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3 February 2021

Kip Meek  
Competition and Markets Authority  
The Cabot  
25 Cabot Square  
London  
E14 4QZ

Dear Kip

### **CMA Redetermination – Introduction to our final submission**

Thank you for the opportunity to make this final submission. As we come to the end of this process we would like to thank you and your staff again for your hard work on the redetermination during what has been a very difficult time.

Feedback we receive from our customers and stakeholders demonstrates that Northumbrian Water is a high performing and efficient company with a strong track record of delivering excellent service and protecting the environment as a socially responsible enterprise. We took very seriously our obligation to listen carefully to those customers and stakeholders in developing our business plan and reflected their preferences in our final submission to Ofwat. Our assessment of the PR19 final determination, just about a year ago, was that it was contrary to the priorities and long-term interests that our customers and stakeholders had set out. Our board therefore decided unanimously, alongside three other companies, to seek a redetermination from the CMA. We have never had cause to seek a redetermination like this and we were surprised and concerned to find ourselves in that situation. We sincerely hope we never have to again.

Ultimately it was the unbalanced nature of Ofwat's determination that compelled us to refer our price control to the CMA. In particular, we considered that:

- the overall package was unbalanced with a short-term focus on bill reductions - even though we were already offering the largest bill reductions in the industry to our customers and they had clearly supported more investment to increase the resilience of our services, Ofwat rejected that investment in favour of even greater price reductions;



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- similarly, the cost allowances and service level targets did not represent a sensible or reasonable level of challenge - even as a high performer we were likely to be facing significant penalties and overspends; and
- the package was quite clearly unfinanceable: the return had been set indefensibly low and Ofwat's approach to meeting the financeability duty was unrealistic given the real-world actions of the rating agencies and the credit metrics that we need to maintain under our licence.

But most importantly, as we reviewed the detail of Ofwat's decision, it was obvious that it moved us a long way from the ambitious plan that we had set out and which had enjoyed such widespread customer and stakeholder support.

We considered that the clear positions that the CMA reached in its Provisional Findings were a big step forward. You did not agree with us on everything, but that is to be expected, and the positions taken moved us closer to our original business plan. Where our concerns were not recognised we felt that the CMA had clearly set out why it disagreed with us and what evidence was driving its views. In response, and in line with your process, we have continued to advocate for further changes that we believe are well evidenced and justified. I have written to you separately about recent events and procedural change, and I will not repeat those points here, but needless to say the latter part of this process has been a much more bumpy road and our Board are now understandably nervous about the fairness and independence of the potential outcome given the recent consultations issued. We hope that those concerns are reasonably addressed when we read your final decisions.

As this submission sets out, the reasons why we sought a redetermination have only become stronger with the passage of time:

- the last year has seen growing calls for more investment to support a 'Green recovery' and for the sector to play an increased role in responding to resilience challenges and supporting the transition to net-zero. Sadly, the sector's response to this has been muted, as Ofwat continues to apply a short-term focus on bills. This is further evidence of an unbalanced approach which is disappointing when there is clear support from customers, a demonstrable need for investment, headroom in bills and borrowing costs are at an all-time low;
- the outturn information for the 2015-20 period, the most recent cost data for the 2019-20 year and even the early information from the listed companies operating under Ofwat's PR19 Final Determination in comparison to the previous period, all suggest that the settlement is too challenging even for the best performers. We agree that it is important that regulators push the sector to deliver more and better for customers', but ambition must be matched with achievability otherwise we risk damaging customer trust and the attractiveness of the sector for international capital; and



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- it has become even clearer that the PR19 approach to assessing financeability was incorrect. The consistent position adopted by the rating agencies in response to Ofwat's final determination and throughout 2020 demonstrates this. One of the most important elements of the redetermination process is the CMA's clear reassertion of the financeability duty. For a capital-intensive sector like this one, where the services we provide are so essential to customers, investability must be maintained.

With time running down on this process there remain three areas that we would urge the CMA to focus on ahead of its final decisions:

- **addressing the clear mistakes in the allowed return and ensuring that the final package remains financeable:** we have identified a range of mistakes in the theory and arithmetic underpinning the CMA's recent consultations on the allowed return. These need to be corrected and the CMA should continue its focus on ensuring that the final package is financeable and allows us to maintain a strong investment grade credit rating;
- **closing the outstanding cost gap:** our business is one of the most efficient in the sector overall and provides some of the best service levels to our customers. In our submissions we have set out evidence which shows a gap of about £83m between your provisional cost allowance and our anticipated efficient costs for AMP 7. It demonstrates that there are cost items outside of our control that are rising beyond inflation, and that there are aspects of the determination that include double-counting, for example in relation to growth allowances. The latest information at a sector level also confirms that the cost allowances provided are too low, by a comparable amount to the gap highlighted. Providing these allowances will help to address the clear asymmetry in the package and reduce the cost overruns we expect in AMP 7; and
- **providing further funding for our sewer flooding investment:** these investments, widely supported by customers and stakeholders, will help us to avoid one of the worst service failures that customers can ever experience. Our proposed sewer flooding programme addresses the clear and escalating risks from climate change and urban creep, which are further underlined by new evidence we provide in our submission and demonstrates a very strong benefit for that associated investment. There is also headroom in bills to make these investments which is unlikely to continue into future price reviews.

We set out in the submission an alternative overall package that reflects the above changes. This package would still deliver a 21% bill reduction, the largest of any company across the sector and provide sector leading affordability support with our commitment to eradicate water poverty by 2030. It would also offer our customers the most stretching service standards ever in the sector's history. And crucially, in comparison to the provisional findings, it would allow nearly £150m of greater investment in resilience with an overall package that is financeable and better able to respond to external shocks. It would also provide an overall position that is both theoretically sound



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and arithmetically correct, consistent with the CMA's important role and reputation in the regulatory framework for investors and consumers.

In conclusion I trust that through the evidence that we have submitted into this process, you have seen that Northumbrian Water is a high performing and efficient company with a long track record of delivering for our customers and protecting the environment. We listened carefully to our customers in the development of our business plan to understand their priorities clearly. Our assessment of the PR19 final determination was that it is contrary to the long-term best interests of our customers and doesn't provide for sustainable investment going forward, to the detriment of all our stakeholders. We believe that we have provided you with good evidence to support our case and sincerely hope that you reflect this evidence in your own conclusions.

Yours sincerely



**Heidi Mottram CBE**

**CEO, Northumbrian Water Limited**



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