

Kirstin Baker
Chair
Special Reference Group – Water PR24 Price Redeterminations
Competition and Markets Authority

By email: waterPR24references@cma.gov.uk

6th November 2025

Dear Kirstin

I am writing in response to the invitation for comments on the CMA's Provisional Determinations issued for the five disputing companies on 9th October 2025.

We welcome the efforts of the CMA Panel in assessing the arguments made by disputing companies in their Statements of Case and the decisions set out by Ofwat in its Final Determination. The regulatory framework is incredibly complex and it is a challenging undertaking to develop understanding and opinions on the vast array of interacting topics across the sector.

As I described in my letter in response to Company statements of case (22/04/2025), Yorkshire Water's decision not to appeal the Final Determination was a finely balanced one. The YW Board was not satisfied with several key elements of Ofwat's process and final determination. The decision was taken in the round and was not on the basis that there was an overall endorsement or acceptance of Ofwat's approach.

Our comments on the Provisional Determinations are limited to issues which we believe are important to shape Ofwat's approach on certain issues within AMP8 and for the new Regulator at the next price review. We reinforce decisions where we agree with the CMA's draft approach but highlight some areas where we consider the CMA should reconsider its decision ahead of its Final Determination.

Since our previous letter to the CMA we have received the findings of the Independent Water Commission (IWC). Whilst we understand that its recommendations are intended to inform future regulation and not PR24, our response is necessarily influenced by the evidence set out within it, particularly where we consider that the CMA's findings are misaligned with the review.

Risk and Return

We welcome the CMA's recognition of the substantial investment required over the next five years and its emphasis on promoting investability. The CMA rightly notes:

"There are risks from setting the WACC too low which in welfare terms may exceed the costs to customers..."

This aligns with our previously stated position that ensuring the water sector remains attractive to investors is essential for delivering the service and environmental outcomes our customers expect, as outlined in our response to company statements of case (22 April 2025).

In that submission, we highlighted the Yorkshire Water Board's view that Ofwat's allowed return for AMP8 was inadequate given the scale of risk facing the company. We therefore welcome the CMA's recognition that the equity return proposed in Ofwat's Final Determination fails to reflect prevailing market conditions and the level of investor risk.

Accordingly, we support the CMA's revisions to the allowed wholesale return and, in particular, the uplift to the cost of equity—an increase of 32 basis points and 80 basis points respectively—which we believe will help deliver sector investability.

We endorse the following key methodological improvements introduced by the CMA:

- **Expanded comparator set for beta assessments**, including Pennon data, ensuring a more representative and robust analysis.
- **Flexible estimation windows for beta**, with the CMA's choice of a three-year period over Ofwat's fixed five-year approach reflecting a more nuanced and evidence-led regulatory judgment.
- **Confirmation that the retail margin adequately compensates the retail business**, removing the need for further adjustments to the Appointee WACC.

While we support these methodological refinements, we remain concerned about the CMA's use of a long-term CPIH assumption of 2.4% in its cost of debt assessment.

Although this figure is based on OBR forecasts, we caution against over-reliance on a single source—particularly as the OBR's March 2025 detailed forecasts suggest CPIH may decline to 2.1% by 2029/30 (with CPI at 2.0%). We would welcome the CMA reviewing this assumption following release of the OBR's updated forecasts later this month.



Finally, we commend the CMA's strengthened approach to financeability. Raising target metrics to 1.7x for AICR and 10.0% for FFO to net debt, alongside stress testing against downside scenarios, represents a more rigorous and credible framework. We encourage the CMA to go further by offering guidance on future financeability assessments to reinforce the robustness of this critical regulatory requirement.

Totex

Base Costs Modelling Approach

The CMA has proposed an alternative econometric modelling method for setting base cost allowances for the disputing companies. We acknowledge that the CMA's rationale stems from the complexity and inconsistent performance of Ofwat's models, as well as the tendency for appellant companies to propose variables that may favourably influence their outcomes. By relying solely on data, and removing the need to assess the validity of each variable, the CMA's method aims to provide a streamlined approach.

We do not hold a definitive position on whether the CMA's models are preferable to Ofwat's, particularly as we have not had access to the models themselves prior to their application in the CMA's final determinations.

Nonetheless, we wish to express several concerns regarding this methodology:

- The LASSO approach represents an even more econometric, top-down approach, which is detached from engineering principles. This is contrary to the recommendations of the Independent Water Commission (IWC), which has cautioned against excessive reliance on such models. It recommends that assessments of capital and operating costs are carried out separately and that at least equal weighting is placed on engineering evidence.
- There may be other relevant variables, not currently used by Ofwat or identified by disputing companies, which should be considered in the modelling process.

However, while we acknowledge the analytical potential of the LASSO technique, we have reservations about the models' implication that base allowances for the industry should be lower. This perspective does not appear to align with the available evidence or the broader consensus that assets require increased rather than reduced funding. Therefore, we question the reliability and validation of the models at this stage.

Our principal concern lies in the precedent that the adoption of this approach may establish for future price reviews. We request that the CMA incorporates narrative in its final determinations to clarify the rationale behind its decisions for the PR24 redeterminations in light of existing constraints. However, these decisions should not be interpreted as the standard approach for any future regulator at subsequent price reviews.

