

BEFORE THE COMPETITION AND MARKETS AUTHORITY

IN THE MATTER OF: AN APPEAL UNDER THE WATER INDUSTRY ACT 1991 AND THE
WATER INDUSTRY DESIGNATED CODES (APPEALS TO THE COMPETITION AND
MARKETS AUTHORITY) REGULATIONS 2017

BETWEEN:

CASTLE WATER LIMITED

Appellant

-and-

THE WATER SERVICES REGULATION AUTHORITY

Respondent

THE RESPONDENT'S REPLY TO THE APPELLANT'S
NOTICE OF APPEAL

Where not defined below, Ofwat adopts the abbreviations used in the Notice of Appeal

STRUCTURE

- A. INTRODUCTION AND OVERVIEW
- B. BACKGROUND TO THE APPEAL
- C. RESPONSE TO THE NOTICE OF APPEAL
- D. DIRECTIONS SOUGHT

A. INTRODUCTION AND OVERVIEW

1. This is the reply on behalf of the Appellant, the Water Services Regulation Authority (“Ofwat”) to the Notice of Appeal of Castle Water Limited (the “Appellant” or “Castle Water”) dated 26 February 2025 (the “Appeal”).
2. On 12 March 2025, the CMA determined that it had jurisdiction to hear the Appeal and granted Castle Water permission to bring the Appeal pursuant to section 207A of the Water Industry Act 1991 (the “WIA”) and Regulation 4(3) of the Water Industry Designated Codes (Appeals to the Competition and Markets Authority) Regulations 2017 (the “Regulations”). Castle Water appeals against Ofwat’s decision dated 5 February 2025 to reject Code Change Proposal CPW132 (“the Decision”).

Summary of Ofwat’s Response to the Grounds of Appeal

3. **Ground 1:** Castle Water contends that Ofwat did not have any or any proper regard to, or attached no or insufficient weight to, the statutory consumer objective to protect the interests of consumers wherever appropriate by promoting effective competition. This contention is unsustainable for at least the following reasons:
 - a. First, the Decision shows that Ofwat considered Wholesale Retail Code Change Proposal – reference CPW132 (“**the Proposal**”) by reference to its statutory duties and expressly considered the consumer objective to protect the interests of consumers by reference to the promotion of effective competition. In particular, the Decision found: *“There is insufficient evidence that The Proposal is consistent with our Statutory Duties to further the objective to protect the interests of consumers, where appropriate by promoting effective competition. Removing the obligation on Retailers to provide Credit Support in the instance of a Wholesaler's credit rating falling below the minimum level could lead to an increased risk of a detrimental impact to the service for, and potentially the cost to, both NHH and household customers where a Retailer fails and no Credit Support has been posted.”* The allegation, therefore, that Ofwat gave no weight to this statutory objective must therefore fail.

- b. Second, Ofwat assessed the “*competition-focused*” limb of the Proposal and found that it was not satisfied that there would be anti-competitive effects of the Decision. The “*competition-focused*” purpose of the Proposal essentially has two limbs:
- i. First, the financial weakness of Wholesalers has an impact on the cost of obtaining credit security by Retailers; and
 - ii. Second, this higher cost disproportionately falls on independent Retailers as opposed to vertically integrated Retailers.
- c. Ofwat rejects the entire premise of this allegation. The Decision concludes that a Wholesaler's financial weakness does not have a discernible impact on the cost of security instruments issued to a Retailer. Therefore, the higher cost that is alleged by Castle Water to fall on independent Retailers, which is said to give rise to competition concerns, was not established.
- d. Third, to the extent that Castle Water seeks to address wider issues such as the extent to which the current allocation of risk between Retailers and Wholesalers remains appropriate based on how the market has evolved since the credit security requirements were introduced, Ofwat has committed to a review which will address this exact topic. Ofwat states that “*a key focus of this review will be to ensure the credit arrangements overall appropriately reflect the characteristics of the market, while at the same time do not risk distorting competition in the market.*” Should this review find that current credit arrangements carry risks of conferring undue preference or market distortions, including regarding the relative circumstances of independent and integrated Retailers, , Ofwat will consult on mechanisms which can be introduced that aim to minimise such risks. At this stage, Ofwat carefully considered the Proposal and whether the discrimination alleged by Castle Water was established in the evidence, and found that it was not proved.
- e. Fourth, in any event, Ofwat’s primary objective within the statutory duty on which Castle Water relies is to “*protect the interests of consumers*”. In the Decision, Ofwat plainly discharges this duty. Indeed, the Proposal was rejected on the express ground that it would not be consistent with Ofwat’s “*Statutory Duties regarding the protection of consumers*” as it would “*result in a net increase in risk in the market,*

compared to a situation where the Proposal was rejected". Ofwat concluded that removing the obligation on Retailers to provide credit support could, *inter alia*, lead to Wholesalers choosing to delay certain investments or reduce aspects of their service to both household and non-household customers and/or increasing charges paid by all customers. Ofwat is bound to promote competition only "*where appropriate*". To the extent that Ofwat did not base its decision solely or primarily on Castle Water's competition concerns, because Ofwat did not consider that the broader competition issues arose in the Proposal, Ofwat was entitled to do so.

- f. Fifth, it is common ground that the Decision could only be interfered with if the error identified by Castle Water was material. To the extent that (contrary to the above), the CMA concludes that Ofwat did not appropriately address the "*competition-focused purpose*" of the Proposal, Ofwat submits that that omission was not material in circumstances where it did consider and dismiss the factual premises on which this aspect of the Proposal was based such that any further consideration would not have affected the outcome of the Decision.
4. **Ground 2(a):** Castle Water contends that Ofwat's finding that "*an illegitimate drawdown on Credit Support is highly unlikely*" was wrong or irrational. This contention is misplaced for at least the following reasons:
- a. First, directors of Wholesalers and/or Administrators (if the Wholesaler is in a Special Administrative Regime), are likely to face serious legal repercussions if they illegitimately call on credit support. For example, the Letter of Credit Template requires that the withdrawing Wholesaler produce a statement to the bank stating that at the time of the withdrawal the Retailer has not paid their Primary Charges. Producing such a statement where the Retailer had in fact paid all Primary Charges would constitute a misuse of funds (which may be fraudulent in some circumstances). The serious consequences of such activities render such conduct unlikely. This is *a fortiori* in circumstances where Administrators are appointed by the High Court.
 - b. Second, in any event, in the unlikely event that a Wholesaler illegitimately draws down on credit support, the amount of Credit Support that the Retailer is required

to provide will be reduced by the excess amount that the Wholesaler drew upon until that excess amount drawn is reimbursed to the Retailer by the Wholesaler.

