

Wessex Water

PR24 CMA Redetermination

**Reply to Ofwat's Response to our
Statement of Case**

23 May 2025








Introduction

- 1.1 Ofwat's response to our Statement of Case (SoC) largely reasserts or clarifies its final determination (FD) position. Nothing in it fundamentally alters the position set out in our SoC, which remains our case to the CMA.


Area of focus: Disinfection

- 1.2 Ofwat agrees the proposed investment is not funded through base expenditure allowances. However, it newly suggests we should agree to legal instruments and that our evidence is new.¹
- 1.3 These activities were included in the bottom-up base costs provided to Ofwat in our initial business plan (October 2023), and our draft determination response (August 2024). Ahead of Ofwat's FD we also wrote to Ofwat (November 2024) stating: *"We have previously included these in our base costs but given their nature as new activities, these could easily be reallocated to enhancement with an associated PCD."*
- 1.4 We agree with Ofwat's view that this would have been better dealt with earlier during the price control process. However, Ofwat has only confirmed its position that this investment is not funded in the base expenditure allowances since its FD. We are therefore seeking resolution of this issue through the redetermination.
- 1.5 As a leading company on water quality, we work constructively with the DWI to take a risk-based approach to improvements before legal instruments are required. We note that c.60% of the work we have done on water quality improvements over the last 10 years has been done without the need for a legal instrument or notice.

Area of focus: Bioresources

- 1.6  Redacted
- 1.7  Redacted²
- 1.8  Redacted
- 1.9  Redacted
- 1.10  Redacted

¹ Ofwat, PR24 redeterminations – expenditure allowances – cost adjustment claims, para 11.5 & 11.9.

²  Redacted

1.11  Redacted

Area of focus: Water supply base costs

- 1.12 There is one company-specific issue we address here, where Ofwat has newly referred in its response to a data input error in PR19.³
- 1.13 In 2016, Ofwat asked water companies to review and approve initial drafts of a file that mapped Local Authority Districts (LADs) to water and wastewater companies. South West Water confirmed that it did not serve Poole for water services, which had initially been allocated to its region and, because no other company claimed its ownership, Ofwat did not allocate Poole to any company in the mapping file.⁴ In fact, Poole LAD is served for water services by both us (c.74%) and by South West Water (c.26%), and thus should have been allocated proportionately to both companies in the mapping file.
- 1.14 Had Poole been correctly allocated, the model values for population density would have been different. Ofwat calculates that not allocating Poole meant our PR19 wholesale water base cost allowance was around £60m higher than it should have been (in 2022-23 prices). Ofwat has corrected this error in PR24 by revising the weighted average population density variables. However, this demonstrates the sensitivity of the models to measures of population density: we serve 11 LADs and the change in population density from the omission of just one results in a movement of £60m, or 12% of the benchmark costs.
- 1.15 In addition to this £60m, Ofwat's changes to the population density variables in its models account for a further £40m adverse movement in our relative water supply efficiency position between PR19 and PR24. This means that, of the 29% adverse movement in water supply efficiency since PR19, 20% is attributable to factors related to population density and rurality.
- 1.16 We maintain that the impact of rurality on efficient costs cannot be fully captured in econometric models, particularly for companies at the extremes of rurality like Wessex Water. In our view, this explains much of the counterintuitive result of the PR24 water supply base cost efficiency modelling when compared to previous periods and to our leading efficiency position on wastewater base costs.
- 1.17 This supports the CMA using our bottom-up approach to avoid such modelling issues or ensuring that any model has a justifiable efficiency challenge.

³ Ofwat, PR24 redeterminations – response to Wessex Water's statement of case, para 3.16.

⁴ This oversight also applied to Woking LAD in the Thames Water / Affinity Water region.

Area of focus: Phosphorus removal

- 1.18 In its response, Ofwat has, in the most part, relied on previous evidence and arguments. However, Ofwat has newly:
- (a) argued that there is no systematic pattern of its models setting a higher cost efficiency challenge for larger schemes but provides no compelling evidence to support this claim;
 - (b) recognised an important limitation in its models: *"the assumption of constant marginal impact of the volume driver in levels models can be argued to be at the other extreme of not fully correcting for economies of scale."*; and
 - (c) said that it correctly captures economies of scale, through the constant term, meaning smaller schemes get higher allowances.⁵
- 1.19 Ofwat's models mistakenly assume a constant marginal impact (cost) of the PE served. We highlighted in our SoC that Ofwat's models systematically disallow more costs for larger schemes, compared to smaller schemes. We explained this implied: (i) omitted variables correlated with size; and/or (ii) a mis-specification of size variables.⁶ Since submitting our SoC, we have undertaken analyses showing marginal costs increase as scheme size (PE served) declines. This confirms (ii).
- 1.20 We maintain the most appropriate approach to assessing P-removal costs is to use our engineering evidence. However, in light of this finding, should the CMA place some weight on models, it should adopt a non-linear approach to the size/cost relationship.
- 1.21 This issue is intrinsically linked to Ofwat's use of historical models. The use of these understates the true efficient costs of P-removal over PR24:
- (a) We find evidence of decreasing marginal costs in relation to scheme size, in both the historical and forecast data (smaller P-removal schemes have higher marginal costs than larger schemes). That is, the cost of serving each additional unit of PE falls as PE served increases.
 - (b) There has been a shift in the distribution of P-removal schemes between PR19 and PR24, from larger to smaller schemes. Median, minimum, and maximum scheme sizes are materially smaller at PR24, relative to PR19.
 - (c) Scheme marginal costs at PR24 are higher than at PR19 on a like-for-like basis. That is, delivering a given scheme at PR24 incurs higher marginal

