Neutral Citation Number: [2023] EWHC 2410 (Admin)

Claim No: AC-2023-LDS-000060

IN THE HIGH COURT OF JUSTICE
KING'S BENCH DIVISION
ADMINISTRATIVE COURT

Leeds Combined Court Centre,
The Courthouse,
1 Oxford Row,
Leeds, LS1 3BG

Date: 09/10/2023

Before:

HH JUDGE KLEIN SITTING AS A HIGH COURT JUDGE

- -

Between:

THE KING (on the application of NORTHUMBRIAN WATER LIMITED)	**Claimant**
- and -	
WATER SERVICES REGULATION AUTHORITY	**Defendant**

- -
- -

Thomas de la Mare KC and **David Lowe** (instructed by **KPMG LLP**) for the **Claimant**
Kieron Beal KC and **Tom Lowenthal** (instructed by **Gowling WLG (UK) LLP**) for the **Defendant**

Hearing dates: 12-13 September 2023

- -

Approved Judgment

This judgment was handed down by the Judge remotely by circulation to the parties' representatives by email and release to The National Archives. The date and time for hand-down is deemed to be 4:30 p.m. on 9 October 2023.

HH Judge Klein:

1. This is my decision following the expedited "rolled-up" hearing of the challenge by Northumbrian Water Ltd. ("NWL") to the decision of the Defendant ("Ofwat") made on 15 November 2022 ("the final determination") to only partially relieve NWL from a reduction in the prices it can charge its customers imposed by the current five-year price control settlement published by Ofwat in December 2019, and operating from 2020-2025, known as PR19, because of NWL's underperformance of its commitments relating to water supply interruptions which occurred as a result of Storm Arwen which seriously damaged NWL's northern supply area (broadly the north east of England) on 26 and 27 September 2021. But for the partial relief in the price reduction granted by Ofwat by the final determination, the water supply interruptions would have resulted in a reduction in the prices NWL could charge its customers in 2023-2024 of £25.79 million (which would have been partially offset by NWL's outperformance (performance which beat its commitments) in 2021-2022 otherwise than during Storm Arwen). By the final determination, Ofwat relieved NWL of £12.894 million (i.e. 50%) of the price reduction.

2. NWL was represented by Thomas de la Mare KC and David Lowe and Ofwat was represented by Kieron Beal KC and Tom Lowenthal. I am grateful to them for all their help in navigating the extensive material in this case and for bringing clarity to the issues in the case.

Water supply price controls - introduction

3. Following the privatisation of the supply of water and wastewater services (together "water supply"), most of those services have been supplied in England and Wales by regional monopolies ("water companies"). This means that customers generally have no choice about from where they get their water supply. Because there is no competition for water supply, a decision has been taken broadly to mimic a competitive market by the imposition of five-year price control settlements by the industry's economic regulator, Ofwat (the provisions of which may be the subject of re-determination by the Competition and Markets Authority ("the CMA") (as happened in relation to NWL's PR19 settlement).

4. Ofwat is a non-ministerial government department, governed by statutory duties which are found principally in s.2 of the Water Industry Act 1991 ("the Act"), which provides:

> "(1) This section shall have effect for imposing duties…on the Authority as to when and how [it] should exercise and perform the powers and duties conferred or imposed…by virtue of any of the relevant provisions.
>
> (2A) …the Authority shall exercise and perform the powers and duties mentioned in subsection (1) above in the manner which…it considers is best calculated –
>
> (a) to further the consumer objective;

(b) to secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out as respects every area of England and Wales;

(c) to secure that companies holding appointments under Chapter 1 of Part 2 of this Act as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions;…

(e) to further the resilience objective.

(2B) The consumer objective mentioned in subsection (2A)(a) above is to protect the interests of consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services.

(2C) For the purposes of subsection (2A)(a) above…the Authority shall have regard to the interests of –

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age;

(c) individuals with low incomes;

(d) individuals residing in rural areas;

(e) customers…whose premises are household premises

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer…

(2DA) The resilience objective mentioned in subsection (2A)(e) is –

(a) to secure the long-term resilience of water undertakers' supply systems and sewerage undertakers' sewerage systems as regards environmental pressures, population growth and changes in consumer behaviour, and

(b) to secure that undertakers take steps for the purpose of enabling them to meet, in the long term, the need for the supply of water and the provision of sewerage services to consumers, including by promoting –

(i) appropriate long-term planning and investment by relevant undertakers, and

(ii) the taking by them of a range of measures to manage water resources in sustainable ways, and to increase efficiency in the

use of water and reduce demand for water so as to reduce pressure on water resources…

(2E) …the Authority may, in exercising any of the powers and performing any of the duties mentioned in subsection (1) above, have regard to –

(a) any interests of consumers in relation to electricity conveyed by distribution systems (within the meaning of the Electricity Act 1989);

(b) any interests of consumers in relation to gas conveyed through pipes (within the meaning of the Gas Act 1986);

(c) any interests of consumers in relation to communications services and electronic communications apparatus (within the meaning of the Communications Act 2003),

which are affected by the exercise of that power or the performance of that duty.

(3) Subject to subsection (2A) above,…the Authority shall exercise and perform the powers and duties mentioned in subsection (1) above in the manner which…it considers is best calculated –

(a) to promote economy and efficiency on the part of companies…in the carrying out of the functions of a relevant undertaker;…

(ba) to secure that no undue preference (including for itself) is shown, and that there is no undue discrimination, in the doing by such a company of –…

(ii) such things as relate to the provision of services by a water supply licensee or a sewerage licensee;…

(e) to contribute to the achievement of sustainable development.

(4) In exercising any of the powers or performing any of the duties mentioned in subsection (1) above in accordance with the preceding provisions of this section,…the Authority shall have regard to the principles of best regulatory practice (including the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed)…

(5A) In this section –

"consumers" includes both existing and future consumers; and

> "the interests of consumers" means the interests of consumers in relation to –
>
> (a) the supply of water…; and
>
> (b) the provision of sewerage services...
>
> (7) The duties imposed by subsections (2A) to (4) above…do not affect the obligation of the Authority…to perform or comply with any other duty or requirement (whether arising under this Act or another enactment, by virtue of any retained EU obligation or otherwise)."

5. There is no dispute that the duties imposed by s.2 of the Act are, or can be, in tension.

6. Ofwat fulfils its statutory duties in relation to pricing by imposing five-year price control settlements (which are subject to re-determination by the CMA), the current settlement being PR19, as I have said.

7. It is helpful to consider PR19 (which runs to 467 pages) in some detail.

8. The first section of PR19 is entitled "Policy Summary" and contains the following:

> "Challenges facing the sector and Ofwat's strategy
>
> Water companies provide essential services that no-one can live without. As part of our strategy we want water companies to provide the very best service for customers, protecting the environment and improving customers' quality of life by providing reliable water and wastewater services, both now and in the future.
>
> The water sector faces profound challenges such as climate change and population growth. Some have also questioned companies' licences to operate. Customers' demands are changing and the services water companies provide must keep pace with them while remaining affordable for all. Companies must also make sure they meet customers' diverse needs, particularly those of customers in vulnerable circumstances.
>
> To meet these challenges will require a step change in company performance, customer service, efficiency and a more resilient and reliable supply of water, and an increased focus by companies on delivering public value. In achieving these goals we will meet the strategic priorities and objectives of both the Welsh and UK Governments. Without this step change, we risk a deterioration in service, unaffordable price increases and continued environmental damage.
>
> The 2019 price review (PR19) sets the price, service and incentive package for water companies for the period 2020-25.

It is the single most significant regulatory lever in driving the step change in the industry. To do this, in PR19, we are:

- setting stretching but achievable performance commitments on the outcomes that matter to customers and the environment;
- challenging companies to go further on cost efficiency; …
- providing more funding for new investment and innovation; and
- reducing the allowance for the return on capital, reflecting prevailing market conditions.

In combination this allows us to improve outcomes for customers and the environment and build more resilient services, while reducing customer bills by 12% before inflation..."

"Background

There are 17 monopoly water and wastewater companies. These provide end-to-end services from securing water resources, water treatment and distribution through to retail. Water companies are natural monopolies, with high infrastructure costs in particular across distribution networks. Without regulation and competitive pressure, water companies would be able to increase prices and reduce service quality.