- c. Third, additionally, should a Wholesaler illegitimately draw down on credit support, they will have acted in breach of the Wholesale Retail Code (“WRC”) and be open to litigation and contractual damages and/or enforcement action by Ofwat.
5. Ground 2(b): Castle Water contends that Ofwat’s finding that “*the evidence ... is insufficient to conclude that a Wholesaler’s financial position (or a perception of the Wholesaler’s financial position) has a direct impact on a Retailer’s availability, and cost, of financing*” was wrong or irrational. This contention is without any merit for at least the following reasons:
- a. First, Ofwat’s analysis showed that the gap between the Retailers' blended rate and the Bank of England base rate (data here was only available for the Retailers Pennon Water Services, Water2business, WaterPlus and Wave) *declined* over time. If lenders had increasing concerns about lending to water Retailers, the gap would have grown as Wholesalers became more financially distressed (as alleged by Castle Water).
 - b. Second, financial institutions primarily assess the Retailer’s own creditworthiness, rather than the Wholesaler’s financial position, when determining the cost of providing security. The financial institution’s risk is limited to the Retailer’s ability to meet its obligations, and the regulatory framework governing the water sector mitigates the risk of a Wholesaler’s failure disrupting market stability.
 - c. Third, to the extent that Castle Water relies upon its own rate, Ofwat notes that there is no clear pattern in the difference between its rate and the Bank of England base rate and that its financing costs appear to be influenced by an intra-company loan at a fixed rate of 8.75%.

B. BACKGROUND TO THE APPEAL

The credit security regime

6. In April 2017, the provision of water and waste water services for non-household (“NHH”) or business customers in England and Wales was opened to competition through the

separation of business retail and wholesale activities. This Business Retail market was established with the intention of helping to deliver lower bills, helping customers to use less water, improving services, and seeing new offers and bundles emerge.

7. In the Business Retail market, Retailers buy services from Wholesalers. Retailers can choose to do this on a 'pre-pay' or 'post-pay' basis, with most opting for post-pay. When post-pay is used, this introduces a counterparty risk to Wholesalers, including in the event that a Retailer defaults and exits the market. Wholesalers cannot directly manage this risk since, *inter alia*, they have no direct relationship with end-customers.
8. Recognising the above, credit arrangements were introduced to the market Codes to help the management of such risks and so support the opening and functioning of the market. Such credit arrangements are a common feature of markets including in other regulated sectors.
9. The key features of credit arrangements in the Business Retail market include:
 - a. Credit arrangements apply to Retailers who have selected Post-Payment or Reduced Notice Post-Payment of Primary Charges.
 - b. These arrangements require Retailers to lodge credit with Wholesalers which is intended to provide security equivalent to a proportion of services delivered and owed.
 - c. A Wholesaler is not entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support unless a Retailer is considered to be a Defaulting Trading Party. Section 10 of the Business Terms sets out clear conditions that need to be met for a Retailer to be considered to be a Defaulting Trading Party.
 - d. In the event that a Contracting Retailer has become subject to an Insolvency Event, then the Contracting Wholesaler shall be entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support up to the limit of the sums owed to the Contracting Wholesaler at that time in relation to services provided which carry a Primary Charge.

The Proposal

10. In January 2022, Castle Water raised the Proposal which sought to remove the obligation on Retailers to provide credit support to a Wholesaler where that Wholesaler's credit rating is classified as below BBB/Baa2.

11. Castle Water stated that the Proposal was made for the following reasons:

- a. To protect all customers' interests and promote confidence in the NHH market by reducing the risk of systemic market failure;
- b. To redress in part the imbalance of risk in the contractual relationship between Retailers and Wholesalers; and
- c. To reduce discrimination in the current arrangements, which favour vertically integrated companies (including Associated Retailers) that do not bear an external cost of providing credit support, and ensure a level playing field.

12. Castle Water relies on this third basis for the Proposal in the Appeal. As expanded upon in Castle Water's subsequent submissions, Castle Water contends that the "*competition-focused purpose*" of the Proposal has the following limbs:

- a. The credit security requirements in the WRC have a disproportionately greater impact on independent Retailers, as opposed to vertically integrated Retailers;
- b. That disparate impact is particularly acute when a Wholesaler is in financial stress or distress and its credit ratings drop, not least because financial institutions have regard to the Wholesaler risk to which Retailers are exposed; and
- c. The disparate impact poses a risk to effective competition, including in relation to barriers to entry and expansion, due to that structural imbalance in the market between different categories of Retailers.

13. Therefore, as noted above, the "*competition-focused purpose*" of the Proposal relied on Castle Water's factual contention that a Wholesaler's financial position (or a perception of a Wholesaler's financial position) had a direct impact on a Retailer's availability and cost of credit. The Proposal sought to address this contention by removing the need for Retailers to provide credit support where a Wholesaler falls below a minimum credit rating.

The MOSL consultation

14. The Market Operator Services Limited (“**MOSL**”), the operator of the NHH water market, ran an industry consultation in relation to the Proposal between 17 July 2023 and 4 August 2023, receiving fourteen responses: ten from Wholesalers, three from Retailers (including Castle Water), and one from the customer representative: the Consumer Council for Water (“**CC Water**”).
15. The majority of respondents (two Retailers and all ten Wholesalers) disagreed with the Proposal, with respondents saying that the risk of Retailer failure remains a more likely occurrence than a Wholesaler failure and that Ofwat’s recent amendments to the cash lock-up trigger in Wholesalers’ licences (which lifts the trigger to a BBB/Baaa2 with negative designation credit rating) actually reduces the risk of Wholesaler failure. The only Retailer which agreed with the Proposal was Castle Water.

Code Change Committee Report

16. MOSL published its Draft Recommendation Report on 11 October 2023, inviting the CCC to provide Ofwat with its recommendation.
17. The Code Change Committee (“**CCC**”) considered the Proposal at its meeting on 11 October 2023. The CCC recommended by majority decision – with eight votes in favour of rejection, none in favour of approval and one abstention – that Ofwat reject the Proposal. The CCC concluded that The Proposal would not better facilitate the principles of the WRC and may introduce risks to all Wholesalers’ customers (including household customers).
18. Accordingly, the Final Recommendation Report was issued on 13 October 2023, recommending that Ofwat reject the Proposal.
19. Following the CCC’s recommendation that Ofwat reject the Proposal and before Ofwat’s July 2024 consultation on its Mindset to Decision, Ofwat accepted further information from Castle Water.

