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Chair
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CMA

By email: waterPR24references@CMA.gov.uk

Dear Panel

PR24 Redetermination – Third Party Submission

We welcome the opportunity to set out our initial third-party response to support the CMA in its PR24 redetermination for the five disputing water companies. Pennon is a FTSE 250 listed company focused on the UK water sector. We provide services through our two licenced wholesale businesses, South West Water and Sutton and East Surrey Water, providing water and wastewater services to Devon & Cornwall and the Isles of Scilly, and water services to Bournemouth, Bristol and Sutton & East Surrey areas. We are also active in the Water Business market through Pennon Water Services, SES Business Services and a minority share in the retailer Water 2 Business.

Through South West Water we have a strong track record of being a leading performer in the water sector. We are the only company to have achieved the top categorisation in Ofwat's business plan assessments at each of the last three price reviews when such categorisations have been made.

The "outstanding" status Ofwat applied to the South West Water PR24 plan reflected the high level of ambition in terms of efficiency and service performance[1]. The status includes an assessment that the plan was deliverable and affordable. In the FD the 23% real bill increase by 2030 is the second lowest of the WaSCs and the SES Water 3% bill reduction and Bristol area 14% bill increase the overall lowest and second lowest bill change respectively[2].

We accepted the FD in the round as a balanced and robust outcome, enabling long-term delivery for customers, supporting national priorities, and maintaining financial resilience across our business.

We trust that our perspective helps the CMA assess the redetermination in the broader sectoral context. Below, we set out our observations across four key areas with more detail contained in the attached appendix:

1. Cost of Capital

We believe the cost of capital set by Ofwat in the FD is appropriate and consistent with the market conditions at that time. Our our view in our PR24 DD response used a cost of equity of 5.17%, cost

[1] Ofwat PR24 FD, Overview of South West Water's PR24 Final Determination, Page 22 (Overview-of-South-West-Waters-PR24-final-determination-1.pdf)
[2] Ofwat PR24 FD, Sector Summary (April 2025), Page 21 (Our final determinations for the 2024 price review – Sector summary)

of debt of 3.04%, and an overall WACC of 4.0%, closely aligned with Ofwat's final determination (5.1%, 3.15%, and 4.03% respectively).

We would not support submissions which suggest further "aiming up" of the cost of equity. Ofwat's FD aimed up for uncertainty in cost of capital measurement including for incentive risk. South West Water's notional ODI RoRE skew of +0.8% was higher than other companies but we believe the incentive package and cost of capital were balanced overall in the FD. Ofwat adjusted incentive rates between the draft and final determinations and took a proportionate, evidence-based approach.

Following the FD, Pennon successfully raised £490m in equity. This clearly signals investor confidence in the regulatory package and our ability to deliver within it. Market to Asset Ratios remain stable suggesting no underestimation of capital costs.

While the CMA may update the WACC mechanically based on newer data, we do not believe a fundamental reassessment of methodology is warranted because Ofwat considered the methodology carefully at PR24 and the FD reflects an appropriate balance between risk, affordability, and investor return.

2. Cost Modelling

We found Ofwat's PR24 cost modelling process to be rigorous, transparent, and evolutionary. The base cost models built on those used in PR19 and incorporated lessons from CMA PR19 determinations. Ofwat's sector-wide approach to real price effects, cost-sharing, and frontier shift formed a coherent and pragmatic package.

We don't believe suggestions to adopt new cost drivers such as regional wages or exclude proven variables like Average Pumping Hea are appropriate given these were assessed and rejected at PR19 and again at PR24 for sound reasons.

On enhancement expenditure, Ofwat made meaningful improvements between DD and FD. For example, wastewater investment modelling became more granular and better reflected local implementation plans. Ofwat was responsive to our evidence, particularly where statutory obligations evolved during plan development.

3. Asset Health

We welcome Ofwat's more pragmatic approach to asset health in PR24, especially its acknowledgement that past base expenditure may not reflect future investment needs. Our "outstanding" plan status was grounded in detailed evidence on "what base buys," and we believe Ofwat's allowances broadly reflect this.

Specific base PCDs and enhancement allowances—for example, on mains replacement and net zero resilience—demonstrate targeted funding where there is clear evidence of need and customer support. In some cases, such as net zero investment, we declined funding because it was not aligned with our customer research, which Ofwat accepted.