Water bills are material to customers, particularly those on low incomes, with an average household combined water and wastewater bills of £405 in 2019-20. Water companies are also sizeable companies with the total revenue across 17 companies for around £11.6 billion per year for the 2020-25 period (all figures in 2017-18 prices)…

Following privatisation in 1989, real (before inflation) customer bills increased over the first 20 years, followed by period of bills being relatively stable. As a result of PR19, bills are forecast to fall from 2020. By 2025, bills will return to the level that they were in 1999-2000…Affordability is an important issue for the sector – water is an essential service and around 3 million customers struggle to pay their bills."

"Our overall approach to PR19

The PR19 performance commitments set the service levels each of company is expected to meet, while the revenue allowance is derived from efficient total expenditure (or totex) and an allowed return on the company's regulatory asset base. The

combination of the stretch from performance commitments and the cost efficiency challenge together provide the overall level of challenge for companies…

Outcomes performance commitments cover key service areas and set out what companies will deliver to customers over the 2020 to 2025 period. Building on experience with PR14, we set 15 common performance commitments that apply to all companies…

Companies were asked to develop a set of bespoke performance commitments that reflect local circumstances and customer priorities. In a number of cases, companies have specific performance commitments to encourage the timely delivery of large enhancement schemes - schemes which will deliver significant improvements to customer service, the environment or resilience.

Customers demand good service from their water and wastewater companies. We intervene to make sure that outcome performance commitments are stretching but achievable.

For…water supply interruptions, we set out our expectations in the PR19 methodology that stretching performance commitment levels should be based on the forward-looking upper quartile service level. That is the level of performance companies forecast will be achieved by 25% of companies in the future. These areas reflect important priorities for customer service and the environment. For [these] performance commitments we consider that all companies should be able to achieve the same common performance levels by management and operational improvements. Consequently the level of stretch will be higher for poorer performing companies. We do not consider it is acceptable for some customers to continue to experience lagging performance due to poor operational or management practices…"

"Balancing risk and return

Our determinations aim to incentivise companies to deliver stretching levels of service and deliver services efficiently while meeting their obligations and commitments to customers. Through the use of incentive mechanisms and the allocation of risk to the party best able to manage it we aim to ensure companies will be incentivised to deliver the best outcomes for customers in 2020-25. Our mechanisms ensure that where companies underperform for customers, their returns will be reduced; if they outperform, they will earn additional returns" (emphasis added).

"Meeting our duties and…Government strategic policy statements

Resilience is central to this review. Companies have duties to develop and maintain systems for water supply and sewerage services, which need to be resilient in the long term, recognising the challenges we mention above. We also have a duty to further the resilience objective…We are strengthening the incentives for companies to increase resilience by maintaining or improving performance through their commitments on asset health. We are also setting stretching commitments on key indicators of day-to-day resilience, such as leakage, supply interruptions and sewer flooding."

"Delivering outcomes for customers

The outcomes framework is a key component in driving companies to focus on delivering the objectives that matter to today's customers, future customers and the environment in the 2020-25 period and beyond. Outcomes define the service package that companies should deliver for their customers, and their incentives to do this. We have two key tools to make sure that companies deliver the right outcomes for customers: performance commitments and outcome delivery incentives.

Performance commitments set out the services that customers should receive.

Outcome delivery incentives specify the financial or reputational consequences for companies of outperformance or underperformance against each of these commitments…

Because performance commitments are the means to hold companies to account for their service delivery, it is essential they are clearly defined and measurable. It is also important that performance commitments are stretching, because this pushes companies to continually improve in order to deliver better service to their customers and for the environment.

…We protect customers against the risk of companies failing to deliver their commitments through underperformance payments. We use outperformance payments to encourage companies to innovate and stretch themselves, where customers value improved performance…

To better align the interests of company management and investors with those of customers, outcome delivery incentives should, in general, be financial rather than reputational. In addition, financial incentives should be settled annually (or "in-period") rather than at the end of the five-year period, to bring the financial impact closer in time to the performance that

> generated it. This focuses management on service delivery and improves companies' accountability to their customers.
>
> It is important that performance commitments are transparent so that we, along with customers, stakeholders, other regulators and companies, can understand, compare and monitor performance. **This is achieved by setting performance commitments that are clear, unambiguous, complete and concise with no inappropriate exemptions. In setting performance commitments for each company, we see a limited role for exclusions. For example, while weather is a factor outside company control, the response to managing the risks and uncertainty associated with weather and the operational response to a severe weather incident are within companies' control**…
>
> *Sector Summary*
>
> …We are placing caps and collars on a number of important performance commitments to limit risk exposure to unexpectedly high or low performance for customers and companies" (emphasis added).

9. A number of features of PR19 emerge from the Policy Summary:

   i) a focus of PR19 was resilience of water supply;

   ii) to achieve the aims of PR19, water companies became subject to common goals, including in relation to water supply interruptions, and each proposed bespoke goals, all of which are known as Performance Commitments. As it happens, the imposition of a broad range of common Performance Commitments was a departure from the previous settlement which operated from 2015-2020, known as PR14;

   iii) to encourage water companies to meet the Performance Commitments, PR19 set financial consequences, known as Outcome Delivery Incentives, for outperformance (effectively rewards) and for underperformance (effectively penalties). If water companies outperform in respect of a Performance Commitment in any one year, they are entitled to increase their prices to customers the following year and, if they underperform in respect of a Performance Commitment in any one year, they become subject to a reduction in the prices they can charge their customers the following year ("a price reduction"). These price adjustments, which are part and parcel of the price control settlement which is PR19, are set by PR19 itself. Some of the price adjustments are subject to collars (in the case of underperformance) and caps (in the case of outperformance), to limit, to what was judged at the time of the settlement to be appropriate, the exposure of water companies and customers to unexpected under- or out-performance;

   iv) PR19 provides for under- or out-performance in any one year being reflected in customers' bills in a later year by annual in-period determinations;

effectively annual reviews by which, at least, Ofwat makes an evaluative judgment about whether any pre-conditions contained in the Performance Commitments for a price adjustment have been met, and by which it formally determines what a water company may charge in that later year;

v) under PR19, supply interruption Performance Commitments are "stretching" because continued supply (resilience) is an "important priority" for customers;

vi) the combination, and the setting, of Performance Commitments and Outcome Delivery Incentives was intended by Ofwat to allocate "risk to the party best able to manage it". Performance Commitments were intended to have "no inappropriate exemptions" and no more than limited exclusions, in particular in relation to severe weather, resilience to which was seen, at the time of the settlement, as being in the control of the water companies.

10. NWL had objected to Ofwat's proposed approach, by way of collars and caps, in its draft PR19 settlement, relating to the common supply interruption Performance Commitment; an objection it appears Ofwat accepted and led to a modification in the actual settlement. In a section of PR19 commenting on responses to its draft settlement, Ofwat noted:

> "Two companies (Northumbrian Water and Anglian Water) consider there should be greater consistency in how we set caps and collars.
>
> Northumbrian Water does not accept our decision to remove the underperformance collar for supply interruptions. It claims that it is the only company without such a collar when it is a common performance commitment, so it would expect a consistent approach. The company does not accept our argument that these underperformance payments are not material – the company considers its underperformance rates are now consistent with the industry range, and an extreme weather event could expose the company to a very high level of underperformance…
>
> Our Response: …where the vast majority of companies have caps and collars it may suggest that there are underlying reasons that all companies should have caps and collars.
>
> There are five comparative performance commitments that have a vast majority of companies (>70%) have caps and collars.
>
> • Supply interruptions…
>
> We do not have clear reasons why a few companies do not have caps and collars, while most do. For these…performance commitments we apply collars and, where outperformance is possible caps, to all companies where performance commitments are not covered by early certainty."

11. Ofwat set out the Performance Commitments (both common and bespoke) and Outcome Delivery Incentives in PR19 which relate to NWL in a section of PR19 entitled "Northumbrian Water – Outcomes performance commitment appendix". This challenge relates to three Performance Commitments:

    i) a common Performance Commitment relating to water supply interruptions lasting 3 hours or more. This requires NWL to measure, and to report to Ofwat annually, the average number of minutes its customers' water supplies have been interrupted for more than 3 hours. As I have just indicated, there is a collar and a cap for under- and out-performance of this Performance Commitment. The purpose of this Performance Commitment is expressed to be: "to incentivise companies to minimise the number of and duration of supply interruptions". This Performance Commitment is said to have no "specific exclusions";

    ii) a bespoke Performance Commitment relating to water supply interruptions lasting 12 hours or more. This requires NWL to measure the total number of properties which have supply interruptions of 12 hours or more each year. This Performance Commitment does not have any collar or cap and its purpose is expressed to be: "to incentivise the company to reduce the amount of lengthy interruptions that customers experience". This Performance Commitment too is said to have no specific exclusions;

    iii) a bespoke Performance Commitment relating to supply interruptions of more than 1, and less than 3, hours. This requires NWL to measure "the average time the water supply is interrupted [for] greater than one hour and less than three hours in the report year as a proportion of the baseline." This Performance Commitment mirrors the common Performance Commitment but for shorter supply interruptions, but does not have a collar or cap. Its purpose is expressed to be: "to minimise the number of supply interruptions of shorter duration". There is a specific exclusion for supply interruptions "above three hours", because they are the subject of the common Performance Commitment.

