

Date: 26 October 2020

By email: waterdetermination2020@cma.gov.uk

Dear Sir/Madam

South West Water's response to CMA provisional findings in relation to redetermination of Ofwat PR19 price determinations.

We appreciate the thorough and diligent approach the CMA has taken to providing an expert and independent review of the merits of Ofwat's determinations. We welcome the opportunity to comment on the provisional findings given their importance for future determinations.

We believe that the price review process for the 2020-25 regulatory period (PR19) has resulted in stretching but deliverable outcomes and that Ofwat has demonstrated a robust approach which has incentivised companies to ensure customers are central to company plans. The outcome has carefully balanced customer affordability with the need for ensuring long-term resilience and investment across the sector.

We believe the CMA review has also focused on ensuring companies can deliver a resilient service into the future and ensuring long term investment into the sector is attracted. We have reflected on two key aspects from this review, namely the cost assessments and balance of risk and returns.

Cost assessment

We note the CMA's findings in respect of customer engagement, cost assessment and service levels. As a company we strive to ensure customer priorities and affordability aspects are at the heart of our delivery plans. We undertook significant engagement with customers for PR19 and continue to believe that this should be given significant weighting in any price review.

We support the CMA's provisional findings in respect of cost assessment and that an element of forward-looking cost assessment would be beneficial. We also note that where a step change in service levels is required then costs of achieving this should be adequately reviewed.

Risk & Returns

One aspect we note is the CMA's assessment in respect of the balance of risk and return and the approach taken by Ofwat in assessing the cost of capital. We strongly believe that the sector has

significant future investment requirements to ensure resilience in the face of climate change and population growth. It is therefore key that the sector remains attractive to investors, but it is also key that Ofwat's decision on the cost of capital is made 'in the round' balancing the delivery risks inherent in the plan and customer affordability.

South West Water has always been supportive of the use of a notional structure that enables companies to set their own financing strategy and corporate structures. We agree that in setting their own strategy companies should be incentivised to manage their financing arrangements efficiently and that any risk should be borne by the company and shareholders not customers, demonstrating a responsible approach to financing. Where companies choose to do something different we do not believe it should be to the detriment of customers.

Therefore, we were strongly supportive of Ofwat's proposals for companies to share financing outperformance from high gearing. Again, we have long believed that high levels of debt are not good for the sector and do not afford customers the right level of protection. We also believe that regulatory consistency is important to investors and aspects such as the smaller water only companies having higher allowances for the cost of financing do need to be considered in line with changing circumstances. For example, through the change in ownership of Bournemouth Water merging with South West Water, it became unnecessary for customers to be charged for a higher return. We believe that these aspects should continue to be considered by Ofwat on a case by case basis.

In summary, we believe the CMA should consider the overall balance of risk and return with customer affordability which was one of the key principles behind Ofwat's PR19 approach - i.e. focusing on ensuring companies can deliver a resilient service into the future through long-term investment, delivering service improvements whilst balancing customer affordability, and incentivising those companies that responsibly manage the risk and return balance through efficient financing structures.

Yours faithfully,



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