INVESTOR GROUP

THIRD PARTY SUBMISSION

Kirstin Baker CBE
Panel Inquiry Chair
Competition and Markets Authority
The Cabot
25 Cabot Square
London E14 4QZ

11 November 2025

Dear Kirstin,

PR24 Provisional Determinations – Investor Group Third Party Submission

(1) We represent a large ad hoc group of over 100 financial institutions that are creditors of Thames Water Utilities Limited ("**Thames Water**"), among them a number of the largest infrastructure investors and capital providers in the UK water sector (the "**Investor Group**"). On behalf of the Investor Group, we are grateful for the opportunity to respond to the PR24 provisional determinations ("**PDs**") and for the panel's continued time and engagement.[1]

(2) As the Investor Group had the opportunity to convey at our meeting on 17 July 2025, PR24 has not created the conditions needed to attract low-cost, investment-grade debt to the water sector. Historic underfunding and the scale of the planned capital programmes expose companies to unprecedented risks.[2] Investors, the supply chain, and skilled workers are exiting the water sector for sectors with more balanced risk-return profiles.[3] Investor confidence has weakened – Moody's and S&P have downgraded the entire sector's outlook[4] – and the Independent Water Commission ("**IWC**") concluded: "*[l]ong-term investors have been clear that, at current risk levels, the sector is not*

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[1] The Investor Group does not speak for Thames Water, nor does it prejudge or constrain any submissions that Thames Water may make, whether as part of its own reference in due course or in relation to the references for other water companies.

[2] Investor Group, Third-Party Submission, Annex 3, paras. 13 and 105, and Annex 5, para. 7

[3] A Framework for Change in AMP8, Supporting the delivery of the UK's future water needs, KPMG/British Water, March 2025 ("*[T]here is a perceived imbalance of risk and reward leading to critical suppliers leaving the industry and prioritising work in other sectors. Suppliers consider other major programmes that may be offering more favourable commercial arrangements and risk positions, resulting in over 35% of skilled water sector roles struggling to be filled, especially in specialist trades such as professional water engineers and pipefitters*.")

[4] Moody's Ratings, Credit Opinion, October 2025: "*[w]e changed our assessment of the stability and predictability of the regulatory environment for the UK water sector under our rating methodology to A from Aa in November 2024*"; National Audit Office ("**NAO**") Report, p.11; S&P Global, U.K. Water Regulatory Framework Support, Low Financial Flexibility in Coming Regulatory Period Drive Rating Actions, Feb 2025, p.3; Fitch Ratings, FD for AMP8 Will Be Crucial for De-Risking UK Water Sector, Nov 2024; S&P Global, Southern Water Services Ltd. CreditWatch Negative, Apr 2025; and Moody's Ratings, Maintains negative outlook on South East Water, Mar 2025.

attractive and will struggle to attract the finance needed from such investors."[5] As the PDs state, "*[i]nvestor sentiment towards the water sector is currently low*."[6]

(3) We welcome the CMA's provisional conclusions that Ofwat's models and approach to returns were insufficient to support the sector. We set out in this letter our analysis of the CMA's proposed revisions to PR24. We explain why these do not adequately address fundamental concerns around financeability, investability, and deliverability. We ask the CMA to act decisively to restore confidence, rebalance risk and return, and enable companies to access low-cost debt finance.

1. Summary

(4) **The PDs identify pervasive flaws in PR24; but, the incremental changes proposed are insufficient and inconsistent with the CMA's statutory duties.** We agree with the overall direction of the PDs in identifying problems with PR24, insofar as they apply to water companies that are not in turnaround or financial distress. The CMA rightly rejects the Ofwat approach that underfunded the sector: misconceived models for base,[7] phosphorus[8] and industrial emissions;[9] unrealistic targets relative to actual performance;[10] and returns misaligned with market realities.[11]

(5) **A step change is required to restore investor sentiment.** The IWC and the NAO have called for a step-change in price control methodology. The IWC cites systemic "*underinvestment*" over *"Price Reviews between 2009 and 2024.*"[12] The NAO concludes both that "*the water sector's regulators have not encouraged water companies to spend what they need to deliver the performance expected. The sector now faces significant environmental and supply challenges*" and that the "*regulatory framework has contributed to worsening investor perception of the sector*".[13] The IWC, NAO, Ofwat, and the CMA agree the sector faces an unprecedented challenge in delivering on a capital programme it has never before undertaken.[14] We are concerned that, despite the scale of the intervention needed to address those issues, the PDs propose only incremental, 'business as usual' changes. Incremental change will not produce a financeable or deliverable regulatory settlement consistent with the CMA's statutory duties.