12. Each type of Performance Commitment is accompanied by reporting guidance, which, it is not disputed, is part and parcel of PR19. The reporting guidance in issue in this challenge – the central document in this case – is "Reporting guidance – Supply interruptions" ("the Reporting Guidance"),[1] which provides:

> "Objective
>
> The purpose of this document is to derive a metric for supply interruptions that consistently calculates the performance of water companies in terms of the average number of minutes

[1] Although the purpose of the Reporting Guidance is said to be to provide "a metric for supply interruptions that consistently calculates the performance of water companies" in relation to the common supply interruption Performance Commitment, both parties have throughout argued the case on the basis that the Reporting Guidance, and, significantly, what has been referred to as the CE exception, relates to all three supply interruption Performance Commitments. If, in fact, the CE exception, on its proper construction, only applies to the common supply interruption Performance Commitment (a construction neither party contends for), I estimate that Ofwat could only have relieved NWL of £7.46 million (and not £12.894 million) of £25.79 million price reduction relating to Storm Arwen.

> lost per customer for the whole customer base for interruptions that lasted 3 hours or more.
>
> This guidance seeks to enable companies to monitor and compare consistently derived and common performance measures for Supply Interruptions…
>
> The adoption of this metric across the industry does not preclude any company electing to have other supply interruption Performance Commitments with company specific definitions or continued reporting against the previously reported DG3 or KPI Dashboard (post 2011) metrics.
>
> Exclusions
>
> The default position is that the water company manages the risk of supply interruptions and there are no exclusions. This measure covers planned and unplanned interruptions. The cause of the interruption is not relevant to the calculation of the reported figure. That is, asset failure caused by third parties would be treated the same as the failure of the company's assets and planned or unplanned interruptions are the same.
>
> Companies may make a representation to Ofwat for an exception to be granted on the basis of a civil emergency under the Civil Contingencies Act 2004, where the supply interruption is not the cause of the emergency [("the CE exception")]...
>
> Measure Definition
>
> Calculation of the Performance
>
> $\sum$ [=]
>
> $$\frac{(Properties\ with\ interrupted\ supply \geq 180\ mins) \times Full\ duration\ of\ interruption}{Total\ number\ of\ properties\ supplied\ (year\ end)}$$
>
> …"

13. The reporting guidance for other Performance Commitments approach exclusions in a different way. So, for example, in relation to outages, the reporting guidance apparently provides:

> "Unplanned outage *(sic)* arising from changes in raw water quality beyond the normal water quality operating band shall be excluded as this is not a measure of asset health. Exclusions must be evidence based including evidence to show what the normal water quality operating for that production site is…"

In relation to mains repairs, the reporting guidance provides:

> "The default position is that the water company manages the risk of mains bursts and there are no exclusions. The cause of the mains burst is not relevant to the calculation of the reported figure, with the following exceptions and points of clarification:
>
> - Any work that is not undertaken on the main e.g. solely on a ferrule, hydrant or valve and clamps associated with these ancillaries, which does not involve a repair on the main shall be excluded. Clamps used to repair the main shall be included.
>
> - All third-party damage should be excluded where costs are potentially (rather than actually) recovered from a third party."

14. This is a convenient place to say something about DG3, the genesis of the Reporting Guidance, and then something about the source of Ofwat's power to impose five-year price control settlements and to make in-period determinations.

15. DG3 was the reporting standard for supply interruptions which preceded PR14. I understood the parties to agree that the effect of DG3 was that water companies were not subject to price reductions arising from water supply interruptions which were not their fault; so the reverse of the default position under PR19 as explained in the Reporting Guidance.

16. Apart from some adaptations by KPMG LLP and Jacobs, which reported to Ofwat and Water UK (the industry body) in a jointly-commissioned report entitled "Targeted review of common performance commitments", and which are not relevant for present purposes, the genesis of the Reporting Guidance was a 2017 report of a working party of UK Water Industry Research Ltd. ("UKWIR") entitled "Consistency of Reporting Performance Measures" (published on 10 July 2017), which appended a draft of the Reporting Guidance. The working party comprised a representative of Ofwat, a representative of the Consumer Council for Water, a representative from each of eight water companies (including a representative from NWL), a representative from Water UK and a representative from the Environment Agency. Because of a submission made by Mr de la Mare, it is important to understand the purpose of the UKWIR report. As the title of the report suggests, the focus of the working party was on consistency of reporting. The executive summary includes the following:

> "Ofwat has confirmed that the output of this project will not impact on PR14 performance commitments and ODIs, but is intended to form the basis of public reporting from 2020/21 and to inform the development of PR19 Business Plans and Water Resource Management Plans."

In relation to the draft reporting guidance for water supply interruptions appended to the report, the report explains:

> "The guidance document for the consistent reporting of supply interruptions is included in the appendices. The calculation and assumptions to be applied have been made as simple and as customer centric as possible in order to achieve consistency of reporting and increase customer trust.
>
> There was clear consensus for a metric for supply interruptions that consistently calculates the performance of water companies in terms of the average number of minutes lost per customer for the whole customer base for interruptions that lasted 3 hours or more."

In other words, the purpose of the report was to propose ways for consistent reporting of Performance Commitments by water companies. It is in this context that two aspects of the report must be understood:

i) the report is silent about how Ofwat is to respond when a water company seeks to exercise the CE exception. In particular, the report does not say in terms that Ofwat then has a discretion whether the CE exception is, or is not, to be granted;

ii) section 4.2.3 of the report says:

> "Exclusions
>
> A key area of simplification was the reduction or elimination of circumstances which would be acceptable as exclusions. Exclusions are to be kept to a minimum and shall be consistent with the reasonable expectations of an affected customer."

Taking into account (i) the purpose of the report and (ii) that it was the report itself which effectively proposed, for the first time, the Reporting Guidance, this section of the report was intended to explain the rationale for the default position and the CE exception being proposed in the draft reporting guidance on water supply interruptions (which has since been expressed in the Reporting Guidance), and, indeed, perhaps, as Mr Beal suggested, to encourage that default position.

17. The day after the UKWIR report was published, Ofwat published "Delivering Water 2020: Consulting on our methodology for the 2019 price review" which contained the following (according to NWL's Consultation Response to Ofwat's draft determination which I discuss more fully below):

> "We have worked to embed resilience in the common performance commitments. For example, the definitions for performance commitments at PR14 often excluded events such as extreme weather, which are precisely the events we want the sector to be resilient to. We have worked with the sector on the definitions of the common performance commitments to ensure that they do not include any such exemptions."

Water supply price controls - licences

18. Water companies operate by way of instruments of appointment (known as "licences") granted by the Secretary of State for (now) the Environment, Food and Rural Affairs pursuant to statute. NWL's licence was granted under the Water Act 1989.

19. The licence regulates the relationship between each water company and Ofwat. Licence conditions B9.4 and B9.6 relate to the five-year price control settlements and provide:

> "9.4(1) In respect of…Network Plus Water Activities…the Water Services Regulation Authority shall determine [a Price Control] in accordance with this sub-paragraph (having regard to all the circumstances which are relevant in the light of the principles which apply by virtue of Part I of the Water Industry Act 1991 in relation to the Water Services Regulation Authority's determinations including, without limitation, any change in circumstance which has occurred since the last Periodic Review or which is to occur)…
>
> 9.6 Each Price Control determined under sub-paragraph 9.4 pursuant to a Periodic Review shall be set:
>
> (1) for the five consecutive Charging Years starting on 1 April 2020; and
>
> (2) thereafter for each period of five consecutive Charging Years starting on the fifth anniversary of the first day of the period in respect of which the immediately preceding Periodic Review was carried out."

A particular feature of these provisions to note is that, in making any five-year price control settlement, Ofwat must have regard to its duties under s.2 of the Act (and, to be clear, such a settlement can be subject to a re-determination by the CMA).