Frontier Shift

We welcome that the CMA has recognised a need to move away from the 1% Frontier shift that has been the default value used in regulatory determinations for several years despite the near zero productivity growth in the wider economy.

The value of 0.7% is in line with Yorkshire Water's PR24 estimate which was at the top end of the range suggested in the Economic Insight report used by the industry. We would welcome the CMA setting out some principles for how this value should be objectively calculated going forward – we believe that the subjectivity of this should be substantially removed and that it should not be used as a regulatory lever.

Asset Health

We strongly agree with the CMA's decision not to apply a PR19 underdelivery adjustment to companies' allowances for metering and mains replacement (and also to growth). This was applied by Ofwat retrospectively on the basis that companies should have delivered a theoretical 'implicit' amount of activity despite a Totex and outcomes regime having no specific outputs defined.

We do not however consider that the CMA has fully understood company arguments when making its decision on the period on which historical activity rates should be considered 'implicit'. The decision was made based on whether the low renewal rates in AMP7 were reflective of long-term base activity – with the CMA finding that they were not.

However this is not what the implicit allowance is – the IA should be the level of activity in the time-period used to set the base allowance. Which, given the time-period for setting the catch-up efficiency, is the 5 years preceding the models.

To illustrate this, had the industry invested more in mains replacement over AMP7 (i.e. in line with long term expectations) this would have been reflected in greater AMP7 expenditure, a reduced efficiency benchmark and greater cost allowances (and IA).

It is important for the industry going forward that the CMA reflects this in its final determinations as it may have implications for all companies in the decisions made by Ofwat in its AMP8 Enhancing Asset Health Roadmap and cost change process.

Outcomes

C-MeX

Southern Water submitted evidence that the median score for water companies has been below the UKCSI all-sector average. It proposes that the downward adjustment factor to the UKCSI score is increased to reflect the most recent data.

We recognise the reasons that the CMA rejected Southern's proposal in its provisional decision:

- that historical performance averaged over a number of years is more likely to reflect the level of performance achievable by an efficient company, and
- the substantial increase in investment allowed in PR24 and the corresponding improvement in outcomes for customers that is expected over the period.

However, there are several factors emerging from the most recent interim C-MeX results that suggest Southern's estimate for the appropriate adjustment is a significant underestimate, and support the concerns raised by the Independent Water Commission :

"The regulator should ensure the measure is focussed on actual customer service delivered by a company rather than more general measures which will tend to pick up broader concerns about industry as a whole and which may to be susceptible to media coverage of other companies' performance."

"Improvements are needed to more effectively capture the quality of service that customers experience..."

Q1 results saw all companies' C-MeX scores reduce, with an average drop of 9.6pts, with the median company approximately 7pts below the estimated PCL. Whilst 6 companies are achieving small rewards, 7 companies are now the facing maximum penalty (hitting the penalty collar).

A combination of factors have driven this which are not related to the actual service that customers are receiving:

- The large bill increases that were implemented in April 2025.
- Negative media related to environmental performance, Thames Water, profits and executive pay.

¹ Recommendation 41

https://assets.publishing.service.gov.uk/media/687dfcc4312ee8a5f0806be6/Independent_Water_Commission_-_Final_Report_-_21_July.pdf

- The implementation of the new methodology for surveying for C-MeX which has become 100% digital – where customers are more likely to provide a more negative response.
- The implementation of Temporary Use Bans due to the severe dry weather in 2025.

We consider based on this that it would be appropriate for the CMA (and Ofwat) to reconsider the decisions on the C-MeX performance commitment to ensure it is achieving the desired outcome of incentivising customer service improvements.

Pollution Incidents

We note that the CMA has made adjustments to the ODI rates for disputing companies for Total Performance Commitments. We draw the CMA's attention to the recent² guidance issued by the Environment Agency on incidents and subsequent Ofwat consultation³ to change three PCs (most notably total pollution incidents) in response.

In brief, the Environment Agency is expanding the number of incidents that will be counted under the total pollution incidents metric from 2026 onwards (to include Category 4 incidents and dry-day spills). This means that the existing PCLs are no longer appropriate. Ofwat has recognised this and is proposing an entirely new comparative measure given the uncertainty of future performance.

We ask the CMA to consider this when making its final determinations and to consider any implications that its decisions may have on Ofwat's ability to make a sector-wide adjustment to the Pollution Incident PC and ODI.

² <https://www.ofwat.gov.uk/publication/guidance-for-reporting-and-assessing-water-industry-regulation-incidents-wiri/>

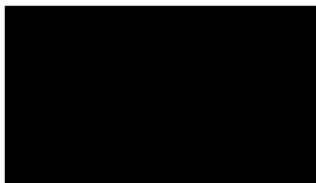
³ <https://www.ofwat.gov.uk/consultation/consultation-on-changes-to-three-pr24-environmental-performance-commitments/>



Summary

We acknowledge the significant work completed by the CMA in its independent provisional redetermination of the PR24 plans for the disputing companies. Our response aims to highlight some particular issues that we believe should be considered further ahead of the final redetermination, as they are consequential to the future success of the sector in AMP8 and beyond.

Yours sincerely,



Tim Hawkins
Strategy & Regulation Director
Yorkshire Water