

1. OVERVIEW

1. This is Northumbrian Water's (NWL) response to the CMA's consultation on its approach and prioritisation for the Water PR24 Redetermination References (**Consultation**).¹
2. Reflecting on the specific questions posed by the Consultation² we note the following:
 - On prioritisation, we support much of the CMA's proposed approach:
 - We welcome the CMA's intention to look in a targeted way at company investment cases (including our asset health investment case and our power resilience investment case) and support the approach proposed for addressing risk and return and setting outcomes. We also support the inclusion of frontier shift.
 - We recognise the challenges facing the CMA in relation to asset health but do not consider that these matters should be deprioritised (see Section 2).
 - We still consider that base cost modelling could be deprioritised (see Section 3.1).
 - Whilst we accept that Bacton and the Suffolk Strategic network activity could be deprioritised, that should be subject to some reasonable assurances regarding the alternative processes proposed (see Section 4.2).
 - We do not support the deprioritisation of business rates and licence fees on materiality grounds (see Section 3.3);
 - On the proposed data driven approach to base cost modelling, we consider that this will add significantly to the CMA's workload whilst not contributing substantially to the overriding objective (see Section 3.1);
 - On the treatment of new evidence, data and information, we support the CMA's approach which recognises the importance of reflecting the latest information and evidence in its redetermination. We confirm that we support the inclusion of the 2024-25 outturn data once available; and
 - On the approach to common issues, we broadly agree with the CMA's approach. We note, however, that should the CMA's consideration of a 'common' issue which was not expressly addressed in our Statement of Case (**SoC**) result in the CMA contemplating a change to our overall settlement, we would expect to be given the opportunity to make representations on those issues.
3. The remainder of this response focuses on specific points of detail outlined in the Consultation.

2. ASSET HEALTH AND CAPITAL MAINTENANCE

4. We recognise that CMA has a specific role in the first instance to provide a redetermination for the Disputing Companies for the 2025-30 period and, particularly in a context where the Independent Water Commission is considering wider reform of the sector and its regulation, the panel may feel that they should not step into wider policy questions.

¹ CMA [Water PR24 Redetermination References: Approach and Prioritisation](#), 28 May 2025 (**Consultation**).

² Consultation, para. 9.

5. In that context the CMA's proposed approach is pragmatic, looking at specific investment cases rather than trying to either completely redesign the cost assessment framework or opine on policy for a future price review. We very much welcome in this context the CMA's intention to look at our asset health investment case.
6. However, whilst this is theoretically reasonable, we do consider that engaging with companies' individual cases and specific issues will require CMA to consider the more general objections and concerns raised in this area on the nature and extent of the asset health or capital maintenance problem. For instance, most of the cases start from a 'need' that says the whole sector is underfunded. In that context it is helpful that the CMA has confirmed that it will take those general issues into account when determining specific cases.³
7. At the same time the Consultation indicates that the CMA will reopen Ofwat's base cost modelling allowances and approach. This suggests that the CMA will review the cost assessment method and approach (including capital maintenance funding) but won't review some of the wider evidence that companies have provided in this area as a consequence of the prioritisation approach to asset health. This feels inconsistent.
8. Ensuring adequate funding for capital maintenance is such a fundamental part of the setting of an appropriate settlement that we do not think it can be de-prioritised and we have set out previously why Ofwat's roadmap process is not one that can be relied upon entirely.⁴
9. We would encourage the CMA to at least provide some commentary on both the nature and extent of the problem as it sees it, based on the evidence submitted in this process, and to make some suggestions about how these matters could be tackled in the future. This could feed into Ofwat's roadmap process or future price review methodologies. We do not see how the CMA can perform its role in the context of this redetermination without some consideration of these issues, particularly as the only expert regulatory review function we have in this sector. Even if the Independent Water Commission does suggest change in this area it would still likely be left to an economic regulator that is entirely independent from Government to implement it. Hence it is entirely sensible and appropriate for CMA to provide its expert views.

3. BASE COSTS

3.1. ECONOMETRIC BENCHMARKING

10. The CMA has indicated that it will look at the set of explanatory variables used in base cost models to consider whether any changes should be made to inform the assessment and/or resolution of Disputing Company claims, including with respect to certain cost adjustment claims. While we understand the rationale for the CMA's suggested approach, we are still concerned that this may be an administratively burdensome exercise and that evaluating the Disputing Companies Cost Adjustment Claims on an individual basis would be a better way of achieving the overriding objective. The CMA could still then look at the Ofwat base cost modelling to understand why it had arrived at a different answer to the CMA's individual

³ Consultation. Para. 27(a).

⁴ Disputing Companies Joint Reply to Ofwat, 27 May 2025, paras. 3-5.

company assessment. This could inform a specific adjustment taking into account the individual company's circumstances. This (much less resource intensive) approach would replace any redesign or reparameterising of Ofwat's base models.