Independent Report

20. On 12 February 2024, Ofwat commissioned a report from a company with extensive experience of corporate finance and insolvency to provide an independent view on the rationale of the Proposal. The Independent Report highlighted that the provision of credit support by Retailers served as a means of risk mitigation for Wholesalers where they have provided services in advance of being paid for them. Credit support helps to mitigate the impact on customers of a disorderly Retailer exit as Wholesalers can draw on the Credit Support, instead of the costs being borne directly by customers, thus reducing the financial impact on Wholesalers from temporarily being unable to recover NHH revenues. The Independent Report concluded that the benefits of retaining the requirement to provide credit support outweighed the drawbacks of removing this requirement.

The Ofwat consultation

21. On 29 July 2024, Ofwat published its *Minded to Decision*: that it was minded to reject the Proposal. Ofwat's two main reasons for rejecting the Proposal relevantly included the fact that there was insufficient evidence that a Wholesaler's financial position (or a perception of a Wholesaler's financial position) had a direct impact on a Retailer's availability and cost of credit.

22. Ofwat decided to run a consultation on its *Minded to Decision*. Ofwat was not obligated under the WIA to conduct this consultation but chose to do so voluntarily to ensure the industry had the best opportunity to present relevant evidence. A five-week consultation period ran from 29 July 2024 to 2 September 2024. Ofwat received seven responses: four Retailers – Advanced Demand Side Management (“**ADSM**”), Castle Water, ConservAqua, The Water Retail Company (“**TWRC**”); two Wholesalers (United Utilities and Yorkshire Water) and CC Water.

The Decision

23. On 5 February 2025, Ofwat published the Decision, which confirmed its decision in the consultation on its *Minded to Decision* and rejected the Proposal. In reaching the Decision, Ofwat took account of the views of: (a) CCC and its recommendation, (b) the evidence and submissions that had been provided by Castle Water throughout the process, (c) the evidence and submissions of all the industry participants in the two consultations conducted in relation to the Proposal and (d) the analysis in the Independent Report. On

the basis of this evidence, Ofwat arrived at its conclusions on the expected impact of the Proposal relevantly finding that it would result in a "*net increase in risk to the market*".

24. Ofwat also considered the Proposal by reference to the Primary and secondary principles of the WRC and its statutory duties. In summary, Ofwat found that the Proposal was not consistent with the Primary principle of the WRC or its statutory duties to protect the interests of consumers because removing the obligation on Retailers to provide credit support would lead to an increased risk of a detrimental service for both NHH and household consumers. For example, the Proposal could lead to Wholesalers choosing to delay certain investments or reduce aspects of their service to both household and NHH customers and/or increasing charges paid by all customers.
25. Further, while Ofwat considered that the implementation of the Proposal would not be in accordance with the Primary principle of the WRC or its statutory duties, Ofwat acknowledged that there was merit in reviewing the credit and collateral arrangements in the market. The key issues the review will aim to consider include: whether the current allocation of risk between Wholesalers and Retailers remains appropriate; whether the mechanisms that underpin the current risk-sharing allocation are effectively designed; and whether these mechanisms are being effectively implemented and utilised.

B. RESPONSE TO THE NOTICE OF APPEAL

26. Without prejudice to the foregoing, Ofwat responds to the Notice of Appeal as set out below. In this section:
- a. Certain headings and definitions used in the Notice of Appeal are adopted for ease of comprehension only and without any admission thereby intended.
 - b. Where a summary of the terms of a contractual or other document is admitted, that is without prejudice to Ofwat's reliance at the hearing of the Appeal on the full terms of that document for their true meaning and effect.

The Appellant

27. Paragraph 1.1 is noted.

28. Paragraphs 1.2 – 1.3 are admitted.

Request for permission to appeal

29. Paragraph 2.1 is admitted.

30. Paragraph 2.2 is noted.

31. As to paragraphs 2.3 and 2.4, Ofwat notes the findings in this regard by the CMA in its decision dated 12 March 2025. While Ofwat does not seek to appeal the CMA's decision on jurisdiction, Ofwat maintains its position that the correct construction of s. 207A(1) WIA is that where Ofwat runs a voluntary consultation under its general, incidental powers contained in Schedule 1A of the WIA, this is not a "*consultation under the [WIA]*".

32. Paragraph 2.5 is noted. As to the last sentence of paragraph 2.5, Ofwat sets out what facts were known to it at the time of the Decision in the witness statement of Emma Joy Kelso ("Kelso 1") dated 19 March 2025.

33. Paragraph 2.6 is noted.

Scope of the Appellant's appeal and materiality; Key documents

34. Paragraph 3.1 is denied. Paragraphs 3-5 above of this Reply are repeated.

35. Paragraph 3.2 and paragraphs 4.1 - 4.3 are noted

Background and Overview of CPW132 and the Credit Support Regime

36. Paragraph 6.1 is admitted save that certain Wholesalers' areas are served by 'new appointments and variations' which are limited companies providing a water and/or sewerage service to customers in an area which was previously provided by the incumbent Wholesaler. This is a point of detail, however, and not germane to the matters at issue. Paragraphs 6.2 and 6.3 are admitted.

37. Paragraph 6.4 is admitted, save that Ofwat notes that within the category of "independent retail operators", there is a distinction between retail operators which purchased a customer

book from a previous incumbent, such as Castle Water, and retail operators who entered the market with no business customers, such as Everflow, as complete new entrants.

38. Paragraph 6.5 is admitted.

39. As to paragraph 6.6:

a. Paragraph 6.6(i) is admitted.

b. Paragraph 6.6(ii) is admitted insofar as it sets out *two* of the eight Supporting principles. Castle Water does not refer to the “Proportionality” and “Efficiency” principles which require that the WRC and arrangements established under the WRC to be “*proportionate to the size of the Competitive Market in England and Wales and proportionate within the context of the Objectives*” and “*ensure efficient, economic and effective administration and operation of the Competitive Market*” respectively. Ofwat will rely, as relevant, on all eight Supporting Principles for their full meaning and effect.

40. Paragraph 6.7 is admitted. The matters to which Ofwat must have regard as set out in s.2(1) WIA are consistent with but not identical to the Primary and Supporting Principles. For example, s.2A(c) states that Ofwat must exercise its power in a manner it considers is best to ensure that water companies can finance the proper carrying out of those functions. This duty is relevant to the Decision but does not appear in the WRC and is not referred to by Castle Water.