20. Licence conditions B12.1, B12.5 and B12.7 relate to the in-period determinations. Mr Beal explained to me (without any dissent from Mr de la Mare) that these licence conditions were introduced as an amendment to NWL's licence and with NWL's agreement. They provide:

> "12.1 This Part 3A applies where the Water Services Regulation Authority has notified the Appointee by 31 December in the Charging Year before the Review Charging Year that a Price Control determined under sub-paragraph 9.3 in respect of the Appointee's Retail Activities or sub-paragraph 9.4 in respect of the Appointee's Water Resources Activities, Bioresources Activities or Network Plus Activities may be adjusted to reflect the Appointee's performance in relation to a specific Performance Commitment…

> 12.5 Under this Part the Water Services Regulation Authority may determine the question of whether there should be a change to the revenue allowed under, or, as the case may be, the level of, any Price Control determined under sub-paragraph 9.3 in respect of the Appointee's Retail Activities or sub-paragraph 9.4 in respect of its Water Resources Activities, Bioresources Activities or Network Plus Activities for the following and any subsequent Charging Year and, if so, the amount of such change…
>
> 12.7 In making a determination pursuant to this Part, the Water Services Regulation Authority shall:
>
> (a) consider the Appointee's performance in relation to each relevant Performance Commitment in the period for which performance is being assessed and, in deciding for which Charging Year or Charging Years an adjustment to a Price Control should be made, shall consider both that and the Appointee's expected performance in the current year or one or more future years up to, but not including, the next Review Charging Year; and
>
> (b) take account of the adjustments to the relevant Price Control which the Water Services Regulation Authority notified to the Appointee under sub-paragraph 12.1 above in relation to each relevant Performance Commitment in question."

There is no dispute that there is no appeal (or right to request a redetermination) to the CMA from an in-period determination.[2] It was not immediately clear to me at the hearing that licence conditions B12.1ff apply to in-period determinations, in particular the one in issue in this case, because the price adjustments made by an in-period determination are adjustments which, including collars and caps, operate as part of a five-year price control settlement (e.g. PR19), so such price adjustments may be said to be part of a price control determined under licence condition B9.4 for example and not adjustments to it, but Mr de la Mare and Mr Beal agreed that licence conditions B12.1ff are the provisions which permit Ofwat to make, and by which it made, the in-period determination in issue in this case.

Storm Arwen

21. There is no dispute that, in NWL's northern supply area, Storm Arwen was a civil emergency within the meaning of s.1 of the Civil Contingencies Act 2004. The severity of the impact of the storm on NWL and its customers is explained in detail by

[2] No-one addressed me on the effect of licence condition B12.10; in particular, whether, on its proper construction, a water company can request a redetermination by the CMA of an in-period determination. As both parties have proceeded on the basis that such a right does not exist, so do I. This means that, in deciding whether, when making an in-period determination, Ofwat can (and must) abide by its statutory duties in s.2 of the Act (which I discuss below), I do not take into account that there may be some support for the conclusion that they can (and must), because of the link, effected by licence condition B12.10, between an in-period determination and the five-year price control settlement regime under licence conditions B9.4ff. which make specific reference to those statutory duties. This also means that I proceed on the basis that a water company cannot challenge an in-period determination otherwise than by judicial review.

Andrew Beaver, NWL's Director of Regulation and Assurance since 2020, at paras.82-101 of his first witness statement, as follows:

> "Storm Arwen has been widely recognised as having been an exceptional event. It has been acknowledged as having been one of the most powerful and damaging winter storms of the last few decades, with several unusual features that exacerbated and intensified its impact. As has been widely reported in the press, over one million trees were felled due to the Storm and around 16 million in total were damaged causing significant transport disruption; three people were killed; and fallen power lines resulted in one million homes experiencing electricity disruption…
>
> The unprecedented nature of the storm, its impact on the energy networks and their response triggered reviews by: Ofgem; the Department for Business, Energy & Industrial Strategy (BEIS) (through the Energy Emergencies Executive Committee); and the Scottish Government.
>
> The Jacob's Report set out, amongst other things, details of the unique features of Storm Arwen, including:…
>
> b) the highest (non-mountain) gust speed in England was 98 mph, recorded at Brizlee Wood in Northumberland. A wind gust as high as this is exceptional for this area. These exceptionally strong winds triggered a rare Met Office "red" warning for wind in the North East of England and the East of Scotland;
>
> c) …When analysed by wind direction the northerly Storm Arwen winds recorded in and around Northumberland are estimated to have return periods between 1 in 20 years to greater than 1 in 50 years;…
>
> In NWL's Northern Supply Area Storm Arwen led to two councils declaring major incidents. This triggered a multi-agency response to a civil emergency which was co-ordinated through the Local Resilience Forums (LRFs). The response included the deployment of military personnel to conduct door-to-door checks on vulnerable people in their homes and to provide any additional support required.
>
> Storm Arwen affected NWL's ability to supply water to customers and maintain wastewater treatment processes. Based on the analysis that has subsequently been carried out by NWL's staff, supported by Jacobs and by Crowders, we have identified that in 98.8% of cases the interruption to NWL's supply was due to power outages that had been caused by Storm Arwen. Those outages affected 55 of NWL's sites across the region and also caused a loss of communications. In total,

> circa 1,000 assets within NWL's network were affected by the loss of power. The other 1.2% of interruptions were caused by direct damage to NWL's water supply…
>
> …As a result of Storm Arwen and the loss of power NWL experienced 40 category three pollution incidents, and a further 15 category four incidents…[A]ll of these events were excluded from the assessment of NWL's pollution-related performance by the Environment Agency (EA).
>
> The power outages also hampered NWL's ability to respond to the impact of Storm Arwen on supplies. The loss of power caused a widescale failure of both fixed and mobile telecommunications systems. This prevented and/or hampered communications between remote sites (such as the operational assets) and our Regional Control Centre (RCC) which is used to coordinate the operational activities and response
>
> Other factors that affected our ability to respond to the situation included the fact that NWL was given no advanced warning from the energy companies to begin to prepare our response, despite BEIS having suggested to Northern Powergrid (NPg) that it start preparatory actions from 24 November…Also, access to sites was initially disrupted by fallen trees and unsafe travel conditions, especially in the light of the cold temperatures that came on the back of Storm Arwen…In light of these circumstances, we recognise the efforts of our staff members that went above and beyond to try and maintain supplies to customers…
>
> …[T]he scope of the power outages was beyond anything NWL could reasonably have prepared for, and simply having more generators would not have been a solution given the complexity of the challenges posed by the storm…
>
> Given the range of challenges posed by the storm, and the inherent reliance upon the remedial actions of NPg, the electricity distribution network operator responsible for all of the affected areas in our region, a full restoration of supply took some time.
>
> Data analysed by our teams after Storm Arwen indicates that water supply interruptions peaked at approximately 8,000 properties at 14:00 on 28 November 2021. More than half of these interruptions were restored within eight hours by 22:00 on 28 November 2021. By 9:00 on 30 November 2021, interruptions were being experienced by fewer than 1,200 properties. All interruptions were restored by 12:00 on 7 December 2021.

> …[A]round 280,000 of NPg's customers had lost power as a result of network faults and damage by 27 November…[T]he majority of NPg's customers were reconnected by 29 November (a day later than NWL's restoration of supply to the majority of its customers) but that still left 30,000 customers without power at that point, and it reportedly took 13 days for all customers to have their supply restored…
>
> To date, NPg has paid out £20.08m to consumers in a mixture of mandatory and voluntary compensation to customers…
>
> [Guaranteed Standards Scheme ("GSS")] payments [by NWL to customers whose supplies were interrupted were made by NWL] amounting to c.£680k.
>
> It is significant to note that the GSS payments were made despite the fact that GSS Regulation 17F para 6(a)(i) expressly allows companies to withhold payments where supply is interrupted due to "severe weather"."[3]

22. By default, NWL had to report the water supply interruptions identified by Mr Beaver as instances of underperformance of the common, and NWL's bespoke, supply interruption Performance Commitments as part of its annual return to Ofwat for 2021-2022 which was required for Ofwat's in-period determination for that year. As I have already noted, the effect of these instances of underperformance was that, by default (and subject to the operation of the CE exception), NWL would have had to reduce the prices it could charge its customers by £25.79 million. Understandably, on 15 June 2022 NWL made a representation for the CE exception to operate.

NWL's Storm Arwen representation ("the Representation")

23. It has turned out that the language of the Representation is important and so I need to set out parts of the Representation verbatim.