(6) **The Investor Group's analysis of the PDs' base model suggests it is not fit-for-purpose.** The PDs propose a LASSO approach to modelling base allowances.[15] Dr Nolan and Dr Moselle of Compass Lexecon, both expert economists and former senior regulators, have analysed the LASSO

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5 IWC, Final Report, para. 753.

6 CMA, PDs, Volume 4, para. 7.439(a).

7 CMA, PDs, Volume 1, paras. 4.45 and 4.58.

8 CMA, PDs, Volume 2, paras. 5.53-69.

9 CMA, PDs, Volume 2, paras. 5.154-163.

10 CMA, PDs, Volume 3, paras. 6.172-174, 6.231, 6.295, and 6.316.

11 CMA, PDs, Volume 4, para. 8.314.

12 IWC, Final Report, Box 26, p. 204.

13 NAO, Report, paras. 23-24.

14 IWC, Final Report, paras. 916, 954; NAO Report, para. 8; Ofwat, Monitoring Financial Resilience Report 2023-24, November 2024, p. 4 ("*the largest investment programme of any five-year period since privatisation*"); and CMA, PDs, Volume 4, paras. 7.481, 7.541, 7.547, and 7.551.

15 CMA, PDs, Volume 1, para. 4.45 *et seq*.

approach in their second report ("**Second Nolan/CL Report.**")[16] They show it has both weak predictive power and skews towards materially underfunding allowances. For example, applying the model to PR19 would have underfunded the sector by 10% relative to actual wholesale water spend and overpredicted wastewater spend by 20%.[17] Applied to PR24, it exhibits a spread of positive 20% to negative 21% for wholesale water, and positive 6% to negative 8% for wastewater when compared to the PR24 allowances.[18] This suggests inherent distortions and a high risk of critical underfunding, given the lack of consistency with Ofwat's modelled allowances. The model increases reliance on black-box theoretical constructs over company-specific circumstances.[19] As Dr Moselle's and Dr Nolan's first report ("**First Nolan/CL Report**") to the CMA showed, this fails to control for: (i) specifics that are masked by company-wide data sets (for example, a company catchment area comprising both sparse and densely populated areas) and (ii) the unicorn effect (inclusion in the model of a large outlier with unique characteristics), with companies like Thames Water skewing the model.[20]

(7) **Analysis of enhancement costs, targets, and overall outcomes suggest the PDs' proposed revisions are underpowered.** The Investor Group asks that the CMA reconsider its approach to efficiency challenges for enhancement costs,[21] address the excessive penalties and double-counting in incentives,[22] and revise returns to ensure there are sufficient incentives and protective mechanisms to attract investment.[23] These concerns are set out in the Second Nolan/CL Report and summarised below.

(8) **The IWC's findings are essential evidence the CMA must consider.** The IWC report is an independent, valuable, and robust assessment that must be considered in line with the CMA's overriding objectives and duties, and it falls within the CMA's 30 September 2025 cut-off date.[24] It is not open to the CMA to decline to take proper account of the IWC's factual findings due to the prospect of future policy development, time constraints, or because the PDs will only apply to a minority of companies.[25] The factual findings of the IWC report are directly relevant to and actionable within the CMA's redetermination process. Declining to address the IWC report's factual findings fails to meet the CMA's mandate to make decisions in accordance with Ofwat's duties.[26]

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16 Reply to certain aspects of the CMA's Provisional Determinations, Dr Dermot Nolan and Compass Lexecon, 11 November 2025, Investor Group, Third-Party Submission, Response to CMA PDs, Annex 1.