41. Paragraph 6.8 is admitted insofar as it sets out *one* of the four strategic priorities for Ofwat, which include priorities to “*deliver a resilient water sector*” and “*serve and protect consumers*”.¹ The Decision takes account of these strategic priorities. As to the strategic priority to “*use markets to deliver for customers*”, which includes the priorities to promote competition “*where appropriate*”, the Government states that it expects Ofwat to:

¹ Available at <https://www.gov.uk/government/publications/strategic-policy-statement-to-ofwat-incorporating-social-and-environmental-guidance/february-2022-the-governments-strategic-priorities-for-ofwat> [accessed: 17 March 2025].

- a. work in collaboration with wider stakeholders to explore whether changes to the business retail market rules, processes and structures can deliver improvements for customers, society, market resilience, investor confidence and the environment;
- b. continue to work with industry to focus on resolving frictions and structural challenges in the business retail market and improve outcomes for customers; and
- c. monitor and promote incumbent water companies' support in the development of a well-functioning business retail market.

The process undertaken by Ofwat to make the Decision took into account each of these expectations.

42. Paragraph 6.9 is admitted.

43. Paragraph 6.10 is admitted, save that the third sentence is not admitted. Ofwat will rely on section 9.2 of the Business Terms for its full meaning and effects.

44. Paragraphs 6.11 – 6.12 are admitted.

45. As to paragraph 6.13:

- a. Insofar as Castle Water contends that the fact that it is an independent Retailer necessarily means that it enters into different credit arrangements to vertically integrated Retailers, this is denied. All Retailers are able to negotiate bespoke credit arrangements with Wholesalers. As set out in Decision: *“Trading Parties are able to negotiate alternative credit arrangements which reflect objectively justifiable differences between Retailers, including the risk profile of the Retailer in question which in turn may be influenced by other factors, including for example the business model or ownership structure of the Retailer”*.
- b. Further, it is denied that SWBS's Government owned status means that there is no requirement for collateral for normal payment terms and only a 'Letter of Assurance' for extended payment terms. SWBS's ownership status confers on it no particular status regarding credit requirements. SWBS's arrangements are derived from its bespoke agreements with its Wholesalers.

46. Paragraph 6.14 is admitted, save the third sentence which is not admitted.

Ofwat's review of credit arrangements for the non-household retail market

47. Paragraph 7.1 is admitted.

48. As to paragraph 7.2, the first two sentences are admitted and it is admitted that the third sentence contains an accurate quotation from the KPMG Report. Ofwat will rely on the 2018 Credit Review and the KPMG Report for their full meaning and effects.

49. Paragraph 7.3 is denied as a mischaracterisation of the relevant comment in the KPMG report, which states as follows: *"It is not possible to examine the materiality of the impact of the credit arrangements. Consultation feedback suggests anecdotally that credit costs are creating a tight operating environment where operating and credit costs for smaller new entrants are close to the maximums allowed under the default tariff caps and the impact of the cost of credit is likely to be material. However a more comprehensive review of retail costs against gross margins is required to confirm this."* Ofwat is currently in the process of carrying this out.

50. Paragraph 7.4 is admitted. It is noted that on 13 September 2019, Ofwat published its Decision on CPW057, which placed obligations on Retailers to provide MOSL and Ofwat with certain details about PCGs and other forms of credit between Wholesalers and Associated Retailers.² This proposal was developed by the Code Change Panel at Ofwat's request in response to the KPMG Report to improve transparency in the market and provide assurance as to arms' length arrangements between Associated Retailers and Wholesalers in the provision of credit for the purposes of promoting competition in matters related to credit support.

Ofwat's review of Wholesaler financial resilience and the amendment to the cash lock-up provisions in Wholesaler licences

51. As to paragraph 8.1, Ofwat's 2021 Monitoring and Financial Resilience report stated that *"Most companies maintain adequate levels of financial resilience", but there was "variation in the levels of financial resilience across the sector". As to the credit ratings of certain water companies,*

² Available at <https://mosl.co.uk/document/changes/2525-cpw057-ofwat-decision-pdf/file> [accessed 17 March 2025].

*the report stated: “Southern maintains a credit rating that is at the lowest of the investment grade. As at 31 March 2021, SES Water and Yorkshire held credit ratings one notch higher than the lowest of the investment grade with negative outlooks. The negative outlook on SES Water has subsequently been removed. There have been a number of positive rating and outlook updates since the year end, which we set out at Appendix 3. During 2020-21, Portsmouth and Wessex withdrew their credit ratings with S&P (BBB Negative and BBB Stable, respectively), Affinity withdrew its Fitch rating (BBB- Stable), and in May 2021 Yorkshire's corporate family rating maintained by Moody's was withdrawn (Baa2 Negative). The removal of a credit rating can result in the loss of information about a company's financial resilience that is important for regulatory purposes.”*³ Insofar as paragraph 8.1 is consistent with the foregoing it is admitted.

52. Paragraph 8.2 is admitted as a summary of the options that Ofwat considered in the discussion paper.

53. Paragraphs 8.3 and 8.4 are admitted.

54. Paragraph 8.5 is admitted, and that Thames Water, Southern Water and South East Water are currently in cash lock-up. The revised trigger for cash lock-up applies from 1 April 2025, and currently no further companies will be impacted. If any Wholesaler's credit rating falls to BBB/Baa2 with negative outlook after 1 April 2025, there will be a three-month grace period between the point that a credit rating falls to BBB/Baa2 with negative outlook and the cash lock-up being applied, which allows a company to make a submission as to why it believes it should not be in a cash lock-up before that cash lock-up takes effect and to submit a case supporting its position. If Ofwat is satisfied that the evidence provided is such that acceptable levels of financial resilience will be maintained, it may decide that a cash lock-up should not apply.

CPW132 and overview of events leading up to Ofwat's Decision

55. Paragraph 9.1 is admitted.

³ Available at <https://www.ofwat.gov.uk/wp-content/uploads/2021/11/Monitoring-Financial-Resilience-Report-2020-21-updated-17Dec2021.pdf> [accessed at 17 March 2025].

