Sharon Mayor
Principal Case Officer
Competition and Markets Authority

[redacted]

By email

Date: 11 May 2020

Dear Sharon

Representation to the CMA's redeterminations of Ofwat's proposed 2020-2025 price controls

Summary

Wessex Water is an appointed water and sewerage undertaker, subject to Ofwat's price controls.

Despite considerable reservations, our board resolved not to appeal Ofwat's PR19 final determination as it considers that, in the round, the determination allows us to deliver some of the short-term expectations of customers, the mandatory environmental improvements up to 2025 and the reasonable expectations of our stakeholders.

However, the board remains concerned that PR19 was a missed opportunity which comes at the cost of longer-term operational and financial resilience. It is our view that the long-term interests of customers and the environment have not been well served by PR19. We made our reservations clear to Ofwat in our letter of acceptance.

It is in that context that we make this representation to the redeterminations, with links to previously published work on specific points of issue.

Background

We understand the political context that led the PR19 design to be focused on achieving reduced bills, and of course we also recognise the contribution that some parts of the industry had made in creating such a climate. Notwithstanding this unhelpful background, we do not believe PR19 delivers long-term value for customers and the environment.

Firstly, it has constrained infrastructure investment below the level required to maintain resilience. We see this both at the company level and across the industry. The rising concern in society on climate change and the need to accelerate investment to deal with the consequences of this is one example where the settlement is running counter to public opinion. The public mood and public policy more generally have shifted in favour of investment that safeguards the nation's wellbeing for future generations and in our view the review means the industry will not be able to adapt at the speed required to meet the new challenges.

Secondly, the final determination has seen a material reduction in our credit quality, and that of the wider industry, leaving ongoing financial resilience at the margins of acceptability. This will leave future generations to bear the increased financing costs. In the very near-term for instance, it has triggered a loss of rating event for us at the European Investment Bank, which has been a key source of very low-cost finance for the industry. While the EIB has now agreed not to exercise this right, it has instead resulted in an increased interest cost payable to the EIB of £0.6m pa – a cost that in future will ultimately be borne by our customers.

This reduction in credit quality is driven primarily by an unduly low estimate of the cost of equity and we have submitted a paper by Professor Alan Gregory to the current CMA enquiry into the NATS determination to make this point. This reduction in returns, if it becomes embedded in regulated sectors, risks constraining investment in the long run, to the detriment of consumers of essential services in the UK.

We have published several pieces that look specifically at some of the causes of this overall issue and draw your attention to them here. These include:

- **The link between service and cost:** the level of performance funded from the base plus models is no greater than the average performance across the industry over the historical data period. Yet, service level targets have been set much higher. See:
    - Response to initial assessment of plans (IAP) section 3.3.4, appendix 5, and appendix 13
    - Response to draft determination (DD) section 5.4 and appendix C11.1

- **The overwriting of customer views:** in making arbitrary and inconsistent adjustments based on industry comparisons that do not reflect our own customer evidence, the determinations incentivise companies to do the wrong things. See:
    - Response to IAP sections 4.2, 4.7, 4.9, and 4.10
    - Response to DD sections 2.2, 2.5 and associated representations

- **An inappropriate cost of equity:** the analysis underpinning the cost of equity is inconsistent and diverges from regulatory precedent despite an absence of evidence to support such a material change. See:
    - Submission to the NATS redetermination “Setting the Cost of Equity in UK Price Controls”, by Professor Alan Gregory
    - Response to the provisional findings for the NATS redetermination sent to Kristin Baker, panel chair, on 15 April 2020

Please find the aforementioned documents attached to this email and do not hesitate to contact me if you would like any further information.

Yours sincerely

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Matt Greenfield
Director of Regulation