17 Second Nolan CL Report, para. 3.44.

18 CMA, PDs, Volume 5, Table D.5 and Second Nolan/CL Report, para. 3.12.

19 CMA, PDs, Volume 1, para. 4.58.

20 Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, Section 3.

21 CMA, PDs, Volume 2, para. 5.186.

22 CMA, PDs, Volume 3, paras. 6.111, 6.339-6.341, and 6.347-348.

23 CMA, PDs, Volume 4, paras. 7.435, 7.439, 7.541, 7.547-577, 7.12(a)(ii)-(iii), 7.23-26, 7.12(a)(i), and 7.17-18.

24 CMA, Approach Document, paras. 83 and 95; Water References Guide, para. 3.10.

25 CMA, PDs, Volume 1, para. 2.6.

26 Water Industry Act 1991, s.2.

2. Base Costs

(9) **The PDs do not take proper account of the IWC's core findings.** The IWC states that "*over-reliance on [a data-driven, econometric] approach, and its over-development, have over the years led to sub-optimal outcomes for the sector, for customers, for investors and for the environment*."[27] The PDs acknowledge the IWC's findings.[28] But the proposed LASSO approach repeats and compounds the error. It takes to a further level of abstraction comparative econometric models that disregard companies' specific circumstances and perpetuate past sub-optimal outcomes.[29] An academic desire to mitigate an assumed asymmetry of information does not justify the adoption of a demonstrably flawed model.[30]

(10) **Bottom-up cross-checks demonstrate that the PD model lacks basic predictive power and does not address each company's unique circumstances.** the Second Nolan/CL Report demonstrates that the base model is flawed and does not provide a safe basis for investment:

(i) If LASSO had been applied in PR19, the overall water sector would have received, on average, c. 10% **<u>less</u>** than actual spend for wholesale water and c. 20% **<u>more</u>** than actual spend for wastewater.[31] PR19 was marked by across-the-board water company overspend and financial underperformance from a badly calibrated price control.[32] The PDs base model would have created a *worse* result in terms of calibration.

(ii) At a company level, the model risks critical levels of underfunding Relative to each company's actual spend, LASSO predictions for PR19 spending range from positive 10% to negative 36% for wholesale water, and positive 37% to negative 5% for wastewater.[33]

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27 IWC, Final Report, para. 417.

28 CMA, PDs, Volume 1, paras. 4.41-4.43, "*We are also mindful that the Independent Water Commission found that, while it is necessary to have objective benchmarking to protect customers form misuse of monopoly power, over-reliance on this approach has led to sub-optimal outcomes [...] We acknowledge that all econometric models are imperfect, and that it is not possible to establish with certainty that they incorporate every single determinant of costs.*"

29 Investor Group, Observations on the CMA's Approach Document, para. 5; Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, Section 3.

30 CMA, PDs, Volume 1, paras. 4.43, 4.243, 4.388, and 4.454.

31 Second Nolan/CL Report, para. 3.44. Applying a 1.1% fronter shift, as Ofwat did in PR19, shows underprediction of 13% for wholesale water and overprediction of 16% for wastewater.

32 PR19 modelled base costs for 2019-2024 underestimated actual spend by 16% for wholesale and 9% for wastewater. See also NAO Report, paras. 3.11-13, highlighting that Ofwat overestimated PR19's expected returns for investors because water companies suffered operational losses largely due to overspending by £5 billion across the first four years of the period, amounting to around 12% of the total expenditure allowance; and Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, para. 1.19, "*In PR19, a badly mis-calibrated package left companies earning returns well below the base cost of capital as they consistently needed to overspend their Totex allowances, and failed to meet their performance commitments*", and para. 2.5, "*Ofwat does not seem to have learned the lesson of PR19, where all but three of the water companies overspent Totex and simultaneously struggled to reach the performance commitment levels.*"

33 Second Nolan/CL Report, para. 3.44 and Figure 3.

(iii) LASSO creates "hallucinations," where simply expressing the *same* value in different units (for example, kilometres vs miles, or even kilometres vs metres) can deliver a difference of over £250 million in allocations.[34]

(iv) The lack of consistency with Ofwat's modelled allowances, demonstrated by the spread of divergence from PR24, from positive 20% to negative 21% for wholesale water and from positive 6% to negative 8% for wastewater, is highly indicative of a lack of overall robustness to the model.[35] It is not credible to consider that water companies can continue basic operations with only 80% of their funding.