56. Paragraph 9.2 is admitted insofar as it sets out when the CPW079 proposal was made and the reactions to the draft price review determinations (published in July 2019) by certain Wholesalers.
57. Paragraph 9.3 is admitted.
58. Paragraph 9.4 is admitted, save that it is noted that the proposal, as originally drafted, was to *“alleviate the Credit Security requirements on Retailers in circumstances where a Wholesaler fails the minimum credit rating criteria”* (emphasis added).
59. As to paragraph 9.5, it is admitted that Castle Water confirmed it wished to pursue the Proposal after Ofwat published its decision on the financial resilience of water companies in March 2023 (*“Decision under sections 13 and 12A of the WIA 1991 to modify the ring-fencing licence conditions of the largest undertakers”*).
60. As to paragraph 9.6:
- a. It is admitted and averred that the Proposal entered the consultation stage on 17 July 2023, and of a total of 14 stakeholders who responded to the consultation, 12 stakeholders responded “No” to the question *“Do you agree that the proposed change better facilitates the Objectives and Principles of the WRC? Please explain your answer”* (10 Wholesalers and two Retailers).
 - b. The balance of the paragraph is denied [See: Kelso 1 at paragraph 91].
61. Paragraphs 9.7 and 9.8 are admitted and averred. Eight members of the CCC voted in favour of rejecting the Proposal and one abstained. No member of the CCC voted in favour of the Proposal.
62. Paragraph 9.9 is admitted, save that it is noted that Ofwat permitted Castle Water to provide further information following a meeting with Castle Water on 12 October 2023 in which Castle Water indicated that it wanted to provide such information.
63. Paragraphs 9.10 and 9.11 are admitted. Ofwat will rely on the Decision for its full meaning and effects.

Overview of the Statutory Framework to determine the Appeal

64. Paragraph 10 is noted.

Statutory grounds of appeal

65. Paragraphs 11.1 – 11.3 are admitted.

66. In the premises, paragraphs 11.4 – 11.5, except insofar as they contain an accurate summary of the relevant statutory grounds of appeal, are denied.

Standard of review

67. Paragraphs 12.1 – 12.8 are admitted.

68. The first two sentences of paragraph 12.9 are admitted. The balance of the paragraph is not admitted. Ofwat avers that it is entitled to a substantial discretionary area of judgment in relation to its decision to reject the Proposal. The Proposal is one which would bring about a material change to the current operation of the wholesale-retail market in general and not just to the position of Castle Water. This makes the determination a complex and polycentric one. Ofwat was required to draw on its experience and expertise in the field to make its determination. As noted in the CMA's 21 September 2023 Final Determination in respect of the RIIO-ED2 price control regime appeal (the "**ED2 Determination**") at §3.46: *"where the exercise of regulatory judgement is involved, GEMA will have a margin of appreciation as an expert regulator. GEMA's margin of appreciation will be at its greatest where all that is impugned is an overall value judgement based upon competing considerations in the context of a public policy decision"*.

69. Paragraphs 12.10 and 12.11 are admitted.

70. Paragraph 12.12 is not admitted. [See: Kelso 1 at paragraphs 67-78 (with respect to the Witness Statement of John Nigel Reynolds) and 123 (with respect to the Frontier Report)]

The competition-focused purpose of the appeal

71. As to paragraph 13.1:

- a. As to the first sentence, it is admitted that Castle Water accurately quotes from the Proposal. The Proposal set out three aims, of which only one was to reduce discrimination.
- b. The second sentence is denied. Paragraph 3b above is repeated.

72. As to paragraph 13.2, it is admitted and averred that Castle Water made the submissions contained in the sub-paragraphs in support of the “*competition-focused purpose*” of the Proposal in the materials it submitted to Ofwat before the Decision was made.

73. As to paragraph 13.3, it is admitted and averred that many of the arguments made by Castle Water in this Appeal were made in materials submitted to Ofwat during its consideration of the Proposal.

The allegation that credit security arrangements have a disproportionately greater impact on independent Retailers

74. As to paragraph 14.1:

- a. It is denied that the cost of meeting credit security requirements is invariably higher for independent Retailers than integrated Retailers. All credit security requirements are the result of arm's-length negotiations; therefore, the cost of security will therefore derive from the perceived credit risk of the Retailer, the type of security required (e.g., cash, Letter of Credit, or Parent Company Guarantee), market conditions, and the negotiating power of the parties involved. Castle Water correctly notes at paragraph 14.6 that there is a requirement that intra-group security is provided on arm's length terms. This is reflected in the Decision which states that “*Trading Parties are able to negotiate alternative credit arrangements which reflect objectively justifiable differences between Retailers, including the risk profile of the Retailer in question which in turn may be influenced by other factors, including for example the business model or ownership structure of the Retailer*”. It is not disputed that some Retailers may face higher costs of credit than others, but Ofwat's position is that this higher cost will be reflective of objectively justifiable differences between the Retailers.

- b. In any event, to the extent that the disparate costs of credit are not reflected by objective differences, as set out above, Ofwat's position is that the Proposal does not address this issue and that Ofwat intends to review the credit arrangements for this purpose.
- c. It is denied that independent Retailers are unable to rely on PCGs, for the reasons explained at paragraph 52 of Kelso 1. Ofwat notes that Clear Business Water, an independent Retailer, has used a guarantee as a form of credit support.
- d. Integrated Retailers would incur arrangement fees and legal costs when arranging credit security in the same way as independent Retailers would.
- e. Prior to the opening of the market, Ofwat introduced a suite of credit options that were designed to support a range of different retail business models and provide flexibility to new entrants. This included a negotiated credit option which would allow Retailers and Wholesalers to agree alternative, bespoke negotiated credit terms where both parties agree to these.

75. As to paragraphs 14.2 – 14.4, it is admitted Castle Water accurately quotes from submissions it made to Ofwat. However, as set out above, it is denied that independent Retailers invariably face higher costs of credit.

76. As to paragraph 14.5, it is admitted and averred that Castle Water made these submissions prior to the Decision being made and that Castle Water accurately quotes from the KPMG Report and its own submissions to Ofwat. Ofwat notes that the risk identified by KPMG was a "*potential*" risk and that KPMG continued to state: "*However, there is no information as to whether they have taken advantage of this lower cost of credit in their commercial offers to end-customers and the detailed arms-length arrangements that different retailers have put in place have not been examined.*"

77. As to paragraph 14.6:

- a. As to the first sentence, it is admitted and averred that Ofwat took steps in response to the KPMG Report.

