

PR24 Panel
Competition & Markets Authority
The Cabot
25 Cabot Square
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7 January 2026

Dear panel members

We are all economists who have been actively involved in the PR24 redetermination process while providing advice and analysis to one or more of England & Wales' water companies.

We bring experience more generally from multiple previous CMA inquiries in the UK's regulated industries working for regulators, regulated companies and previous CMA panels, as well as from a long line of other price reviews and merger investigations in the aviation, communications, energy, rail and water sectors.

We thought it would be helpful to the CMA PR24 panel for us to write separately from the responses that companies are submitting to the CMA's recent working paper: "Assessing Base Costs – Working Paper", published on 18 December 2025. Specifically, we want to convey to the panel our genuine surprise, as subject matter experts, at the course that the CMA's work in this part of the redetermination has taken thus far.

In saying this, we wish to be clear from the outset that we consider that benchmarking is an important input into any price control determination in the UK water industry. Benchmarking models, in some form or another, have been used for decades across multiple price reviews, and there is ample precedent on which the CMA can build for this redetermination.

At the same time, it is important for a regulator to recognise that there are limits as to how precise and accurate any piece of cost modelling can be.

Our strong sense is that the panel has to date overweighted the scope for econometric models to reveal 'the truth' about efficient costs and, in doing so, has underweighted the need for caution and safeguards against regulatory error. We also observe that there have been lapses in quality control at certain points in the process. These two things together mean that the base cost modelling work has fallen below the standards we are used to seeing from the CMA.

This particularly comes through to us when looking at three key features of the CMA's most recent document.

First, it is noticeable that the working paper proceeds from the assumption that the underlying drivers of operating and capital maintenance costs at different water companies in different parts of the country can conceivably be expressed in a single mathematical equation (and likewise for wastewater). As economists, we can appreciate the attraction of an exercise that seeks to identify the regression specification that best fits the available data. However, we also know from experience gained over a period of many years that complex operational realities faced by companies can rarely be fully captured using small, real-world datasets and that it is highly improbable that a single regression will identify the complete set of explanatory variables in precisely the right mathematical form. While the CMA may consider that it has been able to explain a high proportion of the variation in actual historical costs, the CMA's relatively simple, one-size-fits-all models risk conflating structural differences with inefficiency meaning that the resulting model specifications are unlikely to form a robust basis to predict efficient future costs compared with a more holistic approach to model development.¹

Second, as corroboration of this point of view, we note the regressions that the CMA tabled on 18 December differ quite markedly from the regressions that the CMA put forward on 9 October as the best available explanation of industry base costs. This, for us, exemplifies precisely the problem that the CMA's approach runs into. An ostensibly "data-driven" approach to benchmarking that prioritises model fit above most other considerations risks generating materially different cost functions with each iteration, with consequent significant financial implications for the companies that are the subject of the CMA's cost assessment.

Third, we note that the panel has to date provided only the lightest of economic/operational justifications for its chosen equations, over and above its findings of good econometric fit. This is a material departure from what we would regard as good regulatory practice in relation to model selection and benchmarking generally, as exemplified in the CMA PR14 and PR19 redeterminations. It conveys a sense that the CMA panel has delegated an important part of the price review to an algorithm without providing the necessary checks and corroboration that the panel has been giving in the other aspects of its work.²

¹ This point was specifically acknowledged by the Independent Water Commission at p.183 of its final report.

² We note that Professor Andrew Smith (Ofwat's econometric academic advisor on cost modelling at PR19 and PR24) highlighted that *more* work was needed to validate the models from operational and economic perspectives, not less. See Annex A5 Statement from Professor Andrew Smith in Ofwat (2023), 'Econometric base cost models for PR24', April.

(NB: For completeness, some of the signatories to this letter will be highlighting further specific concerns that they have in separate papers and/or within company submissions.)

We recognise that there is only very limited time left now until the CMA's statutory deadline to complete its redeterminations.

We strongly urge the panel to give this workstream the highest personal priority in the coming days and weeks. The base cost allowances that the CMA sets will have a very direct bearing on the quality of services that companies are able to provide to their customers, as well as on their financeability/investability. It is imperative, therefore, that the panel members take full ownership of the final conclusions and that all panellists are content that they have properly answered the question: how much base funding do companies require in order to meet their obligations?

We especially encourage the panel to place much greater emphasis on triangulation and on robust sense-checking as it constructs its final determination. There are useful points of reference that the panel can take from alternative reasonable model specifications, the size of its implied challenge to PR24 business plans, the sizing of the challenge that Ofwat gave to business plans in PR19 and PR14 (and companies' subsequent spending against their allowances), and actual industry expenditure in AMP7, to give just four examples. These kinds of cross-checks should be used to the greatest extent possible.

Finally, we ask that the panel shows pragmatism whenever it is needed. We do not know at the time of writing the regressions the panel will be looking at once the staff team have processed all of the responses to the current consultation. However, we can envisage that it may not be possible to iron out all of the remaining unresolved issues in the work that has been carried out to date and/or to reconcile the econometric analysis with other sources of evidence. In such circumstances, it may be appropriate for there to be further discussions, in light of the degree of confidence the panel has in the final model specifications/results, about the adoption of an alternative to an upper quartile adjustment. It may also be appropriate for the CMA to weigh the scale of the challenge it wishes to present to the disputing companies' base costs with the degree of challenge that it wishes to table in other parts of the decision, as part of a final 'in the round' evaluation.

We appreciate this is an unusual submission for us to make and for the CMA to receive. Most of us have never previously responded directly to a CMA consultation in this manner. As individuals who have advised on the economic regulation of the sector over periods of many years, we nevertheless care deeply about the water industry and its regulation. High quality regulatory decisions benefit customers, driving efficiency and improved performance, whilst also supporting investment into the sector (including

from international investors) and delivering robust infrastructure that underpins the wider economy. Having come through an extremely difficult period, with adverse consequences for the water industry's performance and reputation, the upcoming determinations are an opportunity to right-size and set the companies under review up to meet the challenges of the next five years and beyond. Our overriding interest is to see that opportunity is grasped.

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