1. EXECUTIVE SUMMARY

1. This note provides limited comments on other Disputing Companies Statements of Case (**SoCs**) as submitted to the Competition and Markets Authority (**CMA**) on 21 February 2025.

2. We have focused our commentary on the more material elements in other companies SoCs that we support and those which we do not. We also make some suggestions for consideration by the CMA in the development of its 'approach document' that should support an effective and timely conclusion of the redetermination.

3. There are some areas where it is clear that a "one size fits all" approach has not worked well at PR24, particularly in areas where each company clearly faces different risks and investment needs, such as resilience. Rather than trying to fit all of these risks into one comparative model (as Ofwat is now seeking to do for asset health) or making abstract changes to comparative models (as some Disputing Companies have suggested for base models and outcomes), the CMA could address this for PR24 by looking at individual risks and how these should be addressed. This could then support and inform Ofwat's long-term review of its approach, whilst enabling critical investments to proceed in AMP8.

1.1. CONSISTENT AREAS OF CONCERN ACROSS COMPANIES SHOULD BE PRIORITISED

4. We have mapped out the issues raised by the Disputing Companies and sought to group these (see **Appendix 1**). Across the five SoCs we have identified three common, material, areas of concern, notably:
   - the level of capital maintenance funding provided by the PR24 Final Determination (**FD24**), sometimes articulated as 'asset health' or 'operational resilience' in different individual cases;
   - the overall level of 'stretch' or 'risk' in FD24 and whether or not this is 'achievable'; and
   - the allowed return and whether this is 'financeable', or 'investable'.

5. We consider that these three areas should be prioritised by the CMA in its redetermination as these appear to be common, core concerns across the Disputing Companies.

6. **Capital maintenance** concerns are raised across four SoCs[1] but each company has positioned the issues and solutions differently. This is not surprising given the inherent differences across companies' asset bases and circumstances and the methodological barriers included in PR24.[2] We comment on the different proposals in the context of the operational resilience/asset risk management concerns set out in our SoC, as well as the possibility of the CMA preferring a broader basis for providing required funding beyond the specifics of each company's individual case. Concerns around asset health were also raised in the NAO's recent report on the water sector which noted that there has been "*limited progress in developing a common understanding of asset health*",[3] and that Ofwat "*still does*

[1] See Appendix 1, rows 3-5, and Section 3.1.

[2] As we explain in SoC Section 4.2.3, Ofwat's PR24 process required companies to follow their cost models or face significant penalties under the Quality and Ambition Assessment (**QAA**). Given this barrier companies have taken different approaches in their business plans and subsequently made different proposals in the SoCs as to how the CMA could address these issues.

[3] National Audit Office, Regulating for investment and outcomes in the water sector, Session 2024-25, 25 April 2025, HC 853, p. 12

not have sufficient monitoring that ensures appropriate long-term expenditure and maintenance".[4] This reinforces the need for a change in approach in this area.

7. **The overall stretch or level of symmetric risk in the package** is an issue highlighted across all companies' SoCs.[5] Again, although companies have highlighted the same concern, a range of different proposals are suggested to address it. The Disputing Companies consistently raise frontier shift, Outturn Adjustment Mechanism (**OAM**), and unjustified adjustments for perceived AMP7 under-delivery as key issues and we consider these are fruitful areas for the CMA to prioritise. In our SoC we highlighted that the RoRE gap for the notional company is likely to be at -2.3% and, recognising our comparatively strong performance, we suggested proposals that would provide around 1.1% of RoRE correction.[6] We would ask the CMA to consider and take forward changes that would provide at least this level of correction.

8. **The allowed return** is also highlighted by all Disputing Companies in their SoCs.[7] Companies have used a range of evidence to reach their conclusions with three independent reports provided to the CMA. We consider the CMA should redetermine the allowed return considering this evidence and any new evidence provided by Ofwat.

1.2. ELEMENTS OF OUR CLIMATE RESILIENCE CASE ARE MIRRORED IN OTHER SOCS

9. We are the only company to make a specific case for additional investment to address the impact of increasingly extreme weather affecting power supplies to wastewater assets. This is not surprising, given our evidence that this is a particular issue for us in our North-East region.[8] However, we note that Southern and South East each seek adjustments to their Performance Commitment Level (**PCL**) for interruptions to water supplies (**ITS**) and South East seeks an exclusion from this PCL for extreme weather events. The rationale for these interventions shares some similarities with our climate resilience case, including other potential solutions that could be considered.

