

Wessex Water

PR24 CMA Redetermination

**Response to the CMA's Approach and
prioritisation document**

11 June 2025

Approach and prioritisation

Introduction

- 1.1 We welcome the opportunity to comment on the CMA's Approach and prioritisation document. We have focused this response on elements of the approach where we ask the CMA to reconsider its position.
- 1.2 We would be happy to engage further on any of the points raised.

Consideration of Ofwat's consultation approach

- 1.3 We appreciate that the CMA is mindful of the consultation process Ofwat carried out on aspects of its approaches, and will consider this context in deciding whether to make changes.¹ However, we highlight to the CMA that the existence of a consultation process does not of itself imply that sufficient engagement on matters of substantive importance took place as part of that consultation. Indeed, the lack of sufficient engagement is in part why we find ourselves asking the CMA for a redetermination, as we set out below.
- (a) In relation to **base costs**, the engagement has been largely one-sided and thus substantially limited.
 - (i) We have been working to meaningfully engage on the limitations of Ofwat's models and, in particular, the input data (i.e. outturn spend data, which in our view represents significant underspend) since 2017, where we raised the issue in person with the then CEO and have raised consistently since. We would happily provide a timeline of this engagement to the CMA.
 - (ii) As clearly demonstrated by the substantive evidence we have submitted as part of our statement of case (and with Ofwat directly during the price determination process), we are concerned that Ofwat's general approach to modelling base costs is not fit for purpose and that an alternative approach should be used rather than relying on tweaks and adjustments to the modelling suite.
 - (iii) We consider that Ofwat should have engaged more with our concerns about the modelling between its draft and final determinations, given the very material proposed reduction in base cost allowance between AMPs (which clearly raises questions about the robustness of the proposed modelling approach). We don't believe that Ofwat engaged sufficiently with our concerns in that period, nor did it engage sufficiently with the underlying bottom-up engineering evidence that

¹ Water PR24 Redetermination References: Approach and prioritisation, CMA, 28 May 2025.

supported our view that the outputs of the model in Wessex Water's case were flawed, nor our subsequent cost adjustment claim.

- (b) In relation to **disinfection**, only after its final determination did Ofwat indicate that these costs should be considered separately to our overall base claim and potentially as enhancement costs. This is despite these costs being included, albeit at a high level, in our business plan, draft determination response base cost submissions, and follow up communications to Ofwat (in November 2024).
 - (c) In relation to **bioresources**, we did not raise in detail with Ofwat the specifics of our costs until after the final determination. Whilst it would have helped Ofwat to have had more information sooner, the HSE investigation concluded only in October 2024 and the HSE gave notice of its findings at the end of November 2024 (i.e. after the submission of our response to the Draft Determination).
 - (d) In relation to **P-removal**, and expenditure that made up over 20% of our original business plan, Ofwat only consulted once on these models – in its draft determination. Despite concerns raised by much of the industry, these models remained largely unchanged at final determination.
 - (e) In relation to the **allowed return**, we raised significant concerns with Ofwat's approach in our business plan. Indeed, we were one of only two companies not to use Ofwat's early view of the cost of capital in its financial modelling. As a result of this (and other areas where we disagreed with Ofwat), our plan was considered inadequate at draft determination, and a financial penalty was applied. The Quality and Ambition Assessment process inhibited effective dialogue on this, and other important elements of the price review.
- 1.4 The CMA should not therefore proceed on the basis that, simply because a consultation process took place, it should not make changes to Ofwat's decisions – engagement with the substantive issues that Wessex Water has raised in its statement of case should be a necessary and critical element of the CMA's re-determination.

Base costs

- 1.5 We strongly disagree with the CMA's proposed approach to prioritisation in respect of base cost allowances and would instead request that the CMA continue to engage fully with our evidence which relates both to the limitations of Ofwat's approach, and alternative bottom-up evidence on our view of the most efficient costs, including as a cost adjustment claim if appropriate.

- 1.6 We recognise the constraints imposed on the CMA within this PR24 redetermination process, and therefore the reasons why it is not minded to adopt an alternative bottom-up engineering approach to base costs. However, we ask it to reconsider its position and engage with the evidence we have submitted to it and Ofwat on the limitations of Ofwat's approach; and alternative methods for determining these.
- 1.7 We continue to believe that there are fundamental issues with the outcome of the base cost assessment that Ofwat has failed to explain, and we ask the CMA to address these. Specifically, for the reasons outlined in our statement of case (i.e. measurement error and flawed input data as a result of historic underfunding) the process has resulted in the following outcomes:
- (a) Relative to 2023/24 run rates, modelled costs represent a reduction of 39% in operational expenditure allowances, with an immediate step down on day 1 of AMP8. Such a reduction would be operationally impracticable to implement, given that a third of our costs are non-controllable.
 - (b) Wessex Water's base costs are found to be 30% less efficient than the benchmark for water supply costs, materially different from Ofwat's previous assessments and with its base cost assessment on wastewater.
- 1.8 The main arguments against adjusting the outcome from Ofwat (which the CMA appears minded to support in its draft prioritisation document) appear to be process related rather than arising from engagement with the substance of Wessex Water's case. For example:
- (a) The CMA does not intend to focus on Wessex Water's request on base costs, given the use of econometric benchmarking is a well-established practice². This is despite our case including considerable evidence on the limitations of these models. While econometric benchmarking is a well-established practice, this would not of itself justify a decision to attach little or no weight to other evidence (such as our bottom-up evidence). Nor would it justify using the results of such benchmarking to determine expenditure allowances without regard to the feasibility (and desirability) of the cost reductions implied by it.
 - (b) Ofwat said it followed a rigorous and robust process to developing the econometric models but accepts that no model is perfect. While it noted that it encouraged companies to submit cost adjustment claims where the models do not capture company specific factors, it did not engage sufficiently with the cost adjustment claim we submitted and has, in fact,