11. The Consultation is not clear whether the results of this analysis might lead to changes to all Disputing Companies' modelled base costs. However, if it does then we would want the opportunity to make representations on these topics (we did not cover base cost modelling in our SoC, as we were not disputing our base cost allowances and seeking to provide a focused case). We are conscious that at this stage of the process this would place significant weight on the RFI process and the hearings as a forum for any such representations. It may, therefore, be appropriate for the CMA to issue a short-form consultation or working papers on any such issue that will have a cross-cutting impact so that all Disputing Companies can provide appropriate input.
12. The CMA has indicated that it proposes to explore a data-driven approach to variable selection using econometric tools for base cost modelling (i.e. to use modelling techniques to review which inputs should be included in the models). We do not think that reconsideration of the base cost models should be purely data driven. Instead, we consider that the CMA should ensure that its approach takes appropriate account of factors such as:
 - **Data quality:** it possible that the LASSO or similar approaches to model selection will favour cost drivers based solely on their predictive ability without considering the quality of the data itself which could be significantly worse for some variables (e.g. for average pumping head) than other alternative variables (e.g. booster pumping stations).
 - **Statistical significance:** a LASSO approach to model selection does not take account statistical significance which has been a long-standing factor used to select cost drivers in economic regulation for as long as comparative competition has existed. A departure from this could result in significant change to allowances driven by cost drivers that are not statistically significant. This would be a significant departure from longstanding practice within economic regulation.
 - **Consistency between models:** the modelling suite is estimated at different levels of aggregation (e.g. for wholesale water, and water distribution) where the models currently have common cost drivers with similar signs. Any change to models that introduces divergence between the drivers identified at different levels of aggregation would be at odds with ensuring there is a consistent set of models with a common set of drivers influencing costs. It would not be consistent with any engineering rationale for there to be completely different drivers identified at these different levels of aggregation.
13. Even if the CMA takes these factors into account alongside the data-driven approach, we consider that there should be a high bar for making any changes to the models to ensure that the results are robust, in keeping with engineering understanding and best practice within economic regulation. This would also reflect the significant consultation that was undertaken on those models through PR24.
14. We note that the Independent Water Commission's interim report says that:

In the Commission's view, differences between water companies limit the weight that can be put into a modelled comparative benchmarking approach when assessing whether individual company costs are reasonable... and the Commission believes that there is a need to balance to the modelled comparative benchmarking approach to economic regulation with much greater company specific assessment and engagement with more emphasis on the supervision of individual companies.⁵

15. This report seems to support an approach that moves towards looking at company-specific evidence, rather than revising the modelled comparative benchmarking approach.

3.2. SECTOR WIDE COST ADJUSTMENT CLAIMS

16. We welcome the CMA's decision to redetermine the sector-wide adjustment for mains renewal, meter replacement and network reinforcement, including consideration of the retrospective adjustments arguments. We understand that the similar retrospective adjustment applied to wastewater treatment growth will be considered separately under the approach outlined in paragraph 65 of the Consultation, as this is treated as enhancement expenditure in PR24.
17. We welcome the CMA's intention to look in a targeted way at company investment cases (including our asset health investment case and our power resilience investment case). We would still appreciate the CMA's expert commentary on the broader asset health challenges facing the sector (see section 2).

3.3. OTHER BASE COSTS ISSUES

18. We do not agree with the proposals to deprioritise our claims relating to business rates and licence fee costs on the grounds of materiality by applying a 0.5% totex threshold.
19. Firstly we note that applying the CMA's proposed materiality threshold, we consider that the business rates cost gap exceeds the threshold so should be redetermined. The cost gap is c.£37m versus a threshold of c.£29m based on 0.5% totex. This is equivalent to 25 bps on RoRE, which is significant compared to other issues the CMA is treating as in scope.
20. The application of a materiality threshold for consideration of totex requests may be appropriate if the Disputing Companies were demonstrably putting forward Cost Adjustment Claims for matters that are within their control and favourable to them whilst not raising others which are not (i.e. being silent on areas where allowances have been 'generous'). It may also be appropriate in circumstances where allowances in the round across the sector appear sufficient for the notional company. However, we note in this context that:
- Ofwat has not been able to identify any examples of instances where cost allowances are favourable should be reconsidered and we have raised issues in our own SoC that would reduce cost allowances (in relation to water supply investments in Essex and Suffolk). As such, it is not clear that there is a one-sided approach to these requests that needs to be mitigated by application of a materiality threshold; and

⁵ Independent Water Commission [Interim Report](#), 3 June 2025, para. 178 and 184.