- b. As to the balance of the paragraph, it is admitted and averred that there are requirements that (a) intra-group security is provided on an arm's length basis and (b) trading parties ensure that their credit arrangements are transparent. Castle Water's concerns that such security is not provided on this basis, as it is admitted Castle Water has noted in its previous submission to Ofwat, are noted. These concerns were addressed in the *Minded to Decision*, where it stated that it conducted a review of the compliance of trading parties with their obligations relating to transparency of credit arrangements and payment terms on the market. Ofwat stated that it *"issued an open letter to all Trading Parties to remind them of their relevant obligations and to seek assurance that Trading Parties are compliant with the relevant code obligations"* and that *"[f]ollowing Trading Party responses that explained their actions to bring themselves back into compliance, we intend to work closely with MOSL and strengthen our internal process for the monitoring of compliance with code obligations relating to the transparency of credit arrangements in the market."*

The allegation that the alleged disparate impact is particularly acute when a Wholesaler is in financial distress

78. As to paragraph 15.1, Castle Water correctly accepts that the broader issue of whether the original assumptions as to the extent to which risk should be shared between Retailers and Wholesalers is outdated in the current environment is a wider issue which cannot be appropriately addressed in the Proposal. It is denied that any aspect of this issue is properly addressed by the Proposal because Ofwat has concluded that the financial distress of a Wholesaler does not materially impact the financing costs of a Retailer. In any event, Ofwat notes that it intends to review the underlying credit arrangements.
79. It is admitted that paragraph 15.2 accurately quotes from Ofwat's discussion papers in 2021 and 2024.
80. Paragraphs 15.2 and 15.3 are not admitted, as the information pleaded is not within Ofwat's knowledge, save that it is admitted that Thames Water and Southern Water were put in a cash lock-up. It is noted that South East Water has been in cash lock-up since 4 March 2025.
81. Paragraph 15.5 is denied. Paragraph 54 above is repeated.

82. As to paragraph 15.6:

- a. The first sentence is admitted. Paragraph 54 above is repeated.
- b. As to the second sentence, to the extent that it is alleged that credit ratings are the only appropriate measure of financial distress, this is denied. Credit ratings are only a measure for assessing a Wholesaler's financial position, but not the sole basis of Ofwat's assessment of financial resilience. Further, as set out above, a Wholesaler's credit rating going below a certain level does not automatically trigger the application of cash lock-up provisions due to the three-month grace period and the Wholesaler's ability to make submissions on why despite its credit rating the lock-up should not be applied.
- c. As to the third sentence, Castle Water's summary of the effect of the Proposal is admitted.

83. As to paragraph 15.7, as set out above, Ofwat has concluded a Wholesaler's financial position (or a perception of the Wholesaler's financial position) does not have a direct impact on a Retailer's availability, and cost, of financing. As to the sub-paragraphs:

- a. As to paragraph 15.7(i), it is admitted that Castle Water accurately summarises from its submission to Ofwat, but it is denied that the submission provides evidence of that a Wholesaler's financial weakness have a discernible impact on the access to, or cost of, security instruments issued to a Retailer.
- b. In the premises, paragraphs 15.7(ii) and 15.7(iii) are denied. Further, Castle Water's use of the conditional tense ("*The cost of borrowing for cash collateral would likely rise further upon Wholesaler financial stress or distress given the perceived increased risk in the water sector*") and equivocal language ("*[b]anks have suggested that where a Wholesaler is in financial stress or distress, the bank may ask for its exposure to be cash-collateralised or guaranteed by the Retailer to cover their position*") is noted.
- c. As to paragraph 15.7(iv):
 - i. The first three sentences are denied for the reasons set out above in paragraph 4 above.

- ii. As to the fourth and fifth sentences, as Ofwat explained in the Decision, where a special administration order has been made Schedule 2 of the WIA provides for the arrangements which must be made to ensure that there is no risk of requiring Retailers to duplicate credit support arrangements and any uncertainty about the continued status of such arrangements. Ofwat noted that *“during the currency of the SAR, the Administrator is required to achieve the purposes of the SAR order which include ensuring that the Wholesaler carries out the functions associated with its appointment under licence and statute. This includes its functions in relation to the business retail market, which are enforceable under the WIA91”*.
 - iii. As to the balance of the sub-paragraph, the relevance of Thames’ breaches of the Codes is not adequately pleaded or understood. To the extent that it is alleged that there is a causal link between Thames’ breaches of the Code and financial distress, this has not been adequately particularised.
 - iv. Ofwat noted in the Decision that *“in the period since Thames Water breached its ring-fence licence requirement, it has not made any illegitimate call on Credit Support”*. It is also noted that Southern Water has also not made any illegitimate call on credit support since it has entered cash lock-up. As noted in paragraph 80 above, South East Water has also been in cash lock-up since 4 March 2025.
- d. As to the first sentence of paragraph 15.7(v), to the extent that Castle Water contends there is a risk that a Wholesaler may inappropriately draw down on the credit support for sums not due, this is denied for the reasons set out above. Otherwise, the second, third and fourth sentences are admitted.
- e. As to paragraph 15.7(vi), it is admitted that Castle Water accurately quotes from its submission, however, the alleged “domino” effect is denied on the basis that it is Ofwat’s position that a Wholesaler’s financial distress would not significantly affect a Retailer’s financing costs, including in the event that such a Retailer is an affiliate of the Wholesaler and uses a PCG, since PCGs must be provided on arms-length basis and represent cost to the affiliated Retailer. Therefore removal of any PCG should create neither the financial shock nor the domino effect suggested.

- f. As to paragraph 15.7(vii), as to the risk of a Retailer putting up “double security”, Ofwat’s position is that, as set out in the Decision. In the unlikely instance of an illegitimate drawdown of credit security by a Wholesaler, the WRC ensures that the amount of Credit Support that the Retailer is required to provide shall be reduced by the excess amount that the Wholesaler drew upon until that excess amount drawn is reimbursed to the Retailer by the Wholesaler.
84. As to paragraph 15.8, Ofwat accepts the hypothesis put forward that in general commercial banks consider the impact of direct and indirect exposures in relation to financing decisions. Furthermore, Ofwat’s position is that the alleged (direct or indirect) risks to Retailers, and alleged consequences of such risks in terms of the cost of and access to credit support, are significantly limited owing to rules that prohibit illegitimate drawdown on a Retailer’s posted credit, even where a Wholesaler may be in financial distress. Ofwat tested this hypothesis in the water market. As set out in the Decision, if lenders had increasing concerns about lending to water Retailers then it would expect the gap between the Retailers’ blended rate and the Bank of England base rate to widen to account for the increasing risk of lending to the sector. Ofwat’s analysis of Retailer debt costs did not support this analysis. For example, the data available for the Retailers Pennon Water Services, Water2business, WaterPlus and Wave all indicated a repeated decline in the gap between their rate and the Bank of England base rate over time.
85. It is admitted that paragraph 15.9 accurately quotes from Castle Water’s response to the Minded to Decision. However, to the extent it is alleged, it is denied that credit security will necessarily be more expensive for new entrants. This will depend on the perceived creditworthiness of the new entrant, the type of security required (e.g., cash, Letter of Credit, or Parent Company Guarantee), the availability of alternative credit arrangements, prevailing market conditions, and the negotiating power of the new entrant. Additionally, factors such as the business model, financial backing, and ownership structure can influence the cost and terms of securing credit.
86. As to paragraph 15.10, while it is admitted that Castle Water accurately quotes from its submissions to Ofwat and Ofwat’s guidance, in the premises, the contention that Retailers bear an additional financial burden related to the financial distress of a Wholesaler is denied.