10. As we set out in Section 4 we explored the possibility of an exclusion for severe weather events with customers as an alternative mitigation when we were developing our business plan. Our preference is for our concerns in this area to be addressed via an uplift in funding (see SoC Section 4.5.4) as that reduces the risk of pollution incidents occurring directly, rather than merely excluding the impacts for the purpose of calculating regulatory incentives. We are also keen to ensure that PCLs are set at stretching levels and, for us, the level set in FD24 appears appropriate. However, in the absence of that additional investment, excluding extreme weather events from the pollution incidents PCL, as suggested by South East, would be an alternative option to address this concern.

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[4] Regulating for investment and outcomes in the water sector p. 42.
[5] See Appendix 1, row 6, and Section 3.2.
[6] NWL SoC, Section 5.3 paragraph 406.
[7] See Appendix 1, row 9, and Section 3.3.
[8] NWL SoC, Section 4.5 and Appendix 5.

1.3. ENSURING A PROPORTIONATE APPROACH

11. Other companies, particularly Southern and South East, have raised various issues in relation to the base cost models and certain PCLs or Outcome Delivery Incentives (**ODIs**).[9] We agree with many of these concerns, particularly in relation to the base cost models, and our analysis suggests that application of the remedies advocated by these companies to our settlement would, in the round, be beneficial. We also consider that the CMA should engage constructively with all the substantive arguments raised by each company. However, a full reopening of these matters to completely reset the framework for cost assessment or the incentive framework could prove challenging in the limited time that the CMA has available, particularly in the absence of any company proposing a clear alternative framework.

12. Our suggestion would be for the CMA to engage with these arguments on a by exception basis, applying individual solutions for the companies that have raised the points of challenge in their SoCs, but leaving the modelling and PCL/ODI suite largely unaltered.

2. OVERVIEW

13. Based on our review of the other Disputing Company SoCs we agree with many of the concerns identified regarding Ofwat's approach to PR24, and we have raised some of the same concerns with Ofwat throughout the PR24 process.

14. In shaping our SoC we were cognisant of the challenge the CMA might face if asked to look at all areas of what has now become a very complicated price review framework. As such we have presented a SoC that is focused on issues with FD24 that are material to our business and customers and which can be remedied now, as part of this redetermination for AMP8, within the regulatory framework that Ofwat has applied.

15. Wessex makes similar points in its SoC, taking a "narrow, targeted approach… to ensure that the limited time all parties have available is spent on the key areas".[10]

16. In this response to other Disputing Company SoCs, we set out our views on how the CMA might ensure that they can spend this limited time on the key areas raised.

3. CONSISTENT AREAS OF CONCERN THAT SHOULD BE PRIORITISED

3.1. THE LEVEL OF CAPITAL MAINTENANCE FUNDING

17. Each company recognises that capital maintenance has been underfunded and presents evidence for this. There is a strong consensus amongst the Disputing Companies that there is a fundamental issue with the current framework that requires careful consideration by the CMA.

18. However, given the different issues that companies have across their asset bases and the constraints imposed upon them by the regulatory framework (including the QAA incentives), each company makes a slightly different request. But at the core of these cases there is strong common ground that the current backward-looking approach to setting capital

[9] See Appendix 1, rows 1-2 and 7-8, and Section 5.
[10] Wessex Water Statement of Case, p156.

maintenance allowances is not fit for purpose and that the resulting allowances do not provide for a sustainable level of investment in the long run. Figure 1 summarises the different cases across each SoC.

FIGURE 1 - SUMMARY OF CAPITAL MAINTENANCE IN SOCS

Company	Targeted proposal for capital maintenance	References
Northumbrian	Specific investments in priority areas of civil assets at treatment works and service reservoirs	NWL SoC, Section 4
Anglian	Investments in priority areas of gravity sewers and storage points [i.e. service reservoirs and water towers], or meter boundary boxes	AW SoC, Chapter E.2
South East	Challenges base cost model allowances in general	SEW SoC, Section 4
Southern	Gated allowance for specific asset health expenditure when identified	SW SoC, p200
Wessex	Bottom-up assessment of base costs for their water service	WW SoC, Chapter 8

Source: NWL analysis of disputing companies' statements of case

19. Considering these concerns and the evidence behind them should be an area of key focus for the CMA, in our view. We consider that addressing funding for capital maintenance is critical to the operation of the water and wastewater systems over the next five years and in the longer term. The CMA has the opportunity to address the specific points of challenge for AMP8 for the Disputing Companies, but the expression of the CMA's views will also be valuable to the ongoing debate as to how this addressed in the future. We will of course continue to work with Ofwat on a more comprehensive methodology over a longer time frame, but these specific cases need to be addressed now.