We also support Ofwat's commitment to gather more forward-looking asset condition data to strengthen the regulatory approach for AMP9. Longer term, we believe RCV run-off should align more closely with asset lives to provide a stable basis for long-term maintenance planning and financial resilience—something we've proposed to the Cunliffe Review.

4. Plan Incentives and Economic Growth

We don't agree the notion that business plan incentive framework leads companies to "overbid" or submit undeliverable plans. Pennon has achieved "top" plan status in each of the last three price reviews where Ofwat applied such ratings and our success reflects realistic ambition and disciplined planning.

Ofwat provided appropriate scrutiny and feedback throughout PR24, and adjusted targets where needed, such as updating service performance baselines to reflect 2023–24 data. We only receive plan rewards if we deliver against those commitments, which we fully accept.

We believe the PR24 framework supports Government's ambitions for accelerated delivery and economic growth. For example, our Cheddar 2 reservoir project would not have been feasible otherwise. We are also well positioned to deliver key bioresources and storm overflow investments aligned with policy objectives.

Maintaining regulatory clarity and incentives is critical. Any major alteration to comparator-based mechanisms like the Outturn Adjustment Mechanism (OAM) would risk undermining confidence and weakening delivery incentives for companies that accepted the FD.

Conclusion

We believe Ofwat's PR24 Final Determination is in the round a fair, evidence-led package that supports customers, the environment, and investor confidence. It reflects constructive engagement, proportionate risk allocation, and clear deliverability. As a company that has accepted the FD and raised capital to deliver against it, we urge the CMA to consider carefully the potential impacts of any changes to the PR24 framework.

We remain available to support the CMA in any way during the redetermination process.

Yours sincerely

[redacted]

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Appendix - Third Party submission

Pennon business model and strategy

Pennon's strategy goes beyond our track record of producing high quality and deliverable business plans, to using our sustainable financing to grow the breadth of our sector activities. Since PR19 customers in the Bristol and SES Water areas have benefitted from mergers into the Pennon Group.

As part of our model, WaterShare+ is a unique scheme that rewards our customers when we outperform and gives them a greater say in how we operate. It operates alongside Ofwat's regulatory framework and shares the benefits of outperformance with customers. As part of the scheme, we offer our customers the choice of shares in Pennon or money off their water bill. Following share issuances in 2020 and 2022, 1 in 14 customers are now shareholders in our business and we have a greater number of customer shareholders than any other shareholder group.

Pennon's growth strategy and the Bristol and SES Water mergers give immediate benefits to customers and resulted in relatively low bill increases at PR24. The 2022 share issuance included our commitment to share £25m of the £50m efficiencies from the Bristol merger, savings that have improved its wholesale efficiency position in Ofwat's assessment compared to where it was when Bristol referred PR19 to the CMA. This is in addition to the benefits from mergers to the financial resilience of companies we have acquired. Bournemouth, Bristol and most recently SES Water customers have all benefitted from lower bills from no longer requiring small company adjustments to the cost of capital.

PR24 Final Determination (FD)

We accepted the PR24 FD because in the round the revenue, cost allowances, service levels and financial assumptions were overall aligned with our plans. This allowed us to continue to accelerate our delivery for customers. The early certainty on outstanding plan status had allowed us to accelerate a further £75m of early delivery on storm overflow investment

The PR24 FD also supported our efficient financing. The PR24 FD was aligned overall to our view on the cost of capital, with both the cost of debt and cost of equity in line with our expectations[3]. We continue to target a gearing range of 55% - 65% consistent with Ofwat's notional assumptions and we accepted the PR24 FD because it allowed us maintain this.

As evidence in support of this, following receipt of the PR24 FD we undertook a rights issue that raised c£490m to be invested in financial resilience for SES and delivering the plan, consistent with Ofwat's assumptions and without discounting to the value of existing equity in the business, with a small premium for our performance as we deliver our targeted return on regulatory investment (RoRE) of c7%. We have successfully raised new investment based on the PR24 FD and are targeting outperformance to provide headroom for financial resilience and reinvestment in the business[4].