24. In the section entitled "Executive Summary", NWL said:

> "(4) Northumbrian Water Limited (NWL) is consistently in the upper quartile of performers against water supply interruptions and has a track record of responding well to severe weather incidents. Over AMP6 we were the best performing company in two of the five years and had one of the lowest interruption targets in the sector. During Beast of the East in 2018 we were also amongst the best performers with only 0.05% of customers experiencing an interruption longer than four hours. In its "Out of the Cold" report, Ofwat identified us as an example of a company exhibiting industry leading practices, further indicating our resilience and robustness when it comes to managing interruptions. This strong performance has continued during AMP7. In the year ending March 2021, we had the second lowest average interruption impact in the industry in

[3] In other words, NWL's GSS payments were voluntary.

terms of the common water supply interruptions performance commitment…

(8) The overall impact of Storm Arwen meets the criteria for a civil emergency…In order to protect businesses from unreasonable penalties as a result of extreme events, Ofwat allows companies to make an application to exclude interruptions caused by civil emergencies. The storm therefore appears to us to represent precisely the event that Ofwat must have included the exemption in the PC for.

(9) The exemption appears to have been designed for precisely this type of event and would allow us to reasonably exclude the full impact of the storm. We note that energy networks have similar exclusions in place for extreme weather events. The Environment Agency has already offered a full exemption for pollution events incurred during the same storm on very similar grounds.

(10) Although this would allow us to apply for an exemption for the full impacts, we consider there is room for us to improve in some specific instances and propose a partial penalty. We are therefore proposing a penalty of £3.375m. This is in addition to the c. £1.9m of costs incurred by NWL in responding to the storm, including GSS payments.

(11) We consider a partial exemption is in the interest of customers and preserves incentives to manage service efficiently and effectively in extreme events:

• Applying such a penalty would set poor precedent and be bad for customers over the long-term. It would effectively render the exemption included at PR19 null and void and would place an asymmetric risk into the regulatory process. This would both set an incentive for companies to focus on low probability event mitigation and uneconomic investment to mitigate those risks rather than other service improvements that customers would prefer. It would also drive an increase in the cost of capital to address that asymmetric risk which would result in material additional costs to customers.

• The partial exemption importantly retains the incentive properties to minimise supply interruptions. It means customers do not pay for service areas that could have been improved. The ex-post approach also retains the incentive during an event to return customers to service as fast as possible as any exemption needs to be adequately evidenced and justified.

• The counterfactual of not applying an exemption in contrast would push costs onto customers through higher cost of capital or uneconomic investment to mitigate the risk of an ODI

> penalty for events that are extreme. This would not be in the customer interest and have an opportunity cost to other service areas.
>
> (12) The final penalty we are eligible to pay fits within the balance of risk determined by the PR19 price control. If the ability to make representations for civil emergencies was not in place, then the penalty we would be facing would be more severe than any ODI penalty for supply interruptions incurred since the beginning of PR14. At the same time the full penalty would represent a far greater financial penalty than has been incurred by any of the Distribution Network Operators following the Ofgem and BEIS reviews of the storm. Those companies had far greater numbers of customers off energy supply and the absence of power was clearly the material cause of the supply outages for us. Such a penalty would be disproportionate to the scale of the harm.
>
> (13) Civil emergency events are rare occurrences. As a result, NWL's specific exemption application does not set a broader precedent to be applied to other events due to its rarity. This coupled with the need that any exemption needs to be adequately evidenced and justified provides an overarching level of customer protection…"

25. Section 4 of the Representation looked at "the extent and appropriateness of the response to Storm Arwen" by NWL.

26. Section 5 of the Representation was entitled "Our proposed ODI penalty" and said:

> "Although we believe the full impacts of the storm could be excluded via the allowances provided for in the PR19 reporting guidance, we are proposing an ODI penalty which reflects those aspects of our response which could have been more robust. Notwithstanding the fact that in practice it is near impossible to achieve a perfect response to such challenging events. Therefore, we are proposing an ODI penalty relating to Storm Arwen of £3.375m."

This section of the Representation then set out calculations to which I have already referred; including that the price reduction relating to Storm Arwen because of underperformance of the supply interruption Performance Commitments ("the Storm Arwen price reduction") amounted to £25.79 million and that, of that sum, the price reduction for those aspects of NWL's response to the storm which "could have been more robust" amounted to £3.375 million. This section also showed that, at other times in 2021-2022, NWL had outperformed the supply interruption Performance Commitments and that, for that outperformance, it was entitled to increase prices to customers by £2.808 million. The section continued:

> "The final penalty we are eligible to pay fits within the balance of risk determined by the PR19 price control. If the ability to

> make representations for civil emergencies was not in place, then the penalty we would be a clear outlier when compared to industry wide ODI penalties for supply interruptions incurred since the beginning of PR14…
>
> What is also clear is that the potential penalty NWL faces as a result of Storm Arwen will be bigger than any penalty for interruptions given over this period.
>
> As well as not being in line with the ODI definition (which explicitly allows for exclusions relating to civil emergencies), this would be drastically disproportionate. Especially considering our strong performance both throughout the rest of the year, and during the storm event."

27. Section 6 of the Representation looked at what NWL argued were the damaging consequences of it continuing to be subject to a £25.79 million Storm Arwen price reduction; including that that would "lead to either: a regulated company proposing caps at future price controls to limit risk; or over investment planning for an unbounded impact." In particular, NWL said, in section 6:

> "**The removal (or failure to grant) of the exemption for civil emergency events** alters the downside risk faced by companies in the event of a severe weather event…
>
> Under certain circumstances, a business might be exposed to downside risk that does not have a commensurate upside i.e., there is asymmetric risk. If the assumed cashflows are not appropriately adjusted for such downside events, the un-adjusted cost of equity will not be adequate and will have to be appropriately uplifted to reflect expected losses on a mean probability-weighted expected basis. For example, **where regulatory mechanisms incorporate ex-post review regulatory discretion as in this case, these truncate return distributions because, at best a company will not be exposed to risks from civil emergency, but Ofwat has significant discretion to apply a penalty when these risks occur**…
>
> The risk associated with civil emergency events is downside only, i.e., there is no scope for NWL to outperform under these conditions – when they occur there is only downside exposure. **The removal of the exemption for civil emergency events** would result in an expectation that NWL would be exposed to losses (associated with ODI penalties) associated with these types of events in the future, with no corresponding upside...
>
> **The introduction of asymmetric risk arising from non-application of the exemption in this case** would result in an expected loss which would need to be priced to ensure that the price control represents, all else equal, which would result in a requirement for a higher cost of equity…

> **If the exemption is allowed**, then this mitigates the asymmetric risk and negates the requirement for pricing of the risk.
>
> Additionally, **it is important to consider that the removal of the exemption could reduce the predictability and stability of the regulatory framework and how this is perceived by investors and lenders in the sector**...**The removal of the exemption for civil emergency events could undermine perceived stability of the regulation and increase the cost of capital required in the sector and hence also increase costs to customers – over and above the premium for asymmetric risk set out above**.
>
> In summary, **the removal of the exemption for civil emergency events would result in increased risk for NWL and other companies in the sector**. This increased risk would be primarily asymmetric in nature and would need to be priced in future controls. This change in the risk profile for the company and investors would ultimately lead to an increase in costs to customers" (emphasis added).

28. On the basis of the Representation, NWL proposed that its Storm Arwen price reduction should be fixed at £3.375 million (or, as NWL described it, incorrectly, it should be subject to a £3.375 million penalty for water supply interruptions relating to Storm Arwen).

29. Before NWL made the Representation, NWL representatives had met with Ofwat representatives on 23 May 2022, when NWL made a presentation. One of the supporting slides, entitled "Ofwat's Exemption from PR19 – Ofwat introduced an exclusion in SI PC for precisely this sort of event" ("the May 2022 slide") showed the following:

> "To maintain an appropriate risk balance Ofwat included an exclusion in the SI PCs at PR19.
>
> This allows companies to exclude specific extreme circumstances & ensures that damaging penalties are not incurred for situations that are beyond reasonable preparation or control.
>
> These exclusions also ensure companies are not driven to provide uneconomic levels of resilience, incurring costs that are ultimately borne by customers.
>
> In its reporting guidance on supply interruptions for PR19, Ofwat included an allowance for companies to apply for an exemption on the basis of a civil emergency.
>
> The Civil Contingencies Act (2004) (CCA) states that an emergency is an event or situation which threatens serious

> damage to human welfare in the UK or in a Part or region.
>
> NWL commissioned TupperSLaw to consider whether Storm Arwen would constitute a "civil emergency" under the CCA and, if so, whether that can be relied upon to seek an exception to the reporting requirements under NWL's ODIs relating to supply interruptions.
>
> The report examined factual data on whether Storm Arwen met the criteria for a Civil Emergency including both the impact of the storm and the classification response.
>
> The report concluded:
>
> "Based on the circumstances surrounding Storm Arwen, its impact and the response it required from the Category 1 responders, it satisfies all applicable limbs of the legal test for being categorised as a civil emergency under the CCA.""