20. If the CMA agrees that action is required, then our preference would be that the CMA considers each company's individual cases as that is what the evidence best explains in each case. For us, for example, we think our case for investment in civil structures and service reservoirs is self-contained, easily digestible, substantiated by strong evidence on need and costs and is supported by our customers. The investments are clearly articulated with straightforward and specific Price Control Deliverables (PCDs) covering the outputs.

21. However, if the CMA wanted to consider options for a common adjustment across companies, we would be happy to engage in that process.

3.1.1. Water mains adjustments

22. Ofwat also recognises explicitly (through its water mains adjustment) and implicitly (through its introduction of the asset health roadmap, which provides the potential for changes to allowances during AMP8) that there is insufficient investment in water mains replacement and renewal.

23. For the water mains adjustment provided in FD24, all companies have challenged the detail of the replacement rate funded from base costs, where there is consensus that the renewal rate of 0.3% in FD24 is too high. The position suggested in the SoCs ranges from 0.15% to 0.2% (see Figure 2). We consider this is an area where the CMA could adopt a common remedy for all companies.

FIGURE 2 - SUMMARY OF WATER MAINS RENEWAL ARGUMENTS ACROSS SOCS

Company	Commentary on water mains adjustment	References
Northumbrian	Suggests that 'what base buys' is 0.15% of mains renewal based on an average consistent with the base modelled period of the last five years	NWL SoC, Section 4.4
Anglian	Suggests that 'what base buys' is 0.2%, based on a range of weighted and unweighted models over a 5-12 year period in its CAC.	AW SoC, Chapter 3.1
South East	Suggests that 'what base buys' is 0.15% of mains renewal, based on an average consistent with the base modelled period of the last five years	SEW SoC, para. 4.29 (a)
Southern	Suggests that 'what base buys' is 0.17% of mains renewal, based on several methods including: weighted average approach using the data from 2011-12 to 2023-24; weighted average using last five years; and weighted average using upper quartile companies.	SW SoC, Section 7.1.5
Wessex	No specific proposal on adjustment, other than Ofwat "overestimating the implicitly funded level for mains renewal" – due to wider approach to estimating base costs for water.	WW SoC, para. 2.52 (b)

Source: NWL analysis of disputing companies' statements of case

24. As detailed in Figure 2 there are generally two approaches proposed by the companies for calculating the implicit allowance: either basing this on the average of the last five years (consistent with Ofwat's approach for calculating the efficiency catch up challenge for wholesale water); or using models containing data over a longer period.

25. Based on the evidence and analysis presented by other companies, we continue to consider that the average of the last five years is the most appropriate approach. This reflects the more recent "squeeze" on capital maintenance in base costs and is consistent with Ofwat's approach for calculating the efficiency catch up challenge for wholesale water, which ultimately drives allowances. This approach is also used by South East and Southern (who use it for two of the four approaches that they average together).

3.2. THE OVERALL STRETCH IN THE PACKAGE

26. All companies say that FD24 is, once again, unlikely to be achievable and does not reflect a robust consideration of the risk in FD24 in the round – so it does not represent a balanced package of risk and return. This is summarised in Figure 3.

FIGURE 3 - SUMMARY OF ARGUMENT AROUND 'STRETCH' AND 'ASYMMETRY' IN FD24

Company	Commentary on stretch and asymmetry	References
Northumbrian	Suggests that the package is 'unlikely to be achievable for the median performer in the sector' and highlights three adjustments that could resolve this – reducing the stretch on costs; restoring the flexibility of the totex framework; and removing the deadband from OAM.	NWL SoC, Section 5
Anglian	Suggests that "the multiple, unprecedented challenges and risks facing the sector are not counter-balanced by reasonable returns for investors", and proposes adjustments at source for costs, some specific ODIs, and specific PCDs – including removing the deadband from OAM.	AW SoC, Chapter A.8
South East	Suggests that there is a "material imbalance in Ofwat's PR24 FD package… FD24 results in an overall level of risk that is	SEW SoC, paras. 1.11 and 1.12, Table 1.1

Company	Commentary on stretch and asymmetry	References
	unsustainable", and proposes adjustments at source for costs, some specific PCLs, and removing the deadband from OAM.	
Southern	Suggests that "our own, robust assessment demonstrates that the FD is not a fair bet and is unlikely to attract the necessary levels of investment", and proposes adjustments at source for costs, ODIs, PCLs, PCDs, and risk mitigations.	SW SoC,, p.56 para. 11
Wessex	Suggests that "while we have chosen to focus on the most material drivers of this downside skew, a fully balanced package would need to address the source of other issues", and proposes reducing the stretch on base costs; and adjusting returns to compensate for downside skew.	WW SoC, Table 1 and Appendix A5

Source: NWL analysis of disputing companies' statements of case

27. Companies have put forward several suggestions in this area but these all start from the finding that the overall package is not a fair bet and is instead skewed towards the downside.