We support Ofwat's PR24 FD for the industry. Ofwat had to balance the use of comparative incentive based regulation with a series of company specific issues facing companies. The framework allows companies to take ownership of these issues and it is important that the CMA, as it did at PR19, considers the sector position. For those companies who accepted the FD it is important to consider

[3] South West Water (August 2024), Finance, Risk and Return PR24 DD technical representation document, table A1.10, finance-risk-and-return.pdf. The CMA may find this document helpful as it contains our analysis of the key economic regulation topics around the PR24 DD, alongside our PR24 FD investor document (J522 InvestorDoc_FD FINAL 280125.pdf) which sets out for investors our plan and summarises the regulatory framework and our delivery plans following the FD

[4] Pennon (March 2025) Capital markets day – A vision towards a sustainable future – delivery for customers, pages 19-25 Capital Market Day

how they managed similar issues in their plan and, in the round, evidence from accommodating those issues when accepting Ofwat's FD. As one example, SES Water has a relatively large cost gap of c.14% at the FD, but we accepted this looking at the Ofwat FD in the round. We are on track to deliver the £11m merger savings we have committed to for SES, which alongside the £86m of new efficiency plans we have in place across the group will help to close this cost gap.

The South West Water outstanding plan status reflected that we had prepared a long term plan and minimised bill increases in a sustainable way. We ensured our original business plan aligned to the Government's strategic priorities, and had our highest ever 74% customer acceptability for this plan based on research using a bill increase consistent with our plan and the PR24 FD[5]. We maintained this level of bill increase as new obligations and increased costs emerged during PR24 by agreeing changes in enhancement scheme timing with Government and regulators, linked to the Long Term Delivery Strategy principles we set out in our original plan.

We could not have got the right plan for government and customer priorities without Ofwat's engagement during the PR24 process. The level of engagement we had with Ofwat was extensive and unprecedented in our experience, in particular during the consultation on the PR24 DD and ahead of the FD. This covered a wide range of topics, in particular those raised in our DD representation overview[6]. Nobody should be left with the impression that Ofwat did not consider PR24 in the round and did not thoroughly balance the outcome between the range of representations made to them at the DD. Ofwat adapted the PR24 approach based on changing circumstances and evidence and adopted new ideas during the process. We believe Ofwat considered points we raised carefully and irrespective of our specific FD, we can identify how our input throughout the process shaped the final PR24 approach to cost modelling, outcome incentives[7], Price Control Deliverables and the design of backstop protections such as the Outturn Adjustment Mechanism (OAM).

The benefit of this engagement goes beyond PR24 and our ability to raise new investment consistent with the FD, to the future industry framework. The CMA panel should note that Ofwat have been clear that the PR24 FD is specific to the circumstances the sector faced now, and should be mindful that the future regulatory approach to the sector is under review during the redetermination process. As an example, our engagement with Ofwat on the RCV run off during PR24 has allowed us to develop thoughts on future funding of asset health and this is reflected in our response to the Cunliffe Commission Call for Evidence. It may be helpful for us to engage with the CMA on such topics during the redetermination process.

From our initial review of the disputing company statement of cases we have identified four key areas where we have observations to make.

Cost of capital

The disputing companies generally raise issues with the cost of debt and cost of equity, both in terms of the methodology and data issues. We set out our view on the cost of capital methodology issues in our response to the PR24 DD[8]. Overall, our view of a cost of equity of 5.17%, cost of debt of 3.04% and appointee WACC of 4.0% was aligned to the Ofwat FD of 5.1%, 3.15% and 4.03%. We agree with Ofwat that the "aiming up" of the cost of equity for parameter uncertainty in the FD included sufficient consideration of methodology issues, such as if Pennon beta should be included.

We disagree with submissions that suggest further aiming up of the cost of equity to reflect ODI performance imbalance is required for PR24. We believe the situation at PR24 is different to that