² Paragraph 46, Water PR24 Redetermination References:: Approach and prioritisation, CMA, 28 May 2025.

said that we did not submit one at all.³ Indeed we submitted multiple CACs in our business plan, and then in our draft determination response. The absence of a suitable cost adjustment process during PR24 does not justify the CMA's decision now to deprioritise our request and evidence; if anything, it is a reason why it should be properly and fully considered now.

- 1.9 For the CMA and Ofwat to prioritise process-related implications at the expense of engaging with the substance of our concerns regarding the models, we consider that they would have to assume the substantive outcome of the modelling suite is reliable. This is particularly the case given the real risk of underfunding (a risk we believe we have well-evidenced).
- 1.10 However, it appears unlikely that either regulator is proceeding on this basis given that: (i) Ofwat allows adjustments to the modelling in general because it recognises there are deficiencies in the modelling;⁴ (ii) the CMA is also proposing to consider claims within the PR24 redetermination process in relation to the modelling and additional cost adjustment claims from other companies; and (iii) the resulting efficiency challenges are significantly different from previous price reviews.
- 1.11 It follows that if Ofwat and the CMA accept the modelling can lead to unreliable outcomes, then they cannot rely on process arguments alone in not engaging properly with our fundamental substantive concerns about the base cost allowances that the water supply models have produced for Wessex Water in PR24.
- 1.12 We believe that the primary question the CMA should be asking is whether the modelling has, or could be argued to have, produced results that are substantively irregular and therefore require intervention. If the CMA agrees with this, or even if it considers there is an arguable case, only at that point should it consider the most appropriate process for addressing the issue.
- 1.13 We do not see how any reasonable person can justify the outcome from the water supply base modelling in respect of Wessex Water for the reasons set out above (and in more detail in our statement of case). We therefore believe the only reasonable conclusion is that an adjustment of some sort is necessary to the outcome of the modelling. There is a real risk, not least because of the proposed approach the CMA is consulting on, that neither Ofwat nor the CMA properly consider the substantive issues (and thus Wessex Water's conclusions).

³ Page 21, Response to Wessex Water's statement of case, Ofwat, April 2025.

⁴ Further, it is acknowledged that econometric models are not perfect and this is highlighted by the range of variables considered, the triangulation between models, and the acknowledgement that no company looks like the notional company for efficiency and performance.

- 1.14 Indeed, we are concerned that the CMA's proposed approach implies that it will irrationally ask the process questions first, then conclude there is no reasonable process-related reason to act and that the ways to address our claim are very difficult from a process perspective.

The scope for incorporating Wessex Water's bottom-up evidence in a cost-adjustment

- 1.15 Given the above, we consider the CMA could reframe our base cost claim as a company-specific cost-adjustment claim in a similar approach to other companies' claims (more specifically, we have, in the table below, allocated the value of the claim to specific capex and opex activity).

Base expenditure component	Value (£m)	Proposed justification for considering as cost adjustment claim
Operating expenditure		
Rates, service charges, and taxes	120	Uncontrollable operational cost not otherwise funded by econometric modelling
Infrastructure renewals	60	Uncontrollable operational cost not otherwise funded by econometric modelling
Laboratory analysis	28	Uncontrollable operational cost not otherwise funded by econometric modelling
Power and chemicals	91	Uncontrollable operational cost not otherwise funded by econometric modelling
Capital expenditure		
Supply Distribution System	162	Capital maintenance required to ensure resilience of network
Water Treatment Works	88	Capital maintenance required to ensure resilience of network
Revenue Meters	22	Capital maintenance required to ensure resilience of network
Service reservoirs	18	Capital maintenance required to ensure resilience of network
Boreholes and springs	13	Capital maintenance required to ensure resilience of network
Raw water pumping stations and mains	4	Capital maintenance required to ensure resilience of network
Dams and impounding reservoirs	3	Capital maintenance required to ensure resilience of network
Pumping stations	2	Capital maintenance required to ensure resilience of network
Pumping stations	2	Capital maintenance required to ensure resilience of network
Raw Water Transport & Storage	0.1	Capital maintenance required to ensure resilience of network
Shared assets used principally by water price controls	50	Capital maintenance required to ensure resilience of network

Source: Tables A9-4 and A9-15 of our statement of case.