87. As to paragraph 15.11, it is admitted that Castle Water drew Ofwat's attention to its correspondence with certain financial institutions. It is admitted and averred that this correspondence indicates what may be "*likely*" and not that increased costs have in fact arisen. Further, Ofwat notes that the institutions also provide further general sector (excluding that related to a Wholesaler's financial distress) and company-specific reasons for their reluctance to lend to Castle Water, raising issues related to access to pools of liquidity; customer complaints; approach to bad debts; thin margins; integration risk; banking relationships and the quantum of financing required.

88. As to paragraph 15.12:

- a. The first sentence is admitted, save that Ofwat will rely on its Decision for its full meaning and effects.
- b. The second and third sentences are denied. Ofwat considered whether the market priced in any such rise as related to the financial distress of Wholesalers and, as set out above, concluded that Retailers faced no increased costs related to such financial distress.
- c. As to the third sentence, it is admitted that Castle Water accurately quotes from its response to the Minded to Decision.

89. As to paragraph 15.13, it is denied that Ofwat considered that the only purpose of the Proposal was to address the risk of a Wholesaler drawing down credit support in excess of amounts owed and due. Paragraphs 3-5 above are repeated.

The allegation that the alleged disparate impact poses a risk to effective competition

90. As to paragraph 16.1, it is admitted and averred that one of Ofwat's objectives is to promote effective competition. As to Ofwat's compliance with this objective in making the decision, paragraph 3e above is repeated.

91. As to paragraph 16.2:

- a. As to paragraph 16.2(i), to the extent that it is alleged that a Wholesaler's financial position has a material impact on the cost of security instruments issued to a Retailer, this is denied for the reason set out in this Reply.
- b. In the premises, paragraph 16.2(ii) is denied.
- c. Paragraph 16.2(iii) is denied. Ofwat's findings on Castle Water's submissions that Wholesalers may illegitimately draw down on a LoC are set out at paragraph 4 above.

92. As to paragraph 16.3:

- a. As to the first sentence, Ofwat notes that this sentence replicates the submissions made in paragraph 15.9, therefore Ofwat repeats paragraph 85 above.
- b. As to the second and third sentences, Ofwat admits that Castle Water has accurately quoted from its consultation document. Ofwat accepts that the risk that the credit security regime as a whole poses such a risk and has accordingly stated that it will undertake a Review of credit arrangements, and as stated in the Decision, a *"key focus of this review will be to ensure the credit arrangements overall appropriately reflect the characteristics of the market, while at the same time do not risk distorting competition in the market."*

93. Paragraph 16.4 is admitted, save that Castle Water quotation of CC Water's view as recorded in the Final Recommendation Report is materially incomplete. CC Water continues to state, *"This change proposal may be a way of going some way to achieving this"* (emphasis added). It is further noted and averred that CC Water did not vote in favour of the Proposal. CC Water said that the Proposal, as presented, did not make clear the extent to which there was a material risk of systemic market failure and of the potential impact on customers, Retailers and Wholesalers.

94. As to paragraph 16.5:

- a. The first two sentences are denied. Ofwat's position is that there would be an increase to the risks faced by Wholesalers were the proposal to be adopted because, as noted in the Decision, *"[t]he Proposal risks the effect of increasing Wholesalers' Retailer*

credit risk, which could contribute to a further deterioration of a Wholesaler's financial position if their credit rating fell below BBB/Baa2."

- b. In the premises, paragraph 16.5(i), to the extent that it alleges that the Proposal would have no impact on a Wholesale's credit rating, is denied, save that it is admitted that Castle Water accurately quotes from its Response to the Minded to Decision. The paragraph immediately above is repeated.
- c. As to paragraph 16.5(ii), the quotation from the Decision is admitted as accurate, however, the allegation that Ofwat took a "*cautious approach*" is not understood and is denied. Ofwat properly and carefully came to conclusions on the evidence presented to it.

95. As to paragraph 16.6, it is denied that the Proposal is proportionate or appropriately balance the risks between the parties. As Ofwat concluded in the Decision, the Proposal would be a net increase in risk to the market due to the fact that it would increase the risks faced by Wholesalers and there is insufficient evidence that it would reduce the risks faced by Retailers.

Grounds of Appeal

96. In the premises, paragraph 17.1 is denied.

97. As to paragraph 17.2:

- a. As to the first sentence of paragraph 17.2, it is denied that Ofwat did not substantively engage with the competition concerns in the Proposal.
- b. The second and third sentences is admitted.
- c. In the premises, the fourth, fifth and sixth sentences are denied. Ofwat properly reviewed the Proposal in accordance with its statutory obligations.

98. As to paragraph 17.3:

- a. As to the first sentence, it is admitted that Castle Water identified part of the reasoning found in the Decision. Ofwat will rely on the Decision for its full meaning and effects.
- b. The second sentence is denied. Paragraph 3(b) above is repeated.
- c. The third sentence is denied. Ofwat was entitled to conclude that the evidence showed that financial institutions were not taking into account the financial position of the Wholesalers with respect to credit security available to Retailers.
- d. In the premises, the fourth and fifth sentences are denied.

99. In the premises, paragraph 17.4 is denied.

Ground 1: Ofwat's alleged failure to have regard to, and/or failure to give the appropriate weight to, the objective to protect the interests of consumers, wherever appropriate by promoting effective competition

- 100. Paragraphs 18.1 and 18.2 are denied. Ofwat appropriately considered each of the applicable statutory duties, in particular, the statutory consumer objective. Ofwat was clear in the Decision that its expert view was that the implementation of the Decision would not have furthered the interests of consumers. In fact, Ofwat concluded that the Proposal would have a *"detrimental impact to the service for, and potentially the cost to, NHH and household consumers"* where a Retailer fails and no credit support has been posted.
- 101. As to paragraph 18.3, it is denied that Ofwat failed to address Castle Water's concerns about effective competition in the Minded to Decision. The fundamental allegations in Castle Water's submissions are: (a) that financial weakness among a number of Wholesalers has a material impact on the cost of financing credit support, and (b) this impact is greater on independent Retailers than integrated Retailers. In the Minded to Decision, Ofwat rejected the entire premise of this argument. Ofwat stated: *"we do not believe that compelling evidence has been provided to demonstrate that a Wholesaler's financial position would directly impact Retailers' access to, and cost of, financing credit support."*
- 102. As to paragraphs 18.4 and 18.5, it is denied that Ofwat failed to address the risks to effective competition in the Decision. It is admitted that Ofwat contended that the Proposal was

driven by “two primary concerns” but it is denied that Ofwat “limited the purposes of the Proposal”. A fair reading of the whole Decision shows that Ofwat simply highlighted the concerns which had featured most prominently in the evidence and the submissions of both Castle Water and the other stakeholders.

