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For the attention of Tim Griffiths

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By Email only

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Dear Tim

Yorkshire Water (YW) welcomes the opportunity to contribute to Ofwat's consultation regarding the approach to future mergers.

The consultation clearly conveys the approach that Ofwat intends to employ. The process adopted, and the methods proposed in terms of assessing a merger proposal are well laid out. We appreciate the need to balance industry wide comparators with geographical customer benefits.

YW acknowledges that the use of comparisons underpins Ofwat's approach to regulation and that this approach has delivered significant improvements to customers and is an effective method of regulation.

We have focussed our comments on process clarity as we believe that this is fundamental to ensuring confidence for the industry in relation to mergers. An example of this is the question posed in the phase 1 merger process (page 3) regarding a merger being "sufficiently advanced or likely to proceed". We support your encouragement of early engagement prior to stage 1 and we believe the process could be strengthened, and early confidence regarding the industry's ability to meet the threshold increased, if the method by which this question is assessed was laid out clearly for the industry.

The experience of the industry over the last investment periods has shown that larger, efficient companies have progressively given customers both better value and service. We are concerned that the objective to maintain comparators appears to discourage mergers in a number of areas and will not facilitate customers enjoying the best service at the best price. Proposed mergers involving the loss of a wastewater comparators are highlighted as an area of concern (Page 10) as are the loss of a high performing company (Criterion 3, page 58) or companies that have important differences or similarities. We believe that more thought is required as to how to achieve balance between customer benefits and the value of comparators

We welcome the option of agreeing Undertakings in Lieu (UILs) though there is concern that the direction of travel for UILs appears to be in favour of disaggregation and formal separation. To ensure that customer benefits are always considered ahead of comparators we would welcome

further clarity on the acceptability of comparative data in lieu of comparators where customer benefits are significant.

We have a number of additional specific comments that are appended to this letter. The comments are arranged into themes and contain page references.

We hope that you will find this feedback useful and look forward to working with you in the future

Yours sincerely

Wendy Kimpton
Regulatory Strategy Manager

Appendix 1 – Detailed comments

Comparator loss and customer benefit

The consultation states that benefits should be “accrued as a result of the merger, or is expected to accrue in a reasonable period of time as a result of the merger” (Page 32). Clarity is required on what will be deemed a “reasonable period” for benefits to be realised. We are concerned that customer benefits that are more easily defined and delivered will be preferred over benefits that may, in the short term, appear less well defined. We would like to see further information on how benefits are assessed to build confidence that longer term or difficult to define benefits are not lost through this process.

Further guidance is also required for Criterion 3 (page 58) regarding if weighting awarded to accelerated benefits will be considered; i.e. benefits that may have been reached through existing Regulation but are proven to be accelerated through a merger and delivered to customers over a shorter period.

We would welcome further detail regarding the weight of customer benefits versus the loss of a comparator. The consultation states that “relevant customer benefits can only accrue to customers (and customers of customers) of merger parties whereas the impacts of the merger on our ability to make comparisons will have wider effects on customers across the industry” (Page 32). The consultation does offer useful examples of benefits from previous mergers but further clarity in terms of the analysis of benefits to a geographical customer group versus the loss of an industry wide comparator and the weighting applied to each parameter would be welcomed.

We would welcome details regarding your approach to creating a threshold on the number of comparator points which would be deemed critical to your ability to deliver the regulatory regime. If there was to be a threshold, guidance on proposed actions if this trigger was crossed due to the customer benefits outweighing the comparator benefits would help inform the industry as this scenario could potentially change how future regulation is delivered.

Undertakings in Lieu (UIL)

To create confidence in the industry regarding possible mergers you could indicate in the preliminary stages prior to phase 1 the types of UILs it would consider appropriate to the merger under consideration and if a framework of appropriate UILs would be created over time.

Statement of methods

Criterion 1 and 2 (page 58) appear to effectively set the critical criteria, if this is the case, the statement of methods be set out differently to reflect that these are the essential criteria that must be met.

Document Clarity

The process diagram (Figure 1 page 3) might be better understood if it is written in the positive rather than the negative, for example “Is the merger not sufficiently advanced or likely to succeed” the answer “yes” is slightly counterintuitive and it would be easier to follow if the questions were

posed in the positive, e.g. “is the merger sufficiently advanced or likely to process” leads to a “yes” answer.