(v) For Thames Water, after correcting for code errors, this would result in a reduction of £1.2 billion relative to Ofwat's PR24 allocation across wholesale water and wastewater, based on Thames Water's 2024 business plan ("**Thames Water 2024 Business Plan.**")[36] When including the existing allowances shortfall in Ofwat's final determination, this potentially results in an aggregate shortfall of c. £3.1 billion for wholesale activities relative to the Thames Water 2024 Business Plan.[37]

(11) **LASSO omits quadratic variables with high explanatory power for companies' scale (dis) economies.** LASSO is overly selective in terms of input variables. Removing squared density terms from LASSO leads to critical underfunding for wastewater spending. As set out in the Investor Group's initial submission, omitting the quadratic squared density terms from the wastewater model reduces the appreciation of heterogeneity in geographic density.[38] When adding back quadratic terms, Thames Water is allocated an additional £400 million, more than reverting the post-LASSO reduction.[39] Removing squared density terms from LASSO leads to additional critical underfunding for wastewater spending.

(12) **The "unicorn" and geographic masking effects of applying comparative econometrics to the water sector remain unresolved.** As Dr Moselle and Dr Nolan explained in their first report, comparative econometric modelling functions poorly in regulating highly differentiated businesses. The LASSO model continues to create false predictions resulting from (i) the "unicorn" effect of Thames Water's inclusion distorting the model because of its unique characteristics; and (ii) masking of highly differentiated network densities.[40] This will perpetuate the systemic underfunding of the water sector.[41]

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34 Second Nolan/CL Report, paras. 3.30-3.31.

35 Second Nolan/CL Report, para. 3.12.

36 Second Nolan/CL Report, para. 3.60; and CMA, PDs, Volume 5, Table D.5.

37 This refers to the business plan submitted by Thames Water to Ofwat in October 2023 and updated in April 2024 for the purposes of PR24. The analysis in this response is provided without prejudice to any additional business plan, request for allowances, or otherwise, that Thames Water may advance before the CMA in any redetermination, which will need to reflect its circumstances at such time.

38 Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, Section 3.

39 Second Nolan/CL Report, paras. 3.46, 3.71, and Figure 6.

40 Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, Section 3. Thames Water covers both the densely populated urban London network and the sparsely populated Thames Valley.

41 Investor Group, Observations on the CMA's Approach Document, para. 5; Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report.

3. Enhancement Costs

(13) We welcome the PDs' view that Ofwat's phosphorus removal[42] and Industrial Emissions Directive ("**IED**") models are not robust.[43]

(14) **The phosphorus model requires adjustment to reflect companies' specific engineering challenges in removing phosphorus.** The PDs' model addresses the robustness concerns identified by disputing companies and third parties.[44] But it still leaves material differences compared to companies' business plans. The PDs recognise the unique engineering challenges that companies face (in terms of geographic location and existing infrastructure) in fitting phosphorus removal solutions. For Thames Water, this results in a £71 million gap in expected costs relative to its Thames Water 2024 Business Plan. As the IWC report finds, econometric models must be balanced with an inquiry into company specifics.[45] The PDs omit this step and risk underfunding phosphorus enhancement costs.

(15) **No rationale is provided for the scale of the efficiency challenges of up to 30%.** The water sector undertakes low-return, highly complex capital projects, for which delivery and costs are heavily negotiated with contractors.[46] The PDs do not explain how a company can be expected to deliver a cost reduction of 10, 20, or 30% by way of "efficiency challenge."[47] John Bentley, a civil engineer of 35 years standing and former senior executive responsible for delivering water sector capital programmes,[48] concludes that there is no credible basis for considering that engineering alternatives or savings of this scale – exceeding many times the margins on the projects – can be secured.[49] The PDs provide no explanation for how they reach this conclusion. Appropriate evidence and reasoning are all the more important, as the shortfall will need to be funded by diverting resources from other important areas of spend.