30. Finally, in this section of the judgment, I need to record that the Representation was made under cover of a letter from NWL to Ofwat which said:

> "With climate change these storm events are becoming more frequent. Without an exclusion for these events, the consequential financial impacts on companies can be both very material and asymmetric where we are exposed to downside risk only. Left unmitigated this would result in a higher cost of capital paid for by customers to mitigate this risk and companies being incentivized to invest uneconomically to reduce the impact of extreme weather events rather than improve day to day service. To manage these issues Ofwat included an explicit opportunity to request an exemption in the PR19 Final Determination which applies across these ODIs. That exemption allows for representations to be made where a civil emergency is triggered under the Civil Contingencies Act 2004. **Ofwat can then make an informed decision, flexibly, on the strength of the evidence**" (emphasis added).

Responses before the final determination

31. Ofwat published its draft in-period determination, including its response to the Representation, in October 2022. The draft determination went out for consultation, with responses to be submitted by 21 October.

32. In relation to the Representation, Ofwat noted the default position in the Reporting Guidance; that there are no exclusions from price reductions arising from underperformance of the supply interruption Performance Commitments even for weather events. Ofwat explained that the default position arose from its wish for "companies to be incentivised to minimise the impact on customers". Ofwat noted that, if water companies could press for the exclusion of supply interruptions from underperformance calculations, they might focus their efforts on that rather than

meeting customer expectations. It further noted that NWL had not sought collars or caps on the bespoke supply interruption Performance Commitments, from which it inferred that, at the time PR19 was imposed, NWL did not think that it needed protection for its underperformance of those Performance Commitments. It further noted that the common supply interruption Performance Commitment collar was not triggered by NWL's Storm Arwen underperformance. It concluded that, even taking into account that underperformance, NWL's overall 2021-2022 performance was within the expected range. It commented that water supply interruptions are the most serious service failures from the perspective of customers. It considered "whether not intervening was likely to create unwanted incentives to invest to minimise risk in an inefficient way", but did not express a final view, although it may be inferred that it rejected the point.

33. In the result, Ofwat concluded that, as part of its in-period determination, it would not intervene to relieve NWL of the Storm Arwen price reduction.

34. NWL responded to the consultation ("the Consultation Response"). It addressed the grounds for Ofwat's draft determination and concluded:

> "We consider that the CE exception applies to exclude all impacts associated with a qualifying civil emergency from the calculations under the three SI PCs. We did, however, carry out detailed analysis of our preparedness for such an event, as well as the extent and appropriateness of our response. We wanted to understand the extent to which any of the supply interruptions experienced by our customers could be attributed to factors that are reasonably within our control. To the extent that they are, it is reasonable for our customers to expect us to bear the risk for our failure to invest in appropriate mitigations.
>
> …[W]e [therefore propose] a partial penalty of £3.375m, in addition to the c. £1.9m of costs incurred by NWL in responding to the storm, including GSS payments to customers."

35. The conclusion that the CE exception operates automatically, when underperformance is associated with a civil emergency, to exclude all the impacts of that underperformance, was foreshadowed in other parts of the Consultation Response, some of which I need to set out:

> "Executive Summary
>
> …[W]e consider that…Ofwat has misapplied the CE exception by finding that the establishment of the existence of a civil emergency simply leads to an open-textured discretionary decision - i.e. Ofwat has sought to exercise a level of discretion that is not provided for in the context of the guidance in which the CE exception is set out and how the exception is intended to operate…

Ofwat does not have any discretion in the application of the CE Exception

Ofwat confirms that we have satisfied the relevant criteria under the CE exception for showing the existence of a civil emergency…

However, rather than proceeding to assess our evidence about the causal link between the Qualifying Emergency and our reported supply interruptions, Ofwat instead states that it must consider:

"whether, in light of our duties and policy objectives, we should exercise our discretion to depart from the outcomes that would ordinarily flow from operation of the ODIs to make changes to payments"…

The default position…should be that all of the resulting interruptions to supply should be excluded from assessment of our performance against the three SI PCs. On the PCs, and the Qualifying Guidance, properly construed, there is no discretion at all: the relevant events are simply excluded from consideration and all material calculations…

Appendix 1 Legal framework and history of the CE Exception

…Interpretation of the CE Exception

For the CE exception to apply a company must establish that:

• an event has occurred that constitutes a civil emergency within the meaning of the Civil Contingencies Act 2004 (CCA 04) (a CCA Civil Emergency); and

• the supply interruption is not the cause of the emergency (limb 2).

For the purpose of this response, such a scenario is referred to as a "Qualifying Emergency"…

The Reporting Guidance does not specify any other criteria that must be met, or tests which might be applied, in order for such an exception to be granted. It simply provides that a company may choose to request Ofwat to make an exception if it can show a Qualifying Emergency has occurred…

On its face, therefore, the CE exception is intended to, and does, operate by providing that if it can be demonstrated that a Qualifying Emergency has occurred, the interruptions to supply that can be attributed to it will be excluded, as an exception, from the assessment of performance against the SI PCs.

> It does not support Ofwat's assertion that the relevant test is whether Ofwat "should exercise our discretion to depart from the outcomes that would ordinarily flow from operation of the ODIs".
>
> Instead, the only test that Ofwat should apply to a CE exception representation is to ensure that there is a clear causal link between the Qualifying Emergency and the interruptions to supply that the company is seeking to exclude."

36. The Consultation Response also set out how other regulators and regulated industries respond to extreme weather events. On the whole, according to the Consultation Response, those industries have a "risk sharing mechanism" for extreme weather, except for in the rail sector, where Network Rail is apparently liable for disruption relating to extreme weather.

The final determination

37. As I have explained, by the final determination (as part of its in-period determination) Ofwat relieved NWL of £12.894 million (i.e. 50%) of the Storm Arwen price reduction.

38. By the final determination, having, by way of "Background", explained the role of Performance Commitments and Outcome Delivery Incentives and having summarised the Representation, the draft determination and the responses to the draft determination (including the Consultation Response), Ofwat then addressed principally the Consultation Response. Ofwat noted that, whatever the cause of a water supply interruption, customers bear the impact of it. It further noted that:

> "Our regime does not, therefore, aim or profess to insure companies against all risks outside of their control. Just like in a competitive market, there will be some risks that regulated companies bear the consequences of, even if the cause was not their fault. However, the flip side of the regime is that there are instances where companies benefit from improved performance when the circumstances are more favourable and may gain outperformance payments as a result. For example, if there is a wet summer, per capita consumption, one of the performance commitments we measure, will be lower than normal, even without any company action, as people tend to water their garden less.
>
> Our price review determinations recognise that companies bear risk, including some external risk, and so have a degree of variability in their returns that is outside of their control. What is important is that the upside and downside risks for an efficient company are broadly balanced so that it anticipates a "fair bet" on a forward-looking basis.
>
> Although we consider companies should bear some risk, we limit the extent of this through a range of protection

> mechanisms. This includes cost sharing, which means that customers bear a portion of any company overspend (generally 50%). It also includes collars on ODI payments to protect companies against large underperformance payments on specific performance commitments, as well as caps to protect customers against unexpectedly high payments…"

Ofwat then commented that, following the PR19 settlement, water companies should bear the consequences of that settlement. Ofwat rejected the proposition that giving no relief to NWL under the CE exception would itself risk inefficient investment by water companies; arguing, broadly, that that risk was already priced into PR19 of which the CE exception is part. It noted that a principal aim of PR19 was to incentivise water companies to minimise the effect on customers of weather events and it continued that the CE exception gives it a discretion whether to intervene in relation to a civil emergency when it must "consider all the relevant circumstances in light of [Ofwat's] statutory duties and PR19 policy objectives". It continued:

> "Although not necessarily determinative in this case, wider factors we take into account when considering our duties include the factors set out above [(i.e. in relation to risk – see above)] concerning how the overall outcomes framework is intended to operate…We are also mindful of the natural information asymmetry between companies and regulators that favour companies in identifying circumstances that have a negative financial impact on them but makes it harder to identify circumstances which provide fortuitous benefits..."