- 1.16 Specifically, by comparing our AMP8 planned base costs with the AMP7 costs (where Wessex Water was determined to be an efficient company), the CMA can take an objective view of the expenditure Wessex Water needs to fulfil its obligations. We would welcome the opportunity to provide supporting data and evidence to the CMA to facilitate this approach.
- 1.17 We acknowledge that such a way of presenting and considering cost adjustments claims is different from Ofwat's requirements under its framework. This is not because the cost adjustment claim is without merit, but rather because Ofwat's framework was not (and is not) designed with this type of claim in mind (as discussed at paragraph 1.8b above). In our view, this further underlines the unsuitability of any reliance on process arguments in dealing with the material substantive issue that Wessex Water has identified.

- 1.18 Therefore, we consider that this 'quasi-CAC' approach is a pragmatic and efficient way for the CMA to engage with the substance of our base cost allowance claim and the bottom-up engineering evidence we have submitted.
- 1.19 To the extent the CMA believes this approach is inappropriate, we would be happy to work with it to develop an alternative process that would be acceptable in dealing with the claim. However, it would not in our view be consistent with the Duties for the CMA to deprioritise altogether the potential for a cost-adjustment claim for Wessex Water, particularly (as seems to be the case here) when the modelling has produced outputs that are neither reasonable nor justifiable.
- 1.20 We also recognise that our base cost allowances may change as a result of the work that the CMA is doing on the Ofwat model, given the arguments in other companies' statements of case. To the extent any proposed changes by the CMA result in increases in Wessex Water's base cost allowance, thereby closing the gap between Ofwat's allowance and our claim, we would expect to reduce our claim by an equivalent amount.

Claims relating to bioresources and disinfection

- 1.21 We welcome the CMA's indication that it intends to consider our claims relating to bioresources and disinfection (unless it considers, following consultation with Ofwat and Wessex Water, that these claims are expected to be addressed by Ofwat through an alternative route).
- 1.22 We would welcome such further consultation, and would be happy to work with Ofwat to find an alternative route. That said, we are not aware of any existing alternative routes through which these items can be appropriately addressed, but for the CMA's redetermination. For example, any correction that Ofwat may be able to make will likely suffer from the equivalent limitations as those corrections for unambiguous errors (that the CMA has said it will consider), or may require a licence change.

Enhancement costs

- 1.23 The CMA notes that it is mindful of Disputing Companies' incentives to selectively raise areas where the price control settlement might be unfavourable to them. With regards to this, we highlight that Ofwat's final determination represented a 16% reduction compared to our view of the efficient costs; and in our statement of case, we have focused on the most material cost gaps.
- 1.24 As set out in Annex A5 of our statement of case, we had a number of concerns regarding other elements of the determination that we have walked past in order to facilitate a proportionate and timely approach.

- 1.25 To this end, we also highlight that in Ofwat's final determination we received an allowance more than requested in our draft determination response in just a handful of areas, totalling £13.3m. Of this, the largest difference was storm overflows where we received £9.5m more than the £506m requested (i.e. just 2% more than we asked for).

Allowed return

- 1.26 We welcome the CMA's intention to carry out an independent assessment of the WACC, which is consistent with the ask in our statement of case.

New evidence and updated information

- 1.27 We agree the legal framework requires the CMA to consider relevant, available and robust data. To this extent, we ask the CMA to consider the most recent information available e.g. in relation to national insurance.

Relevance of the Independent Water Commission

- 1.28 We ask the CMA to consider relevant findings in the Independent Water Commission's Interim Report.⁵ This is on the basis that, whilst the Commission's terms of reference mean it will not make *recommendations* that impact PR24 redeterminations, the Report nonetheless contains findings that are relevant to the statements of case of the disputing companies. We highlight the following comments from the report which are relevant to our case and encourage the CMA to consider the findings in full.
- (a) *"Water infrastructure resilience must be brought to the fore. Climate shocks, ageing assets, and rising demand mean the system faces growing pressure. Resilience must be treated not as a technical afterthought but as a strategic imperative"* (see the report's foreword). This is relevant to our case on base costs.
 - (b) *"There are limits to how accurate such a benchmarking framework and econometric tools can be and the extent to which these can be relied upon. This is particularly true for the water industry in which water firms face very different challenges (for example, geography, hydrology, demography and history) and for which the public policy objectives have become more complex and demanding"* (paras 28, and 178). This is relevant to our case on P-removal and base costs.
 - (c) *"The Commission's view is that the water industry is likely to be best served by investors that take a long-term, low return-low risk investment approach."*

⁵ [Independent Water Commission: interim report](#)

It is further of the view that the lack of clear government strategy, a negative political and public narrative and Ofwat's approach to economic regulation have made the sector less attractive to such investors" (para 238). This is relevant to our case on the allowed return.