4. Incentives

(16) **The incentives framework leaves companies facing significant penalties in PR24 due to double counting and flawed metrics.** The PDs' incremental changes fail to address fundamental issues. It is not open to the CMA to decline to review the overall outcomes package.[50] This is not a case of requiring "*a complete reset*" but of addressing the incentives package holistically.[51] That is the essence of *de novo* redetermination, the statutory review the CMA is charged with undertaking.

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42 CMA, PDs, Volume 2, para. 5.68.

43 CMA, PDs, Volume 2, paras. 5.154-163.

44 CMA, PDs, Volume 2, para. 5.68.

45 IWC, Final Report, para. 417.

46 Opinion of John Bentley, J Bentley Consultancy Ltd, 11 November 2025, Investor Group, Third-Party Submission, Response to CMA PDs, Annex 2 ("**John Bentley Report**"), paras. 13-17.

47 CMA, PDs, Volume 2, para. 5.186.

48 John Bentley Report.

49 John Bentley Report, paras. 18-22.

50 CMA, PDs, Volume 3, para. 6.6.

51 Second Nolan/CL Report, para. 4.2.

(17) **Persistent underperformance on mandatory incentives:** Over the past decade, companies have consistently underperformed against mandatory incentives, with bespoke incentives in PR14 and PR19 providing limited relief. The reality is that mandatory incentives have repeatedly been set at unachievable levels, a fact previously masked by bespoke incentives which helped companies secure upside. PR24 relies primarily on non-bespoke, mandatory incentives. So sectoral underperformance on this mostly non-bespoke incentive package is highly likely.[52]

(18) **Continued reliance on metrics the PDs acknowledge are flawed.**[53] The PDs acknowledge that the customer measure of experience ("**C-MeX**") metrics are flawed but defer action to Ofwat, stating that "*we would support Ofwat and CCW continuing to work together to strengthen the data for PR29, with the aim of including a complaint-related measure into a future performance commitment or some other form of performance incentive*."[54] As set out in the Investor Group's initial submission, C-Mex is flawed and over-powered.[55] The Investor Group asks that the final determination withdraw the C-MeX metric and/or minimise the associated outcome delivery incentive ("**ODI**") rate.[56] The CMA is required to redetermine PR24 on the merits. It cannot delegate remedial work to Ofwat, particularly if this is delayed until PR29.

(19) **Double penalisation.** Companies remain at risk of double-counted penalties for the same delivery shortfall.[57] This creates disproportionate downside exposure, particularly for companies facing complex, multi-year infrastructure programmes.[58] The "*double jeopardy*" of the incentives framework was criticised by the IWC.[59] Again, the PDs propose to defer remedying incentives and defer to Ofwat to consult on changes. We ask that the CMA reconsider this approach. The CMA is required to redetermine the full merits of Ofwat's decision. Deferring to Ofwat is to disregard its statutory duties. The Investor Group urges the CMA to ensure that companies are not penalised twice for the same underlying delivery risk.

5. Investor Returns

(20) **Supply chain risks remain underestimated.** Both the IWC and NAO warn PR24 investment will outpace supply chain capacity, driving up costs for labour, materials, and services.[60] The PDs acknowledge a "*step change in the level of investment to be delivered by water companies*"[61] and "*record levels of new capital.*"[62] However, they do not address stakeholder concerns that Ofwat's real price effects ("**RPEs**") insufficiently protect companies.

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52 Second Nolan/CL Report, para. 4.23.