28. In our SoC we highlighted that the RoRE gap for the notional company is likely to be around -2.3% and, recognising our comparatively strong performance, we suggested proposals that would provide around 1.1% of RoRE correction. Consistent with the challenge presented by all companies, we ask the CMA to consider and take forward changes that would provide at least this level of correction. We highlight below three adjustments that could achieve this, reflecting on how these are addressed in the other company SoCs, but alternative or modified adjustments may be acceptable if these can achieve the same overall level of correction.

29. Two areas we consider the CMA should focus on as part of this are frontier shift and the Outturn Adjustment Mechanism (**OAM**).

30. **Frontier shift:** This is a common issue across companies where there is consensus that the 1% per year assumption adopted in FD24 is too demanding and unachievable. In our SoC we suggested a stretching 0.8% assumption (consistent with our BP24) but note that some companies adopted lower numbers (0.5%).[11] In our view, reaching a view on the appropriate level of frontier shift does not need to be a data intensive exercise as the key issue of debate is not the way the numbers are calculated; it is their interpretation. From our perspective there are two key issues for the CMA to consider:

- More recent data since 2008 shows a slowdown in productivity. We consider this to be more relevant for the next five years than longer term growth rates in productivity which were significantly higher. We do not think it is reasonable to expect the water sector and its supply chain to buck this trend.
- The level of frontier shift needs to be considered in the context of the overall settlement. As set out in our SoC,[12] FD24 already sets four challenging upper quartile challenges on costs that only one WASC is currently able to meet and sets a stretch on service improvements averaging around 10% over AMP8 (compared to a 3.4% improvement over the last five years). These improvements in service quality already represent productivity

[11] Appendix 1, row 6.
[12] NWL SoC para. 401

improvements that we must make and layering on a further 1% per annum reduction in costs is not achievable.

31. **Outturn Adjustment Mechanism**: Some companies have made arguments about specific ODIs (e.g. South East and Southern) but from our perspective the neatest solution to addressing asymmetry in the ODI package is just to remove the deadband in the OAM. This achieves the objective with certainty and avoids the need to look in detail at specific targets or mechanisms, which we think is a more proportionate approach. This would leave the CMA to then only consider if there are company specific factors warranting a different approach for each individual company.

32. In Section 5.4.2 of our SoC, we also described the issue of **unjustified AMP7 delivery penalties**, which applied a downward adjustment to efficient totex allowances for wastewater growth and meter replacements. South East makes the same point, saying that *"Ofwat has wrongly penalised certain companies – including SEW – by removing allowances where it argues companies did not deliver the activities set out in their PR19 business plans. This is an arbitrary, asymmetric and retrospective regulatory intervention that is inconsistent with the principles of the PR19 price control…"*.[13] Anglian notes it has "*deep concerns regarding Ofwat's historical approach and that it will apply a similar approach for future asset classes. In particular, Ofwat is wrong to apply retrospective expectations as to how much companies should have spent in the past on a specific asset class*".[14] Anglian illustrates this point for mains renewal and asks the CMA to call out this "error", as although it does not affect Anglian Water now, it is concerned that Ofwat will repeat this for other asset classes.[15]

33. Ofwat applied this approach across three areas at FD24: meter replacements, mains renewals (both in base) and wastewater growth (previously in base expenditure at PR19, now in enhancement). The CMA could consider a common principle across these areas, and so apply the same approach in its response for the three companies concerned.

3.3. THE ALLOWED RETURN

34. All companies agree that the FD24 allowed return is too low to attract equity investment and support the financeability of the notional company. All propose an increase in the cost of equity with companies proposing between 6.05%-6.89%. In arriving at these estimates, the expert reports from KPMG[16] (Southern and South East), Oxera[17] (Anglian) and Kairos[18] (Northumbrian and Wessex) and the company SoCs set out a series of common points:

- Index-linked gilt yields are distorted below the true risk-free rate and should be adjusted either directly for the convenience yield and/or by placing weight on AAA rated bonds consistent with the Brennon model, and in line with CMA FD19 precedent.
- For total market returns, the focus should be solely on the long run ex post approach.

