WOCs deliver a better quality of service than WASCs; and
- WOCs help to drive lower bills for all customers in the industry.

In determining whether the likely prejudice is outweighed by the relevant customer benefits you state that monetised impacts are considered first. We would urge you to consider qualitative uses of comparative data equally with these monetised impacts as they remain integral to many areas of regulation beyond price setting.

Please contact us if we can be of further assistance on this.

Yours sincerely,

Mike King  
Regulatory Director

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