53 CMA, PDs, Volume 3, paras. 6.339-341, and 6.347-348.

54 CMA, PDs, Volume 3, paras. 6.348.

55 Investor Group, Third-Party Submission, Annex 4: First Nolan/CL Report, paras. 5.74-109.

56 CMA, PDs, Volume 3, paras. 6.433-436.

57 CMA, PDs, Volume 3, para. 6.111.

58 Second Nolan/CL Report, paras. 4.70-72.

59 IWC, Final Report, para. 475.

60 IWC, Final Report, paras. 984, and 988; NAO, Report, paras. 2.41, and 2.44.

61 CMA, PDs, Volume 4, para. 7.547.

62 CMA, PDs, Volume 4, para. 7.481.

(i) Excluding RPEs from base expenditure. The PDs state that no separate RPE adjustment is required because labour and energy costs are already embedded within the econometric models.[63] These inputs are calibrated on historical data, which may not capture structural shifts anticipated in AMP8.[64] Companies would bear full exposure if future input inflation exceeds past trends. Differences in firms' labour and energy cost weightings also mean those with atypical cost structures risk systematic over- or under-funding without a separate RPE layer. As input effects are now implicit in regression coefficients rather than presented as a distinct adjustment, stakeholders have less visibility and limited scope to test sensitivities. Reliance on historic modelling risks underestimating future cost pressures.

(ii) Misplaced reliance on COPI enhancement expenditure. The PDs maintain that RPEs based on the Construction Output Price Index ("**COPI**") – based on road and bridge construction – is the only option available.[65] But COPI does not reflect the structure or volatility of water-sector investment, nor the impact from rapidly rising demand from capital projects.[66] Water projects are fundamentally different to roads and bridges in terms of the mix of inputs, regulatory requirements, and legacy infrastructure/brownfield site challenges.[67] Water and sewage costs indices have consistently outstripped CPIH and COPI for that reason.[68] Particularly as Ofwat accepted that "*COPI was not a perfect index*,"[69] it is all the more important to adjust returns upwards to reflect execution risk.

(iii) Ex-post true-ups amplify financial stress. As the Investor Group previously submitted – but which the CMA did not address – ex-post true-ups, "*imposed additional financial stress on water companies because they occurred only at 'the end of the pricing period', leaving companies underfunded for up to five years. This posed an acute risk where there was considerable doubt about the abilities of many companies to maintain investment grade credit ratings given the myriad other challenges in the overall PR24 settlement.*"[70] By deferring recovery to the end of the period, the mechanism effectively transferred liquidity and credit risk from regulators to companies – an unsustainable burden in the current investment climate.

(21) **The PDs' "fair bet" analysis is falsely premised on PR19's outturn being anomalous.** The PDs present no evidence for stating PR19 sector performance was the consequence of external factors rather than a poorly calibrated price control.[71] They unquestioningly accept Ofwat's circular reasoning: because its price control is fair then it represents a fair bet. They reject KPMG's well-observed data that major capital projects are inherently risky and prone to overruns. But the PDs

63 CMA, PDs, Volume 1, para. 4.60.

64 CMA, PDs, Volume 1, para. 4.51.

65 CMA, PDs, Volume 2, para. 5.206.

66 John Bentley Report, para 11.

67 John Bentley Report, paras. 9-10.

68 John Bentley Report, para. 12.

69 CMA, PDs, Volume 2, para. 5.202.

70 CMA, PDs, Volume 2, para. 5.205, referencing, Thames Water Investor Group, Third party submission on the Water PR24 References, Annex 5, paras. 14-15, and Annex 4: First Nolan/CL Report, para 4.15, and paras. 5.162-163.

71 CMA, PDs, Volume 4, para. 8.60.

fail to provide the CMA's own analysis, as required in a de novo redetermination.[72] The NAO found no significant improvement in key metrics since 2015-16, and ODIs failed to deliver lasting gains.[73] The IWC found companies missed their allowed rate of return due to operational issues and an increased cost of financing.[74] These risks – now amplified by the scale and complexity of PR24 investment – are not anomalies but enduring features of the regime. The final determination must recalibrate the balance to address these structural risks and provide adequate downside protection.

