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Dear Ofwat

## Response to Ofwat's PR14 Review Discussion Paper

Thank you for the opportunity to provide feedback to Ofwat's discussion paper summarising the findings from its review of PR14. We agree with the majority of points noted in the paper, that thoroughly encompasses all key aspects of the price control and should provide another useful set of data points for consideration of the draft PR24 methodology.

We would emphasise the two broad points below for your consideration ahead of the PR24 draft methodology statement issuance:

### Totex approach in cost assessment

Moving to a totex approach was a significant improvement in the cost assessment process. However, decreases in capex and increases in opex should, by themselves, not necessarily represent an indication of any efficiency gains. The following factors require to be analysed to provide a more complete picture, and extension of this approach into PR24 would be welcomed:

- companies' investment cycles that may or may not justify the rise or fall in capex.
- falling capex should not be looked at as a target or criterion of improvement in the long run.
- in some cases, a fall in capex that is compensated by a rise in opex is only delaying costly future investment.

### Allowed cost of capital

The allowed return on capital, based on the extensive trail of historical data inclusive of the pre-financial crisis high interest rate environment, is an indicator that history is not always a good prediction of future. PR19 appeared to follow – at a high level – a similar route, using historical low interest environment to set benchmark for future allowed cost of capital. Further consideration of using the most appropriate historical data in both this – and other key price control areas – is key for PR24.

We are happy to elaborate our view on the points raised above if you have any queries.

Yours sincerely



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Group Chief Financial Officer

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