39. Having lastly made these general remarks, Ofwat set out its decision:

> "In relation to whether to adjust the company's reported underperformance payments, the company argues in its response to our draft determination that our consideration should focus on the impact of the event on the performance commitments in question, rather than look at the wider performance by the company on all performance commitments in the reporting year and the control period to date. Having considered the company's arguments, we agree that in these particular circumstances, we should consider carefully the specific financial impact of this event on the performance commitments in question…
>
> **…[A]lthough Storm Arwen's impact on ODI payments averaged over the [five year PR19] period is within the expected risk and return range in the company's overall price review package, we recognise that it was relatively significant, particularly viewed in terms of the single year figure (-1.59%) [(i.e. below the bottom of the range of the return NWL was expected to obtain)]…Taking together the fact that there was a qualifying emergency, which the performance commitments expressly refer to, and that the size of impact on the company was relatively significant, we**

> **have considered the appropriate level of underperformance payment…**
>
> … We have considered carefully and weighed the points made by the company, including those about the extreme nature of the impact of Storm Arwen and the steps the company took to mitigate its impacts on water customers; the potential impact on the overall PR19 package of risks and incentives; and the need to ensure that there are continuing incentives on companies to respond and mitigate adverse impacts on customers even in the face of a qualifying emergency. We have also borne in mind that the in-period regime generally operates annually and is not intended to be as burdensome as a full price control. In this case, we have reviewed evidence from the company that demonstrated that it worked hard to mitigate the impact on customers.
>
> …[W]e consider it appropriate and proportionate to exercise our discretion in favour of a broad sharing of risk (risk-sharing being an approach we adopt in other parts of our regime such as totex, to maintain incentives while sharing burdens between companies and their customers). In our judgement, in the specific circumstances of this case, the appropriate share for the financial impact of the event is 50:50 between customers and the company.
>
> This means for each of the three performance commitments in question we are excluding 50% of the impact on reported ODI payments. As such, customers will still receive some underperformance payments, which acknowledges customers' services were severely disrupted.
>
> We consider this achieves an appropriate balance between the interests of customers and the company, retaining incentives on the company to continue to strive to deliver the best possible service and response to supply interruptions and is in line with the risk and reward package…" (emphasis added).

40. In short, Ofwat concluded that, whilst generally its focus, when exercising its statutory duties, should be on the overall risk and reward package which a price control settlement reflects, in this case, in the light of the Consultation Response, its focus should be on the financial impact on NWL of NWL's underperformance relating to Storm Arwen. It also concluded (having considered all of NWL's arguments) that it should take into account the severe disruption to customers' water supply during Storm Arwen. Having weighed up all these matters, and having made an evaluative judgment that its overall conclusion would support resilience improvements by NWL and was in line with PR19 as a whole, Ofwat concluded that the financial impact of Storm Arwen should be split, on a broad brush, rather than strictly mathematical, approach 50:50 between customers and NWL. In doing so, Ofwat concluded that no assistance could be gleaned from the approach taken by other regulators (see e.g. para.76 of Ms Aileen Armstrong's witness statement).

NWL's pre-claim position

41. Whilst there are certain paragraphs of the Representation which may, on one reading, suggest otherwise, and whilst the May 2022 slide does suggest otherwise, reading the Representation as a whole it is clear that, at the time it was made, NWL believed that:

    i) the pre-conditions for the CE exception to operate are that (a) there must have been a civil emergency and (b) the civil emergency must not have been caused by the water supply interruptions in issue;

    ii) so long as those pre-conditions are met, Ofwat has a discretion about whether the water company in question will be relieved from reporting the water supply interruptions ("a CE exception discretion");

    iii) in the exercise of its discretion, Ofwat can (and, in the case of Storm Arwen so far as it relates to NWL, should) distinguish between those minutes, hours, days etc. of water supply interruptions where the water company's response to the interruptions could have been more robust and those in respect of which no fault can be attached to the company's response.

42. If NWL's belief was otherwise, in particular, had it believed that, so long as the pre-conditions for the operation of the CE exception are met, Ofwat is obliged to permit a water company to exclude water supply interruptions relating to a civil emergency from its reporting, there would have been no need for the Representation, for example:

    i) to address NWL's overall performance otherwise than during Storm Arwen;

    ii) to address in detail, as it did in section 4, its performance during Storm Arwen;

    iii) to make out the case it did for a partial reporting exception;

    iv) to argue why not permitting any reporting exception would be unfair;

    v) to argue, in section 5, that the £3.375 million price reduction it proposed fits with the balance of risk set by PR19;

    vi) to argue in detail, as it did in section 6, that not relieving it at all from any price reduction would be damaging, and there to refer to the "removal", "failure to grant" and "non-application of" the CE exception.

43. Even more clearly, had NWL's belief been otherwise, it would not have said in the Representation:

> "…where regulatory mechanisms incorporate ex-post review regulatory discretion as in this case, these truncate return distributions because, at best a company will not be exposed to risks from civil emergency, but Ofwat has significant discretion to apply a penalty when these risks occur…"

After I pointed out to Mr de la Mare, during the hearing, that this paragraph of the Representation appears to make clear that NWL believed, at the time of the

Representation, that Ofwat has a CE exception discretion, ultimately he was unable to suggest an alternative interpretation, because there is none.

44. The conclusion I have reached about NWL's belief at the time of the Representation is reinforced by the covering letter to the Representation in which NWL asserted that Ofwat had flexibility in responding to the Representation.

45. My conclusion about NWL's belief may also be corroborated by its response to the draft PR19 settlement, if the draft settlement incorporated the CE exception. In that case, NWL's objection to the absence of a collar on its common supply interruption Performance Commitment (that extreme weather could expose it to a very high level of underperformance) would be most consistent with the belief I have found NWL to have at the time of the Representation.

46. This conclusion about NWL's belief requires me to reject Mr Beaver's evidence. In his first witness statement, Mr Beaver said, in response to the proposition that, if NWL was unhappy that the CE exception gives Ofwat a discretion, NWL should have raised the point when the PR19 settlement was being re-determined by the CMA:

> "Ahead of its CMA redetermination NWL undertook a detailed review of Ofwat's final determination for PR19 to both understand whether it could accept Ofwat's decision on specific issues, as well as in the round, and also to identify the basis for any case that could be made to the CMA. I was involved in that review as an external advisor. NWL identified a number of features of the PR19 package it wished to challenge. As part of that review the PCs, their definitions and the associated reporting guidance was reviewed and it was decided that the business could accept them. This included the SI PCs, the SI Reporting Guidance and the CE exception. **NWL concluded that the risk allocation it contained, namely that [water companies] should not be penalised under SI PCs for interruptions caused by truly exceptional weather that constituted a qualifying emergency, was acceptable**…
>
> …NWL did not raise any concerns about the SI PCs or the SI Reporting Guidance in the context of the CMA's redetermination of the PR19 price controls. This was because NWL did not have any concerns about the CE exception, based on how it had been drafted and how NWL expected it to be applied…" (emphasis added).

47. Though Mr Beaver was an external advisor to NWL at the time PR19 was being settled, he was not an employee or director of (or apparently other decision-maker for) NWL. It is not clear to me that he has personal knowledge of NWL's internal conclusions about the risk allocation under PR19 and he does not identify in his witness statement the source of his belief about NWL's conclusions set out in this part of his evidence. Putting this criticism to one side, before I reached my conclusion about NWL's belief, I did consider Mr Beaver's evidence and whether it was appropriate to reject it. I bore in mind, in particular, what is said about the correct approach to witness evidence in section 11.2 of the Administrative Court Guide 2023.

I am satisfied that Mr Beaver's evidence is contradicted by the Representation and the covering letter.

48. NWL's approach in the Consultation Response was very different to its approach in the Representation. The Consultation Response as a whole reads as a pre-cursor to a potential judicial review claim and as if it was drafted, in part, by lawyers. Most importantly for present purposes, however, as a whole it advocates for a markedly different approach to the CE exception. By the Consultation Response, NWL contended that:

    i) the pre-conditions for the CE exception to operate are that (a) there must have been a civil emergency and (b) the civil emergency must not have been caused by the water supply interruptions in issue;

    ii) so long as those pre-conditions are met, Ofwat is obliged to relieve the water company in question from reporting any of the water supply interruptions;

    iii) nevertheless, NWL would not object to a Storm Arwen price reduction of £3.375 million.

49. As I explain, when considering ground 1, NWL's case on the proper construction of the CE exception has moved on from its case in the Consultation Response.