[5] South West Water (August 2024), Representation Overview, page 4 (our-representation.pdf)
[6] South West Water (August 2024), Representation Overview, (our-representation.pdf)
[7] As evidence of how PR24 involved effective engagement, the Ofwat top down approach to RCV allocation that emerged during PR24 was discussed at an early stage and in our contribution on simplifying ODIs to Ofwat's PR24 Future Ideas Lab (PowerPoint Presentation), and more dynamic adjustments such as OAM to balance RoRE risk was suggested in our original plan and DD response (e.g. page 110 of finance-risk-and-return.pdf).
[8] South West Water (August 2024), Finance, Risk and Return PR24 DD technical representation document, Annex A finance-risk-and-return.pdf

successfully argued for by Bristol Water at PR19 which the CMA adopted at that time. In line with the CMA PR19 findings, UKRN guidance and Ofwat's PR24 methodology that if at all possible incentive issues should be adjusted at source rather than through aiming up that increases customer bills, we accepted the PR24 FD on the basis of the cost of equity and ODI incentives skew in the FD. Ofwat reset ODI incentives between DD and FD and considered risk on a company specific basis, and although South West Water has the highest notional ODI RoRE skew in the FD of 0.8%[9], in our view it is a balanced package overall and consistent with the FD cost of equity.

We disagree with submissions that suggest that the recent equity raise by Pennon, or the performance of our business units, provides evidence that Ofwat have set the cost of capital incorrectly at PR24. In our post FD investor document[10] and in our recent capital markets day investor presentation[11] we set out evidence of our expectations to be able to perform well against the PR24 FD. Although it takes some time after completing a rights issue for the net impact to be fully reflected in the share price, its successful completion at a scale and terms consistent with the FD suggests a Pennon Market to Asset ratio of c1x – 1.1x, at the same level as after Ofwat's FD as would be expected[12].

As we recognised in our DD response to Ofwat the cost of capital will depend on the market data available at the time and for this reason the CMA may reach a different view on the level of the WACC. In our view this could be a simple mechanical update based on the latest information rather than requiring extensive debates about the methodology, as we believe Ofwat considered cost of capital methodology issues carefully at PR24.

Cost modelling

Ofwat undertook an effective and extensive base cost modelling consultation process at PR24. We were content with the overall suite of base cost models. We believe they are a logical development of the PR19 cost models, including the minor amendments made by the CMA panel at PR19. We also note that the extensive exploration of Cost Adjustment Claims, noting for instance that the Bristol Water canal cost adjustment was not contentious in line with the CMA findings at PR19. We also welcomed Ofwat's overall approach to real price effects (such as energy), cost sharing and frontier shift as package for the sector. Ofwat also took other welcome steps in the FD, such as including historical bioresources enhancement expenditure within the base cost allowance modelling. We disagree with submissions that suggest regional wage variables or to not use Average Pumping Head as a variable, as such suggestions were thoroughly reviewed and rejected at PR19 and PR24.

On enhancement expenditure, Ofwat had to evolve its modelling approach given the policy changes affecting the statutory wastewater enhancement programme shortly before the October 2023 plan submissions deadline, and subsequent to plan submission. The more granular and scheme level modelling possible between DD and FD improved the model robustness. For companies with less clarity than ourselves in the original plan on the local implementation of the statutory programme, this may have been more challenging to assess the impact and respond to the efficiency modelling in the DD in reviewing plans than we were able to. For us, Ofwat carefully reviewed further evidence between DD and FD, having quickly acknowledged that there had inevitably been more focus on the wastewater enhancement programme than DWI statutory schemes and water WINEP at the DD. Together with responding to evidence, this resolved many of our issues at the DD as would be expected between a DD and the FD. We considered the enhancement allowances, Price Control Deliverables and uncertainty and risk mechanisms in the FD in the round and believe they support the efficient delivery our plan.

[9] Calculated from Ofwat FD RoRe model (https://www.ofwat.gov.uk/wp-content/uploads/2024/12/PR24-FD-RR04-PR24-RoRE.xlsx) as difference between ODI P10 and P90 position of -0.8%. Ofwat show -0.2% for the median company.

[10] PR24 FD investor document (J522 InvestorDoc_FD FINAL 280125.pdf)

[11] Pennon (March 2025) Capital markets day – A vision towards a sustainable future – delivery for customers, pages 19-25 Capital Market Day

[12] We can provide further support to this calculation to the CMA on request.

Asset health

We recognise that the area of funding for asset health in the water sector is an area that will continue to evolve. Unlike at PR19 Ofwat have accepted that the recent cost increases and expenditure in recent years may not fully be reflected in wholesale base cost allowances, if this was just based on industry historical expenditure. We provided Ofwat with extensive information on "what base buys" during PR24 and used this to look at areas we could target further efficiencies and stretch service levels, which we believe contributed significantly to our "outstanding" plan status[13].

