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Dear David

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

Thank you for the opportunity to respond to your consultation on your proposed approach to mergers.

The scope of restrictions on merger activity since 1996 is likely to have reduced the efficiency challenge from equity and reduced innovation in the sector. Given the long-term challenges the industry faces we believe it is in customers' interests to reduce the level of restriction.

The industry structure is already changing and there will be scope soon for demergers of some activities and greater scope for new market entrants which will mitigate any perceived risks of greater consolidation in some parts of the water market. We welcome the fact that this consultation notes that the potential for these factors to negate or mitigate any perceived disbenefits, and the recognition that there be changes to regulation that Ofwat can make that could further offset this.

We also welcome the transparency of your approach to assessing future mergers as set out in this consultation. This transparency will in and of itself reduce barriers to potential M&A activity.

Jonson Cox recently noted the limits of comparative regulation and declared that the previous model of merger assessment which sought to gain a share of the productive efficiency created would no longer be supported by Ofwat.¹

Some of your proposals in this consultation appear to be at odds with this, in particular, paragraph 4.3.1. suggests that in your assessment of customer benefits most weight will

¹ Uncharted waters: a look at managing change in the water sector, March 2015 - Policy Exchange



continue to be applied to companies that agree to reduce prices to customers within the current price control period.

In our view your proposed approach also underestimates the ongoing benefits for customers of greater equity challenge through potential merger activity. By assuming that merger savings will be time limited (because ongoing regulation would be expected to erode them over time) you ignore the ongoing efficiency dynamic created by the threat of further M&A activity. This benefit will be felt both within and outside of the newly merged entity.

While we understand that they may be difficult to quantify, we would support changes to your assessment that would allow the ongoing benefits on efficiency and innovation that the greater threat of M&A activity can be expected to create to be more explicitly considered.

Yours sincerely

*Best regards,
Andy*

Andy Pymmer
Director of Regulation & Customer Services