[13] South East Water Statement of Case, Section 4.26.
[14] Anglian Water Statement of Case, para. 48.
[15] Anglian Water Statement of Case, Section 8.2.
[16] SOU–7-0034 KPMG Estimating the cost of capital for PR24
[17] ANH Annex 036b – Oxera PR24 Cost of equity estimation
[18] NES SOC001 – Kairos PR24 Allowed Return 2025

- The beta dataset should include data from Pennon.
- There should be some form of de-weighting for the Covid period of the beta data.
- The forward-looking beta is likely to be above the long-run average due to the step change in the investment programme
- The risk-free rate dataset should be updated using the latest market data, which has increased materially since the FD data point.
- The MAR and MFM analysis support the use of a higher cost of equity.
- Under the CAPM framework, aiming up is required to account for estimation uncertainty and the asymmetric consequences of setting the cost of equity too high versus too low, which is particularly acute at PR24, given the step change in investment.
- Although CAPM is used as the primary model, it has many flaws, including omitted variables and performing particularly poorly for low beta stocks, like utilities. It is therefore important to cross check the CAPM figures with alternative models, such as multi-factor-models, debt versus equity premium analysis, inferred cost of equities from market to asset ratios, infrastructure fund returns, equity analyst reports and financeability.

35. The CMA should redetermine the allowed return considering this evidence and any new evidence provided by Ofwat.

4. ELEMENTS OF OUR CLIMATE RESILIENCE CASE ARE MIRRORED IN OTHER CASES

36. As outlined in Section 1.2 the details of our power resilience and climate change investment case are specific to us and the circumstances in our North-East operating area, but there are consistencies with issues raised by Southern[19] and South East[20] with respect to interruptions to supply – in particular regarding the potential use of an exclusion for severe weather events as a mitigation for the impact of climate change.

37. When developing our BP24 we explored the possibility of an exclusion for severe weather events with customers as this had existed in performance commitments until 2022. We commissioned work examining the way other regulatory regimes managed the longer-tail risks of extreme weather events on customers and this confirmed that most regulatory regimes include exclusions for extreme weather events.[21] The report noted that:

> … regulatory mechanisms which share the risk of extreme weather are common across other regulated infrastructures.[22]
>
> We suggest that the core set of ODIs that are temporarily suspended during and immediately after the event are the common PCs which can be materially affected by extreme weather events: supply interruptions, leakage, mains repairs, internal and external sewer flooding, per capita consumption, pollution incidents, discharge permit

[19] Southern Water Statement of Case, Chapter 6 Section 4.1.
[20] South East Water Statement of Case, Section 5.
[21] FE Managing Extreme Weather, SOC478.
[22] FE Managing Extreme Weather, para. 1.6, SOC478.

compliance, bathing water quality, river water quality, storm overflows, unplanned outages and sewer collapses.[23]

38. Our preference is that our concerns in this area are addressed via an uplift in funding (as set out in our power resilience and climate change investment case) because this reduces the impact of pollution incidents directly, rather than simply not counting these for regulatory purposes. We are also keen to ensure that PCLs are set at stretching levels and, for NWL, the level set in FD24 appears appropriate. If, however, there is not an appetite to fund additional investment at this time, then excluding extreme weather events from the pollution incidents PCL would be an alternative option to offer some mitigation against the risks we have identified. This would be consistent with the views expressed by customers: when we asked our customers for their views about Ofwat's DD24, the majority of our People Panels said that *"it is unfair to limit the spending that NWG can make in their Business Plan and then also penalise them for circumstances outside of their control."*[24]

5. TAKING A PROPORTIONATE AND TARGETED APPROACH

39. We anticipate that the CMA will want to take a proportionate and targeted approach to its redetermination in order to maximise the limited time it has available. To achieve this, our suggestion would be that rather than fully reopening the base cost models or the PCL/ODI package the CMA could instead simply do so on a targeted basis for specific companies raising these concerns, alongside undertaking updates for new information. Fundamentally reopening these areas would be a very resource intensive exercise as they represent one of the largest and most complex areas of the PR24 process. A targeted approach that makes limited adjustments could save significant administrative time.

40. In its notice of referral Ofwat argues that its FD24 is 'an integrated package' and that looking at one element alone cannot be done in isolation. But in reality, the companies show in their SoCs that this is not true, and in fact the lack of integration is a key weakness of the FD24 process. As such we consider that it is actually fairly straightforward for the CMA to make adjustments to one part of the package and leave others undisturbed: Ofwat has set each independently in any event; and Ofwat's collective risk analysis of the package overall is significantly flawed.