(22) **Undue weight on OBR's CPIH forecast distorts returns.** The PDs miscalibrate the cost of capital by overemphasising the OBR's 2.4% CPIH inflation forecast,[75] compressing the real WACC and ignoring market inflation expectations that correspond with the measured nominal cost of debt in the market.[76] Anchoring the cost of debt to a newly derived statistic produced by the OBR only once,[77] without triangulating against market data, risks setting the regulatory real cost of debt too low and deterring investment.[78] By contrast, Ofgem's RIIO-3 Draft Determinations adopt the Bank of England's 2% CPI target.[79] The error is acute for restructuring companies, where the mix of new and old debt can diverge sharply from the sector average, denying them the benefit of legacy, lower-cost debt. A rigid sector-wide CPIH assumption ignores forced refinancing, underfunds affected companies, and blocks the recovery of higher new debt costs. The final determination should recalibrate the CPIH assumption to deliver a fair, investment-supportive cost of capital.

(23) **Inadequate beta adjustment for AMP8 capital intensity**. Financing PR24's unprecedented infrastructure programme entails material delivery, supply chain, and execution risks that have not been sufficiently recognised in the cost of equity.[80] As S&P Global observes, "*the whole sector will have to execute a much bigger capital programme than in the past […] each company will face significant pressure to secure its supply chain and financing accordingly.*"[81]

(i) The PDs' reliance on short-term betas to capture this risk is inadequate.[82] Short-term betas insufficiently account for structural, forward-looking changes. Even the CMA concedes that "*this type of analysis implicitly assumes that risks faced by investors historically are broadly representative of forward-looking risk*."[83] Yet PR24 represents a clear structural break. The CMA itself acknowledges the "*record levels of investment*"[84] and the "*unique circumstances of this price*

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72 Second Nolan/CL Report, para. 5.13.

73 NAO, Report, paras. 1.19, and 3.18.

74 IWC Report, para. 752 (Box 20).

75 CMA, Volume 4, PDs, para. 7.49.

76 CMA, PDs, Volume 4, para. 7.52.

77 CMA, PDs, Volume 4, para. 7.51.

78 Second Nolan/CL Report, section 7.

79 Ofgem, RIIO-3 Draft Determinations, Finance Annex, para. 2.48.

80 Second Nolan/CL Report, section 6.

81 S&P, U.K. Water Regulatory Framework Support, Low Financial Flexibility In Coming Regulatory Period Drive Rating Actions, February 2025, pp. 5-6.

82 CMA, PDs, Volume 4, para. 7.430(c).

83 CMA, PDs, Volume 4, para. 7.364.

84 CMA, PDs, Volume 4, para. 7.541.

control."[85] If markets have not yet fully priced in the scale and risk profile of PR24's capital intensity – whether because the investment programme is only just beginning or its full scope remains uncertain – short-term betas will understate true forward-looking risk.[86]

(ii) Heightened operating leverage compounds this exposure. Elevated operational gearing amplifies the impact of fixed costs on earnings volatility, increasing systematic risk.[87] By failing to adjust beta for both capital intensity and operating leverage, the CMA underestimates the true cost of equity, jeopardising the sector's ability to attract the capital necessary to deliver statutory, resilience, and environmental obligations.

(24) **Modelled returns insufficiently address market realities.** The CMA's 5.90% equity return – 30 basis points above the midpoint – compensates for understated inputs, not sector risk.[88] Recalibrating CAPM inputs would reflect the true cost of equity, eliminating the need for discretionary uplift. The CMA's TMR range of 6.70–7.30% relies on outdated data, ignoring current market dynamics, particularly as real-world equity premia have exceeded historical averages since 2022.[89] The CMA's reliance on a 20-year ILG yield of 2.11% plus the RPI–CPIH wedge fails to account for gilt volatility.[90] A broader, market-based approach is needed to accurately reflect the true cost of capital.

6. The Position of Thames Water

(25) This submission concerns the CMA's PD for the five disputing companies, not Thames Water. The commercial circumstances of the five companies under redetermination differ from those of Thames Water. Should Thames Water's final determination be referred to the CMA, these differences must be addressed. Natural justice, statutory framework, and public law require the CMA to consider Thames Water's specific position.