Ofwat made the pragmatic decision to allow some specific additional allowances where there was evidence of how this could be targeted and customers protected. Examples include the additional expenditure and base PCDs on mains replacement and net zero resilience. In our case we rejected the additional net zero expenditure at the DD as it was not aligned to customer views in our plan, which Ofwat accepted. Similarly on mains replacement Ofwat's assumption on 0.3% p.a. mains replacement aligned with some of our regional plans (e.g. this level was supported by our asset modelling for the Bristol area as it was at PR19, but not for other areas (e.g. South West). We consider that Ofwat have taken a pragmatic approach based on the information available for PR24, and have also recognised that in the absence of the industry identifying an agreed set of forward looking asset health measures, it is sensible to collect further condition and performance information for more asset categories than was possible for PR24. We support Ofwat's intention to accelerate further expenditure into AMP8 if evidence shows a need to do so from this further data.

We believe that asset condition and performance can also provide an underpin to asset maintenance allowances at a company level. This is because for investors the RCV run off should reflect the historical assets age and condition and if a link is maintained on this basis to revenues, we should use this as a good cross check for maintenance needs as the asset base expands with enhancement over time. However, this underpin link is lost if the RCV run off diverts from asset lives for groups of assets as they age. This is something we are suggesting as a regulatory simplification to the Cunliffe Review on asset health funding for resilience as part of our wider proposals for changing the governance of the water sector. We would therefore disagree with any submissions that suggest RCV run off or "Pay as You Go" rates should be adjusted up or down for financeabillity or customer affordability reasons, thereby moving away from reflecting the underlying asset lives of each company's asset base. This is consistent with the CMAs PR19 findings but is now more important given we are no closer to identifying an agreed set of forward looking asset health measures for the water sector.

Looking across base and enhancement expenditure we would reject submissions that suggest that Ofwat do not consider long term asset health and investment issues generically. We would highlight the context of our enhancement investment in lead pipe replacement which also has long term resilience and sustainability benefits to asset health and public health. Both Ofwat and the DWI supported the ambition we showed despite there being an option to postpone accelerating this investment beyond 2030[14].

Plan incentives and economic growth

Several company submissions and industry commentators have expressed concern that business plan incentives encourage companies to "bid" with unrealistic or undeliverable plans at a price review. We disagree. Having achieved the top status with our business plans and delivered outperformance of the regulatory framework over time we do not believe there is sound evidence to support this contention. In the PR24 FD Ofwat have recognised the strengths of most company business plans and provided the opportunity to amend where necessary. Ofwat also reset targets for emerging 2023-24 data between DD and FD. For the outstanding plans such as our own, Ofwat

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[13] Summarised in South West Water (October 2023), Risk and Return, Annex C risk-and-return.pdf

[14] DWI (July 2023): Drinking water 2023 – public supplies England p.51 (Drinking Water 2023: The Chief Inspector's report for drinking water in England)

have gone further in the past and placed specific conditions (which we agreed to) before we will benefit from the plan rewards – we only get paid if we deliver and have accepted the PR24 FD on this basis.

Maintaining such incentives is important at a time when the Government is asking the water sector and its regulators to revisit what more it can do to accelerate delivery to support economic growth and housing. Our focus is on the procurement and delivery of the three major water resource schemes in our area, not least Cheddar 2 reservoir which is not something that Bristol Water would not have done without the merger with Pennon. There are other aspects to support economic growth such as bioresources and storm overflows where Government expects us to work with Ofwat and where we believe the PR24 framework provides a flexible enough platform to do so. We are keen to support the CMA with its PR24 redeterminations as much as we can, to avoid the risk that it creates uncertainty that prevents Ofwat from building on the PR24 framework to support the sector in delivering on priorities such as economic growth.

We would ask the CMA to consider the specific context of PR24 and put a higher threshold to amending backstop protection mechanisms such as OAM that could result in differences in how such comparator and dynamic mechanisms operate compared to companies that have accepted the FD package.

Conclusion

We hope the overview above of our approach to PR24 and how this led to a successful outcome for customers and investors is helpful. We are ready to answer any questions or requests for information on how we approached specific topics at PR24, the potential solutions we considered with Ofwat and how we are using the PR24 framework having accepted the FD and raised investment funds to deliver it in line with Ofwat's assumptions.