5.1. BASE COST MODELS AND THE OUTCOMES PACKAGE DON'T NEED TO BE RE-OPENED

41. The base cost models are an important part of the PR24 framework and have been used to set a significant element of allowances (£2.7bn).[25] They are one of the few areas where companies' interests are not aligned as the use of different cost drivers generally moves money between companies rather than increasing or decreasing them overall. There are therefore areas where companies have significantly different views as their interests are very

[23] FE Managing Extreme Weather, para. 1.9, SOC478.
[24] NWL DDR People Panels DD, p39 and 40, SOC217
[25] Sum of final allowance for NES from PR24 Final determinations: CA05 Base costs water model 3 (**FD24 Water FM3**), December 2024, tab "Final allowances"- cell H10, SOC330; and Ofwat, PR24 Final determinations: CA08 Base costs wastewater model 3 Network Plus (**FD24 Wastewater N Plus FM3**), December 2024, tab "Final allowances" – cell H10, SOC331; and Ofwat, PR24 Final determinations: Base costs wastewater model 3 Bioresources (**FD24 Bioresources FM3**), December 2024, tab "Final allowances" – cell H10, SOC332; and Ofwat, PR24 Final determinations: CA12 Base costs residential retail model 3 (**FD24 Retail FM3**), December 2024, tab "Real allowance" – cell Q10, SOC333.

disparate. As a result, they have been the focus of extensive consultation and development throughout PR24 where Ofwat has iterated the models from PR19 and has invited companies to make their own model proposals. The position of the companies across these base cost models but also PCLs/ODIs is summarised in Figure 4

FIGURE 4 - SUMMARY OF ARGUMENTS AROUND BASE COSTS MODELS AND PCL/ODIS

Company	Commentary on base costs and PCLs/ODIs	References
Northumbrian	None	N/A
Anglian	The CMA should revise PCLs for leakage, pollution incidents, external sewer flooding, and water supply interruptions.	AW SoC, Chapter G.1
South East	Ofwat has made errors on water econometric modelling and cost adjustment claims; errors on water supply interruptions PCL and C-MEX.	SEW SoC, Chapters 4 and 5
Southern	Ofwat has made errors on water and wastewater base cost econometric modelling and cost adjustment claims; errors on 12 performance commitments; and errors on ODIs and risk protection	SW SoC, Chapters 2 and 5
Wessex	The CMA should engage with the bottom-up analysis for wholesale water costs.	WW SoC, Chapter 8

Source: NWL analysis of disputing companies' statements of case

42. Base cost modelling will never be an area where companies agree on the outcome because the choice of each cost driver creates winners and losers. Although we have some objections of our own to the final model specifications,[26] we do not consider that there is an objectively better modelling approach that could be adopted (when we disregard the material concerns that we have around capital maintenance funding). Therefore, despite our concerns, we do not think reopening this area of PR24 would result in a better outcome overall for companies or for customers. We would therefore support the base cost models not being reopened as part of the redetermination, or if they are to be reopened, only reopening them for the companies' raising concerns. This would allow greater focus on what we see as the key issues for the CMA.

43. We faced a similar situation as part of the PR19 redetermination where we did not challenge the base cost models developed by Ofwat for similar reasons as set out above. Nonetheless, because other companies disputed the models, we spent considerable time and effort debating these issues. We did not feel that this was a productive exercise and would consider that the changes made were relatively minor – the biggest change was from the use of the additional year of data (2019/20) that became available during the process. However, if the CMA does reopen the models in a way that affects our overall settlement then we would reserve the right to make representations on the evidence as set in our SoC.[27]

44. For similar reasons, we do not see any reason to reopen PCLs or ODI rates for all companies. We do have concerns that there is a downward skew in the ODI package as set in our SoC.[28]

[26] NWL SoC Appendix 1, Section 1, Figure 1.
[27] NWL SoC Appendix 1, Section 1, para. 2.
[28] Figure 34 of our SoC shows that Ofwat's own assessment indicated a 0.2% of RoRE downward bias in the package and KPMG identified a larger 0.5% downward bias.

However, rather than trying to recalibrate individual ODIs we think the most sensible solution to resolve the downward skew and to ensure a fair bet in the ODI package is through the removal of the OAM deadband as we argued in our SoC. This is a straightforward change that addresses these concerns without needing to get into the detail of individual targets or incentive rates.

45. However, we recognise that some of the issues described by other companies may lead to significant and unacceptable levels of risk for them. We think these could be addressed as specific issues for those companies only, as those companies describe these issues either as issues relating to maintaining frontier performance, or issues relating to particularly poor performance (including for specific reasons that companies show are not always in their control).

46. In theory, all parts of the price control should be calibrated together, and so an argument could be made to reopen everything. However, in practice, Ofwat did not calibrate these together at FD24. For example, base costs do not link to service levels, but instead to historical costs and drivers which are independent of performance commitments. Performance commitments have generally been set in comparison to current performance and to other companies and on an individual PCL by PCL basis, rather than taking enhancement expenditure into account (except for a small number of PCLs such as storm overflows). The frontier shift target is set in reference to productivity in the wider economy and does not reflect performance commitments or consider the level of 'catch-up' efficiency.