⁵ Ofwat, PR24 redeterminations – expenditure allowances – common issues, paras 5.26, 5.27 & 5.28.

⁶ Wessex Water, Statement of Case, paras 9.50 – 9.53.

costs than an identically sized PR19 one. This results in efficient P-removal costs being understated at PR24.

- 1.22 The combination of (a) and (b) above means placing any weight on the historical PR19 models will strictly understate efficient P-removal costs at PR24. This is because, even if marginal costs for individual schemes of the same size were identical between PR19 and PR24, 'on average' efficient marginal costs at PR19 were lower than at PR24 (i.e. because the mix of schemes at PR19 was more skewed towards larger schemes, thus with lower marginal costs, relative to PR24). Wessex is especially adversely affected by this problem.
- 1.23 We would be happy to provide the CMA with our evidence relating to points (a) to (c) above.
- 1.24 When combined with the fact that the models capture some key cost drivers but not every cost driver, Ofwat recognises that its models cannot set accurate allowances for every scheme.⁷

Area of focus: Allowed return

- 1.25 Given our previous submissions⁸ and the substantial volume of technical information already produced on this topic for PR24, we did not submit additional evidence in our SoC and instead ask the CMA to determine the appropriate level based on a balanced interpretation of existing evidence and current market data.

Other issues

- 1.26 **Deprioritisation.** We consider it necessary for the CMA to consider, and therefore not deprioritise: (i) base cost models and asset health, for the reasons set out in chapter 8 of our SoC and the joint submission; and (ii) unambiguous errors⁹ and business rates¹⁰, because we consider it prudent and in the best interests of customers for the determinations to be set with reference to the most recent and accurate information available.
- 1.27 **Affordability support.** Ofwat's response requests clarity on our shareholder's financial commitments to support affordability¹¹. The 0.01% RoRE value included for Wessex Water excludes matched debt funding (which is included in the figures for the other Disputing Companies). Over the past five years, our

⁷ Ofwat, PR24 redeterminations – expenditure allowances – common issues, para 5.23.

⁸ For example, see *WSX31 - Risk and return* and *WSX-R01 - Risk and return* and associated annexes.

⁹ For Wessex Water, an error relating to growth should be reflected (as set out in row 3 of table 1 in our SoC). Please see SoC Appendix A195 and A361 - Received from Ofwat - Growth STWs - WSX - FD vs corrected.

¹⁰ The bottom-up base opex costs in our statement of case included revised business rates costs to reflect the latest information on the rateable value from the VOA.

¹¹ Ofwat, PR24 redeterminations – overview of our response to the statements of case, para 4.17.

matched debt funding scheme has equated to a RoRE of 0.18%. Our affordability support will increase significantly over the coming price review period, and we expect our shareholder support for social tariffs to be above the forecast sector average RoRE of 0.17%. In its third-party submission to the CMA, CCW stated it is supportive of the affordability plan that we have put in place for 2025-30.¹²

- 1.28 **Outcomes framework.**¹³ The stretching performance trajectories proposed in our August 2024 business plan were dependent on the required activities being funded in the FD (which represented a 16% challenge to our proposed expenditure). In our asks to the CMA we have focused on areas where Ofwat has already identified a workable way forward,¹⁴ and consider Ofwat's introduction of the OAM will mitigate the downside risk in relation to outcomes.¹⁵ Furthermore, we note that how we perform against other companies in the AMP will depend on the extent to which they were also funded to meet their forecasts, and the degree to which these represent accurate and achievable trajectories. There is considerable uncertainty in this across the sector as, for example, weather variations will also impact company performance.

¹² [Consumer Council for Water Wessex .pdf](#), para 3.35. The plan is set out in Chapter 8 of Appendix A010 of our SoC.

¹³ Ofwat, PR24 redeterminations – response to Wessex Water's statement of case, para 2.21 to 2.25.

¹⁴ Wessex Water Statement of Case, March 2021, para 2.10.

¹⁵ Wessex Water Statement of Case, March 2021, Table 1.