103. As to paragraph 18.5, it is admitted that Ofwat obtained and relied upon the Independent Report. It is further admitted and averred that Ofwat did not, and could not, fetter its consideration of its statutory duties by reference to the company which drafted the Independent Report.
104. As to paragraph 18.6, it is denied that Ofwat’s reasoning at Point 2 of the Decision was company-specific. Ofwat’s conclusion under Point 2 that the evidence does not support the view that increasing concerns regarding the resilience of Wholesalers has resulted in higher financing costs for Retailers was based on a consideration of all Retailers for which it had data. For example, Ofwat noted that the “data available for the Retailers Pennon Water Services, Water2business, WaterPlus and Wave all indicate a repeated decline in the gap over time [between the Bank of England base rate and the Retailer’s debt costs].”
105. As to paragraph 18.7, it is denied that the concern about effective competition is only touched upon in Point 15. At Point 2, Ofwat addressed the core factual premise on which the entire “competition-focused purpose” rests and concluded that the relevant Wholesaler’s financial position does not have a discernible impact on the cost of security instruments issued to a Retailer. This finding, without more, defeats Castle Water’s contention that the Proposal has any impact on competition within the market.
106. As to paragraph 18.8, it is denied that Ofwat’s engagement with issue 15 was insufficient. Ofwat does not state that it would always expect new entrants to be as well capitalised as existing Retailer. Ofwat concluded that it had not been proved that new entrants are likely to be less well-capitalised in this context and hence subject to such alleged effects such as increased costs for credit relied on by Castle Water.
107. Paragraph 18.9 is denied. Ofwat should be afforded a margin of appreciation in relation to its reasoning on the “competition-focused purpose” of the Proposal in accordance with established principle. The allegation that Ofwat simply failed to address this aspect of the Proposal is wrong. Further, Ofwat was entitled to conclude that in circumstances where the

Proposal does not adequately address the competition issues that arise in the credit security regime, it will commission a review of this topic.

Ground 2: Ofwat was allegedly wrong in its findings about the response of financial institutions to Wholesaler distress

108. As to paragraphs 19.1 and 19.2, it is denied that Ofwat's conclusions that "*an illegitimate drawdown on Credit Support is highly unlikely*" and "*the evidence ... is insufficient to conclude that a Wholesaler's financial position (or a perception of the Wholesaler's financial position) has a direct impact on a Retailer's availability, and cost, of financing*" were wrong or irrational. Paragraphs 4 and 5 above are repeated.

109. As to paragraph 19.3, Ofwat notes that Castle Water relies on its submissions in paragraph 15 of the NOA, and Ofwat likewise repeats its reply to paragraph 15 above.

110. As to paragraph 19.4, Castle Water mischaracterises Ofwat's position. Ofwat does not state that financial institutions would have no regard to the financial weakening of the Wholesale sector. Ofwat's position is that the financial weakening of the Wholesale sector did not have any discernible impact on the cost of credit to Retailers. Ofwat's conclusions were based on the evidence as to the fact that the Retailer's cost of credit had not increased (and had in fact decreased) despite the financial weakening of certain Wholesalers. This is not inherently implausible. Financial institutions primarily assess the Retailer's own creditworthiness, rather than the Wholesaler's financial position, when determining the cost of providing security. The financial institution's risk is limited to the Retailer's ability to meet its obligations, and the regulatory framework governing the water sector mitigates the risk of a Wholesaler's failure disrupting market stability.

111. Paragraph 19.5 is admitted as containing accurate quotations of the Decision.

112. As to paragraph 19.6:

a. Paragraph 19.6(i) is not admitted.

b. Paragraph 19.6(ii) is denied. To the extent that Castle Water relies on only its own rates to contend that the gap between Retailers' blended rate and the Bank of

England rate is not declining, Castle Water is wrong to do so. Further, Ofwat was correct to base its conclusions on the data available across several Retailers.

c. Paragraph 19.6(iii) is denied. Ofwat reviewed the 2023-24 financial accounting statements of Castle Water. It is stated in note 17 (i)(b) (page 67 of Castle Water's 2023-24 accounts) an unsecured loan of £79.5m from the parent company was reported for the year ending 31st March 2024 (£72.9m for 2022-23). Note 17 disclosed the associated interest on the loan from Related Parties as 8.75% (page 68 of Castle Water's 2023-24 accounts). This paragraph provides an alternative explanation and states that the parent company loan of £79.5m (as reported in note 17), is not actually a loan but a form of equity and therefore the reference to an 8.75% interest rate is incorrect. Ofwat was entitled to rely on information and disclosures in Castle Water's financial statements in its analysis. In any event, Ofwat did not place sole weight on this factor in coming to its conclusion.

d. As to paragraph 19.6(iv):

i. In the premises, the first sentence is denied.

ii. As to the second sentence, paragraph 72 is repeated.

113. Paragraph 19.7 is denied. As set out *E.ON UK Plc v GEMA, Decision and Order of the Competition Commission, 10 July 2007 ("E.ON")* at §3.55, "*GEMA, as the specialist regulator may well have an advantage over the CC in finding the relevant primary facts. ... GEMA ... has an advantage of experience, and will often have the benefit of having conducted a consultation with the industry ... For these reasons, the CC will be slow to impugn GEMA's findings of fact.*" The same principles should be applied in the present case.

114. Paragraph 20.1 is admitted.

115. In the premises, paragraphs 20.1 and 20.2 are denied.

Relief sought

116. In the premises, it is denied that Castle Water is entitled to the relief it seeks in paragraphs 21.1 – 21.3.

D. DIRECTIONS SOUGHT

117. For the reasons set out above, Ofwat requests the CMA to confirm Ofwat's decision under Regulation 18(3) and order Castle Water to pay Ofwat's costs of the proceedings.

Details under Rule 7.2

In accordance with Rule 7.2 of the Water Code Appeals: Competition and Markets Authority Rules, it is confirmed that the details of the legal representatives and address for service for the Authority are the same as provided in the Acknowledgment of Service dated 3 March 2025.

Statement of Truth

The Respondent believes that the facts stated in this Reply to the Appellant's Notice of Appeal are true. I am duly authorised to sign on behalf of the Respondent.

Signed: 

Name: Emma Joy Kelso

Position: Senior Director, Ofwat

Dated: 19 March 2025