47. Instead, Ofwat draws these parts of the price control together only for the RORE risk assessment, which is materially flawed and we address this in our SoC.[29] None of the remedies we propose for items in our SoC would change anything about base models or performance commitments.

48. Overall, we do not think it is necessary or proportionate to reopen this part of the determination for all companies.

49. Although we do not favour reopening the approach to base costs or outcomes, we do provide some initial views on other companies' proposals – they are set out in Appendix 2.

[29] NWL SoC, Section 5.

APPENDIX 1: SUMMARY OF ISSUES RAISED ACROSS APPELLANTS

Area	Northumbrian Water	Anglian Water	South East Water	Southern Water	Wessex Water
1) Base cost models	-	-	Adjust water base cost models – to reflect topography, population growth, and water treatment complexity; Revise UQ benchmark.	Adjust water and wastewater base cost models – to remove load treated and average pumping head. Change assumptions around power cost share and forecast energy prices.	Appropriate and triangulated approach to wholesale water base costs.
2) Cost adjustment claims	-	Increase leakage allowance to reflect marginal cost of frontier performance	Review CACs for economies of scale and network reinforcement	Review CACs for AAD, regional labour, and coastal population	-
3) Asset health – mains replacement	**Set implicit allowance** to 0.15%	**Set implicit allowance** to 0.2%	**Set implicit allowance** to 0.15%; Revise unit cost.	**Set implicit allowance** to 0.17%; Revise unit cost.	**Redetermine implicit allowance.**
4) Asset health – other	**Fund specific investments** at WTWs, STWs, and service reservoirs	**Fund specific investments** at boundary boxes / storage points and gravity sewers; Signal need for a step-change in Ofwat's approach to asset maintenance.	-	Fund gated allowance	Include base capital maintenance allowance with regard to bottom-up maintenance.
5) Enhancement expenditure	Fund specific investments in power resilience (1 item)	-	Revise allowances for all areas with a cost gap >£1m (14 items); Revise contingent allowance	Revise allowances for 9 items.	Revise allowance for phosphorus removal (1 item)

Area	Northumbrian Water	Anglian Water	South East Water	Southern Water	Wessex Water
6) Reducing overall stretch	**Set frontier shift** to 0.8%; Remove **unjustified AMP7 delivery penalties**; Passthrough for regulatory costs; Reflect cost for network reinforcement activity; **Remove OAM deadband**.	**Set frontier shift** to 0.8%; Call out **unjustified AMP7 delivery penalties**; **Remove OAM deadband**.	**Set frontier shift** to 0.5%; Remove **unjustified AMP7 delivery penalties**; **Remove OAM deadband**; Change ASM thresholds.	**Set frontier shift** to 0.5%; Revise delivery mechanism and change allocation to large scheme gated process; Review notified item materiality; **Remove OAM deadband**.	**Set frontier shift** as appropriate.
7) PCLs/ODIs	-	Revise PCLs for leakage, pollution incidents, external sewer flooding, and water supply interruptions.	Revise PCL and collar for water supply interruptions; Revise C-MEX methodology.	Revise PCLs and ODIs for 12 PCs	-
8) PCDs	Flexibility in mains renewal and lead replacement PCDs	Remove annual time limits and time delivery incentives; Flexibility in mains renewal PCD; Simplify smart meter PCD; More proportionate reporting requirements.	-	Redesign PCD framework to include true non-delivery mechanism; two-way time incentives; within-AMP adjustment mechanism; offset mechanism; Remove base PCDs funded by implicit allowance.	Remove base PCDs funded by implicit allowance.
9) Cost of capital	**Redetermine cost of capital**	**Redetermine cost of capital**	**Redetermine cost of capital**	**Redetermine cost of capital**	**Redetermine cost of capital**

Area	Northumbrian Water	Anglian Water	South East Water	Southern Water	Wessex Water
10) Updated information	Update water business rates; Address Howdon WWTW growth through notified item.	Update water business rates	-	-	-
11) New statutory requirements	Change phosphorus schemes to reflect EA changes; Reflect new requirements for IED; Change delivery timelines for Suffolk Strategic Network; Reflect updated timing for Bacton bulk supply scheme.	-	-	-	Disinfection improvements at rural treatment works; Improvements at bioresources centres.
12) Correcting unambiguous errors	Correct unambiguous errors in FD24	-	-	-	-