- companies are currently overspending PR19 cost allowances by c.12%⁶ with the Disputing Companies all expecting material overspends in AMP8 too. As such the cost allowances do not appear to be sufficient in the round and instead there is evidence of material downside risk.
21. The business rates and licence fee adjustments also raise important points of principle. These costs are both outside of company control and the latest information available clearly demonstrates that the FD24 allowances have been set at the incorrect level:
- business rates are a tax set by Government and licence fees are set by regulators - companies have negligible opportunity to exert any material influence over these costs. They are different, therefore, to the general cost risks and opportunities companies may face. This is why in other, similar, regulatory regimes like the energy sector, these costs are treated as a straightforward pass-through item;⁷
 - in both instances the CMA has better information readily available than Ofwat did at the time of FD24. The CMA notes elsewhere in its Consultation that “we do not consider that the current legal framework allows us to disregard relevant, available and robust data”.⁸ The latest business rates valuations from the VOA are relevant, available and robust data that clearly demonstrate that Ofwat’s FD24 estimate was too low. Similarly, Ofwat increased its own licence fee by 41% shortly after FD24 – this new data also meets this test; and
 - not addressing these issues is particularly concerning in the context where all companies are overspending materially against allowances and these cost items are growing exponentially within the cost base but are not well reflected in the allowances.
22. We also consider that these matters are administratively simple for the CMA to consider and resolve in its redetermination, in order to reach the right overall determination in the round. This is consistent with the purpose of a water redetermination in which the CMA stands in the shoes of Ofwat to reach its own decision on the appropriate price control settlement. We have already accepted much of the FD24 challenge on costs, so this additional filtering has a materially greater impact than is recognised in this proposed approach.
23. We are also concerned that deprioritising issues such as business rates and licence fees based on materiality creates an unintended incentive for Ofwat to “aim down” on all such forecasts in future reviews, on the premise that as long as the residual costs are less than 0.5% of totex, there will be no meaningful route of challenge to that decision.
24. In any event, if a materiality threshold is deemed to be an appropriate measure for addressing prioritisation for a redetermination, it is important that an appropriate threshold is set. We consider that at the very least any threshold should be applied at the individual price control level, consistent with how the efficiency challenges in FD24 are applied and pre-cost sharing reflecting the best view of the efficient cost in setting allowances. Cost sharing is a separate

⁶ NWL SoC para 139

⁷ NWL SoC para 461

⁸ Consultation, para. 96.

mechanism to allocate risk in relation to outturn costs and materiality assessments of this type typically are done pre-cost sharing.

4. ENHANCEMENT COSTS

4.1. BENCHMARKING MODELS

25. The CMA states it will consider cost allowances in relation to the Industrial Emissions Directive (IED). On the assumption that this means the CMA will consider our IED cost request, we support the proposed approach.

4.2. INDIVIDUAL ASSESSMENT ALLOWANCES

4.2.1. Bacton desalination bulk supply pipeline

26. We would be satisfied to progress this through alternative funding mechanisms, such as the RAPID gated scheme process – but only if Ofwat can provide clearer assurance about how this would work. We would like Ofwat to confirm: the conditions under which this would be funded (for example, if the Environment Agency states that this work should go ahead, or if this is agreed through the separate WRMP change process); and that the scope that would be funded under this process would be the same as in our business plan (and the SoC). Since this work would need to be completed in time for our decisions about water resources through the large scheme gated process in 2027, we would need this confirmation soon.
27. An alternative approach could be that, once Ofwat has confirmed that this work should go ahead, this is then funded through an adjustment made in the large scheme gated process determinations for Lowestoft Reuse. These determinations will already need to take into account any reconciliation of accelerated delivery costs for Lowestoft Reuse, and this decision point could lead to any or all of Lowestoft Reuse, North Suffolk winter storage reservoir, or other options such as the Bacton desalination bulk supply pipeline being selected as the best value option(s) for water resources.

4.2.2. Suffolk Strategic Network

28. We would be satisfied to progress this through alternative funding mechanisms – but only if Ofwat can provide clearer assurance about how this would work in practice. We do not think the large scheme gated process (as set out in FD24) can remove funding from AMP8 allowances, and it seems counter-intuitive to leave customer bills higher than they need to be until this process is concluded. We also do not see how Ofwat could move this allowance into the large scheme gated process now that it has made its PR24 determinations, as it cannot change the legal determination which sets this out.
29. A sensible alternative might be for the CMA to make the changes to totex and PCDs as set out in our SoC, but then to include this in the large scheme gated process too. This would provide flexibility for Ofwat to be able to assess and redetermine the timing of this totex allowance and PCDs as part of the large scheme gated process, if for example this could be delivered earlier than the current project schedule. Making this change would have two benefits:

- this would support lower bills for customers under the CMA determinations, reflecting the most likely totex profile. This would also avoid the need for a large downwards adjustment at PR29, which (given the size of this scheme) could create financeability concerns; and
 - this would be more aligned with the large scheme gated process as envisaged in FD24 and would give Ofwat a clearer basis to apply this process.
30. If the CMA were to take this approach, we would like to see a commitment from Ofwat that such an adjustment would continue to use the approach to assessing efficient totex that Ofwat applied at FD24.