

19 January 2021

Competition and Markets Authority (the “CMA”)  
Water Redeterminations 2020 Panel

By email: [waterdetermination2020@cma.gov.uk](mailto:waterdetermination2020@cma.gov.uk)

Dear CMA,

**Re: Water Redeterminations 2020: 2019/20 data for base cost models – Working Paper (the “Working Paper”)**

Thank you for the opportunity to respond to the Working Paper. We are writing to you in our capacity as a longstanding investor in the sector, which currently involves us advising the iCON Infrastructure family of institutional funds that own 80% of Bristol Water plc. This letter presents the views of iCON Infrastructure LLP and does not purport to represent any opinions of Bristol Water plc.

We have been deeply concerned that the highly aggressive posture adopted by Ofwat in response to the redeterminations generally, including threats of judicial review following the CMA’s Provisional Findings, has created undue pressure on the panel (and water companies more widely) with resulting potential risks to objective and fair redeterminations by the CMA. This has compounded the risks to the integrity of a Bristol Water specific redetermination in this case arising from the omnibus appeal process being conducted by the CMA.

Our review of this Working Paper along with the cost of capital working paper has heightened these concerns, notably because of: (a) the limited scope of these consultations (especially insofar as they specifically relate to Bristol Water’s position), and (b) the apparent weight attached to opinion versus objective and properly interrogated data and evidence.

As the process has progressed, it has become increasingly evident that an overarching PR19 “narrative” appears to have driven the regulator’s selection, specification and interpretation of data, sometimes in the face of actual sector history, practices and regulatory precedent.<sup>1</sup> We are alarmed that the consultation papers create room for the suspicion that a similar approach risks filtering through to the CMA’s redetermination. This letter summarises our concerns in the context of the question of inclusion of 2019/20 data.

As outlined in CMA’s June 2020 approach to the redeterminations (and restated in Paragraph 2 of the Working Paper): “where there is additional and updated information available, produced since Ofwat’s determination, and which is relevant to the redeterminations, we will take account of this to inform our redeterminations ... However, we will also consider whether information is complete and robust so that we can place reliance on it”. In the provisional findings contained in Section 4 of the Working Paper, it is contended that it is common practice “for the CMA to exclude data that it finds to be unreliable or unrepresentative”. This represents a change to the “complete and robust” test outlined in the CMA’s June 2020 approach document, notwithstanding the assertion that it is consistent. One concern arising from this change, which is borne out by the Working Paper’s contents, is that it risks shifting the weighing process away from relying on objective data integrity towards mere selective narrative.

---

<sup>1</sup> Refer to Mervyn King and John Kay’s recent book “*Radical Uncertainty*” for an elucidation of the risks for decision-making from the interaction between, and limitations of, narratives and models.

In the context of the June 2020 approach, we would observe in relation to the 2019/20 data:-

1. There is no dispute that the 2019/20 data constitutes “additional and updated information”.
2. There is no basis to question whether the 2019/20 data itself is “complete and robust”, being produced as part of companies’ Annual Performance Reporting which is subject to companies’ robust assurance and audit processes as well as regulatory scrutiny.
3. The 2019/20 data is highly relevant to the redeterminations. For example, the inclusion of the 2019/20 data in cost models would yield material changes to base cost allowances, especially for Bristol Water.

Notwithstanding this, the Working Paper appears to adopt a subjective approach coupled with contortions in seeking to establish a “narrative” that the 2019/20 data is somehow “unrepresentative”, on the basis of which it then surprisingly settles on the most extreme approach of ignoring the 2019/20 data. There are, however, many other valid explanations for the data, the support for the chosen narrative appears unreliable and the narrative chosen is by no means robust in its ability to explain the data. We, as the representative of shareholders in Bristol Water, can attest to that company’s focus on the demanding costs allowances from PR14 in the initial years of AMP6 followed by increasing costs associated with delivery of AMP6 service standards in the latter years.

An example of shortcomings in the Working Paper’s analysis is the manner in which sprinklings of anecdotal, second-hand commentary has been relied upon as a key underpinning of the conclusion reached to exclude the 2019/20 data. In Paragraph 10 of the Working Paper, the CMA summarises Ofwat’s proffered selection of some companies’ purported quotes regarding timing of investment. These comments are neither “reliable” nor “complete”, let alone supportive of the particular interpretation taken. The quotes refer to “investment” and include verbiage such as “in readiness for the 2020-25, rather than investment brought forward”, “to ensure it was in the best possible position to deliver 2020-25 targets” and “in preparation for AMP7 targets”. It could be said that everything a long-lived water company does in terms of “investment” is in preparation for the future, so all of this is just stating the obvious rather than indicating any spend brought forward from AMP7 as the Working Paper seems to leap to conclude. In fact, when Ofwat discloses that it has sought specifically to interrogate the reasons for spend to support the contention of base costs acceleration, the narrow group of companies approached appear to have explicitly demurred (and notwithstanding likely pressure to lend support to the narrative). In Paragraph 45 of the Working Paper, the CMA goes on to state:- “As reported in paragraph 10, the comments from the water companies to Ofwat indicated that their overspend was, at least partly, due to the targets set in PR19”. This seems to accept the reliability and completeness of this commentary and Ofwat’s interpretation, with limited (if any) challenge. Surprisingly, Paragraph 51 then goes even further postulating:- “Overall, **all water companies’** comments suggest that **a substantial amount** of investment is likely to have been brought forward from AMP7 to 2019/20 [*emphases added*]”, notwithstanding that this even more all-encompassing statement does not appear to follow from the scope or content of the narrow discussion in the Working Paper, including that contained in Paragraphs 45 to 50.

Excluding verified data from models because its inclusion would yield different results is highly problematic, especially where such models are otherwise considered to be reliable. Practitioners recognise the limitations of models because of, inter alia, data included, starting and ending points and specification.<sup>2</sup> However, the subjective choice made in Paragraph 30 of the Working Paper to not include data which the CMA acknowledges “increases the precision of our estimates” is very challenging to comprehend. In such circumstances, the scientific approach (not to be easily overturned) should always be that the output of the models is not “complete and robust” in the absence of inclusion of the 2019/20 data.

---

<sup>2</sup> *Ibid*

Compounding the described analytical weaknesses, representations on which the Working Paper's provisional findings are explicitly based do not appear accurate. For example, Paragraph 61 of the Working Paper contends:- "In the CMA's PR14 Redetermination of Bristol Water, the CMA did not include 2013/14 data due to some explanatory variables not being available and the fact that it had used data to 2012/13 for its provisional findings." This statement, however, fails to reflect properly the PR14 Redetermination decision-making process as outlined in the relevant CMA document. There was some missing data in 2015, which is not the case here. Nevertheless, the CMA in that 2015 case still undertook the analysis, with approximations used where necessary. What was decisive in the 2015 case was that the analysis, supported by sensitivities, demonstrated that the "effect of these updates would be to increase the estimate for Bristol Water's expenditure by less than 1%". Critically, in this case, the analysis conducted with the inclusion of 2019/20 data gives rise to a material difference in cost allowances. Accordingly, the substantive approach adopted in the Working Paper does not appear consistent with either: (a) regulatory precedent established by the CMA in its PR14 redeterminations, or (b) the CMA's proposed approach for the PR19 redeterminations to use of available information outlined in June 2020.

Given the extension of the deadline for the redeterminations to March 2021, we believe that the CMA has the time and space to undertake a thorough, evidence-led, analysis of the inclusion of the 2019/20 data which is consistent with the approach documented in June 2020.

We would be happy to discuss the contents of this letter and further observations with you.

Yours sincerely

*icon Infrastructure LLP*