(26) **"Secure" vs "further" duties.** In its redeterminations, the CMA must fulfil the same statutory duty that binds Ofwat under s.2(2A) of the Water Industry Act 1991 ("**WIA91**"). The CMA is required to exercise its powers in a manner which it considers is 'best calculated' to achieve its primary duties set out in WIA91 s.2(2A). The language of that section distinguishes between duties that must be *secured* – namely, s.2(2A)(b), and (d) (statutory functions of undertakers and licensees) and s.2(2A)(c) (financeability) – and those that must be *furthered*, namely, (2A)(a) (the consumer objective) and s.2(2A)(e) (the resilience objective). To *"secure"* is an obligation of result requiring that an outcome is achieved. To *"further"* is an open-ended duty to promote or advance an objective. Treating these primary duties as undifferentiated objectives that must be "balanced evenly" fails to give effect to the wording of s.2(2A).

(27) **The PDs treat the duties as undifferentiated.** If, for example, there is no risk to financeability or to the performance of regulatory functions, then this distinction may not make a significant difference to the regulatory analysis. However, where either is threatened, it is necessary to reflect the sharp distinction drawn in the legislation between the duties that must be secured, and those

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85 CMA, PDs, Volume 4, para. 7.552.

86 Second Nolan/CL Report, para. 6.24.

87 Second Nolan/CL Report, para. 6.8.

88 CMA, PDs, Volume 4, paras. 7.435, 7.439, 7.541, and 7.547-579.

89 CMA, PDs, Volume 4, para. 7.12(a)(ii).

90 CMA, PDs, Volume 4, para. 7.12(a)(i).

that must be furthered, particularly when the company being regulated is in financial distress and at greater risk of being unable to perform its regulatory functions or finance its operations.

(28) **In the event of a Thames Water reference, this issue will need to be considered on its merits.** Previous regulatory settlements have failed to properly account for these duties. The House of Lords Industry and Regulators Committee in September 2023 concluded that, "*Ofwat has failed to ensure companies invest sufficiently in water infrastructure, choosing to keep bills low at the expense of investment.*"[91] The NAO warned that "*regulators must understand the scale of the challenge in terms of cost and deliverability and the condition of assets across the sector, ensure the sector raises the investment needed and meets government outcomes, and achieve value for money for bill payers*"[92]. And the IWC found that "*actual rates of return appear to have been out of line with levels of risk in the water sector.*"[93] The PDs acknowledge these problems but have deferred addressing them to future policy development. The Investor Group makes no comment on the appropriateness of doing so in relation to the five companies subject to the PDs. But, in any redetermination of Thames Water, it would be necessary to consider these issues afresh.

(29) **Companies in financial distress, such as Thames Water, raise distinct issues**. Whatever framework is adopted by the CMA with respect to the five water companies seeking redetermination, it would be neither possible nor lawful to apply that framework to Thames Water. The impact on Thames Water's operations and financial stability makes this especially important. The Investor Group reserves the right to make further submissions on Thames Water's financial position and regulatory treatment, including amendments or expansions.

7. Next Steps

(30) The Investor Group appreciates the opportunity to share its views on the PDs, and values ongoing engagement with the CMA. Following our productive meeting on 17 July, the Investor Group would be grateful for the opportunity to arrange a further meeting between the Panel and its advisers on the matters raised in our submission. Dr Moselle and Dr Nolan would be pleased to present their findings and address any questions.

Yours sincerely,

[redacted]	[redacted]	[redacted]
Akin Gump LLP	Skadden, Arps, Slate, Meagher & Flom LLP	Towerhouse LLP

For and on behalf of the **Investor Group**

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91 "*Cleaning up failures in water and sewage regulation: Industry and Regulators Committee report*", 22 September 2023, p. 4.

92 NAO Report, para. 23.

93 IWC, Final Report, para. 751.

ANNEXES

Annex 1:	Reply to certain aspects of the CMA's Provisional Determinations, Dr Dermot Nolan and Compass Lexecon, 11 November 2025
Annex 2:	Opinion of John Bentley, J Bentley Consultancy Ltd, 11 November 2025