Source: NWL analysis of disputing companies' statements of case

APPENDIX 2: INITIAL VIEWS ON ISSUES RAISED

Company and SoC reference	Issue	Initial NWL views
South East (p38) Southern (p122)	• The inclusion of average pumping head (**APH**) in the base cost models. South East argue that it should be included in the water models alongside booster stations whereas Southern argue that it should be removed altogether.	• Our position during PR19, the PR19 redetermination, and PR24 has remained unchanged in that APH still suffers from data quality issues and should not be included in the water base cost models. This is the conclusion reached by the CMA in the last redetermination and we do not think the evidence has changed since then.
South East (p38)	• Inclusion of connected properties as a cost driver in the water distribution models. Part of South East's argument is that growth costs are better related to connected properties.	• Length of main is a much better driver of distribution (i.e. network costs) than the number of properties as it is directly related the volume of network that must be maintained and operated. Including connected properties to account for growth costs is unnecessary as most developer services costs now sit outside of the price control and there is a separate sector wide adjustment for network reinforcement costs so including this variable could result in double counting.
South East (p38)	• Model WAC (weighted treatment complexity) in levels rather than logarithms.	• We are unsure about the engineering rationale for this change. For us it makes more sense to use logarithms as the estimated coefficient is then an elasticity where the percentage change in treatment complexity affects the percentage change in costs. The use of a logarithm is also consistent with the approach to other similar variables such as the weighted average treatment size for the wastewater treatment models.
Southern (p114)	• Drop the % load bands1-3 cost driver from the wastewater models.	• Southern argue that the weighted average treatment size is better from an engineering rationale but we disagree. There is no engineering theory that we are aware that specifies a stable relation between scale and costs. In fact, the data supports the inclusion of this cost driver as it has a consistent magnitude across both the treatment and network plus models where in both it shows that costs for these bands of works are materially different from using weighted average treatment size alone.
Southern (p148)	• Inclusion of a median wage variable in the base cost models.	• We disagree that this is necessary for the same reasons as Ofwat. The models already include density variables which are highly correlated with regional wages so do not consider that this change is required. Moreover, the existence of workers travelling between regions to carry out jobs (e.g. a civil infrastructure company based in a lower wage region could carry out jobs in a higher wage region) undermines the use of this variable as it does not measure the wages of the workers doing the job for those

Company and SoC reference	Issue	Initial NWL views
		companies. The variable also has poor levels of statistical significance in several of the models, particularly for wastewater.
Southern (p33)	• Calculation of the power cost share for the energy adjustment should use 13 years of data rather than 5 years	• We strongly disagree with this suggested change. The whole rationale for the energy cost uplift is that the level of energy costs resulting from the base costs model is below the levels implied by recent energy costs. This means that in working out the current share of energy costs to apply the adjustment to must use an estimate consistent with both current operational circumstances and recent levels of energy prices – this makes the last 5 years much more appropriate and that also aligns with the approach to calculating allowances which uses the upper quartile also over that 5-year period. If the approach were changed to the last 13 years this would not be representative of the recent level of energy costs, the current operational setup of each company (e.g. changes in onsite generation and changes in treatment processes that may be more energy intensive), and the level of efficiency in procuring and using energy within the business. • We do understand Southern may be an outlier due to their hedging strategy and it may be appropriate to make an adjustment for this reason. However, we do not see why this rationale should be extended to other companies.
Anglian (p145)	• External sewer flooding – use a common sector 2024/25 baseline	• We disagree that external flooding targets should use a common 2024/25 baseline because this has not previously been a common performance commitment (unlike internal sewer flooding) and so companies have had different incentives and starting points.
South East (p74)	• CMEX should be benchmarked for South East average, not overall average	• Regional differences in UKCSI scores have been observed for some time. However, there is no evidence to suggest that this is due to differences in individual customer expectations and views – instead of the specific mix of sectors and individual companies that operate in those areas. In 2023, we observed a higher proportion of customers in our Essex & Suffolk area saying that they were satisfied with customer service than in the North East (CCW's Water Matters report[30]).
Southern (Chapter 5)	• Request for a revised PCD framework	From a better regulation perspective, we agree with Southern that:

[30] Water Matters May 2024, Table 5 and Table 6

Company and SoC reference	Issue	Initial NWL views
		• The PR24 PCD framework is inflexible and does not allow PCDs to be altered where different solutions are agreed with the DWI or the Environment Agency that better meet the interests of customers or the environment. • The framework is likely to be asymmetric with more downside risk for companies, particularly as a result of the potential for allowances to be completely withdrawn if projects are not delivered within a few months of the start of AMP9 even if the change in delivery date has been agreed with other regulators or if the reason for the delays are due to factors outside our control.