Inefficient investment

50. My conclusion, that, at the time of the Representation, NWL believed that Ofwat has a CE exception discretion, has a significant impact on the case. I consider that impact when considering NWL's grounds for judicial review, but the impact of my conclusion can also usefully be considered now in the context of a theme running through the whole of NWL's case, which is also a convenient place to discuss my approach to those parts of NWL's case which are in truth challenges to the merits of the final determination.

51. A repeated point made by NWL has been that, if Ofwat has a CE exception discretion, water companies will invest inefficiently to protect themselves from the financial impact, arising from possible exercises of that discretion, of a civil emergency, to the disadvantage of their customers. So, for example:

    i) in relation to ground 1, NWL argued that the fact that water companies will invest inefficiently if Ofwat has a CE exception discretion points to a construction of the CE exception which does not contain such a discretion (see para.18.7 of counsel's skeleton argument);

    ii) in relation to ground 2, Mr de la Mare effectively argued that there is a duty of prescription in this case because, without a policy setting out how Ofwat will exercise a CE exception discretion, water companies will invest inefficiently;

    iii) in relation to ground 3, NWL argued that the final determination was irrational because it will result in inefficient investment by NWL (see, for example, para.40 of counsel's skeleton argument).

(see also, for example, paras.50.2 (ground 1), 64 (ground 2) and 85 (ground 3) of the Statement of Facts and Grounds).

52. I confess that I do not immediately follow the logic of NWL's point. Whilst I follow that the risk of being subject to a substantial price reduction relating to a civil emergency may cause a water company to invest inefficiently, I do not follow how that risk will cause that water company to invest inefficiently. There is no dispute that civil emergencies are rare events. Not all civil emergencies will have the same financial impact on a water company as Storm Arwen was at risk of having on NWL (and, in this regard, the hindsight that NWL has about that possible financial impact cannot be allowed to cause the possibility of inefficient investment to be overemphasised). I do not follow why a water company, which can be assumed to be efficient and profitable, might not decide that, rather than investing now against a civil emergency, it will just bear the financial impact of such an emergency in what may be the distant future when the civil emergency occurs. Mr Beaver notes in para.9(e) of his second witness statement:

> "…the effect of spreading a penalty of £3.375m across our circa. 2.1 million customers would be that each customer benefits by around £1.62 each off their annual bill…"

On the same analysis, a price reduction of £25.79 million would equate to about a £12.38 reduction in a customer's bill in one year. A water company bearing the whole of the financial impact of a Storm Arwen type event may prefer to forego £12.38 of charges to their customers in a single year at some point in the future, than invest now against the risk of foregoing such sums. Put another way, NWL's operating profit for the year ending 31 March 2022 was £174 million. A water company may be prepared to effectively forego about 15% of that profit in a single year, rather than invest against the risk of having to forego that sum. To be clear, I do not suggest that a £25 million reduction in revenue is not a significant event for an efficient, profitable water company. Rather, the point I make is that it is not immediately clear to me how a CE exception discretion will (rather than may) cause inefficient investment.

53. In fact, the very point I make was made in section 6 of the Representation. As I have noted, there NWL argued (by a submission that appears to have since been abandoned) that, if the CE exception discretion was not exercised in its favour, that would "lead to either a regulated company proposing caps at future price controls to limit risk; **or** over investment planning for an unbounded impact" (emphasis added); that is, NWL argued that water companies can rationally seek to limit their exposure to financial risk otherwise than by inefficient investment.

54. NWL's own conduct supports what I have said. NWL presents itself, without dispute, as an efficient water company. There is no suggestion that it had invested inefficiently before Storm Arwen, even though, as I have shown, it believed that a CE exception discretion exists. In such circumstances, I do not follow how NWL can maintain that an efficient water company would invest inefficiently if a CE exception discretion exists.

55. For present purposes, however, it is more important to note that the contention that a CE exception discretion will lead to inefficient investment is contested by Ofwat, the economic regulator of the water industry (as it was in the final determination).

56. Whether NWL is right or Ofwat is right about whether or not a CE exception discretion will, or will not, lead to inefficient investment is a judgment which I am unable to make and which I am satisfied, in the circumstances of this case (particularly as I have just set them out) I should not make, because it is a predictive economic judgment about how a water company might respond to a particular construction of the CE exception. I derive support for this last conclusion from *R v. The Director General of Telecommunications, ex p. Cellcom Ltd.* [1999] ECC 314, a decision of Lightman J which has since been endorsed and approved.

57. In that case, the mobile telephone regulator ("Oftel"), in order, it concluded, to improve competition, had released two new entrants into the mobile telephone market from certain licence conditions which remained in the licence conditions of established operators. That decision was challenged by independent service providers who perceived that the decision would have a severe impact on their businesses. In that case, Lightman J explained, at [26]-[27]:

> "It is appropriate to state briefly the relevant principles on which the court is to act in judicial review proceedings when a challenge is made to a decision by a person on whom decision-making powers are conferred by the legislature. **Where the Act has conferred the decision-making function on the Director [(i.e. Oftel)], it is for him, and him alone, to consider the economic arguments, weigh the compelling considerations and arrive at a judgment**. **The applicants have no right of appeal: in these judicial review proceedings so long as he directs himself correctly in law, his decision can only be challenged on *Wednesbury* grounds**. **The court must be astute to avoid the danger of substituting its views for the decision-maker and of contradicting (as in this case) a conscientious decision-maker acting in good faith with knowledge of all the facts**. As Lord Brightman said in *R v. Hillingdon London Borough Council, ex parte Puhlhofer*:
>
> > "Where the existence or non-existence of a fact is left to the judgment and discretion of a public body and that involves a broad spectrum ranging from the obvious to the debatable to the just conceivable, it is the duty of the court to leave the decision of that fact to the public body to whom Parliament has entrusted the decision-making power save in a case where it is obvious that the public body, consciously or unconsciously, is acting perversely."
>
> If (as I have stated) the court should be very slow to impugn decisions of fact made by an expert and experienced decision-maker, **it must surely be even slower to impugn his educated prophesies and predictions for the future**. Guidance as to the appropriate approach to the written reasons of the decision-maker for his decision (in that case the Secretary of State for Education) was given by Lord Wilberforce in *Secretary of State for Education v. Tameside Borough Council*:

> "These documents are to be read fairly and in bonam partem. If reasons are given in general terms, the court should not exclude reasons which fairly fall within them: allowance must be fairly made for difficulties in expression. The Secretary of State must be given credit for having the background to this situation well in mind, and must be taken to be properly and professionally informed as to educational practices used in the area, and as to the resources available to the local education authority. His opinion, based, as it must be, upon that of a strong and expert department, is not to be lightly overridden."

The guidance is particularly apposite in this case where (as Ms Chambers states in her first affirmation) the Director (assisted by his expert staff) made his decisions of 2 April 1998 after a prolonged consultation period in the light of "his experience of monitoring and regulating the mobile telephony market over a long period".

The court may interfere with a decision if satisfied that the Director has made a relevant mistake of fact or law. But a mistake is not established by showing that on the material before the Director the court would reach a different conclusion. The resolution of disputed questions of fact is for the decision-maker, and the court can only interfere if his decision is perverse, e.g. if his reasoning is logically unsound, as it was found to be in *R v. Director General of Electricity Supply, ex parte Scottish Power plc*. The court may interfere if the Director has taken into account an irrelevant consideration or has failed to take into account a relevant consideration. But so long as the Director takes a relevant consideration into account, the weight to be given to that consideration and indeed **whether any weight at all should be given to that consideration is a matter for the Director alone, so long as his decision is not perverse**" (emphasis added).

See too per Andrews J in *R (London Borough of Hackney) v. Secretary of State for Housing, Communities and Local Government* [2019] EWHC 1438 (Admin), at [41]:

> "The intensity of the review of the decision under challenge depends on the subject-matter. **This decision was taken in an area of socio-economic policy, a paradigm example of something falling within the remit of the Executive, and a matter with which the Court will not lightly interfere**, especially where the policy has been endorsed in primary legislation. **Moreover, the decision involved the exercise of predictive judgment by the Secretary of State as to how best to realise that policy**, coupled with value judgments on matters such as the seriousness or significance of the departure from the Code. **It therefore falls within an area where a wide**

> **margin of appreciation is to be afforded to the decision maker**" (emphasis added).

The parties' cases – introduction

58. The parties' cases have more (in the case of NWL) or less (in the case of Ofwat) developed since the claim was begun, even since counsel filed their skeleton arguments. The principal purpose of a judgment is to set out the decision made on the dispute as developed at the hearing, and to explain to the parties the reasons for that decision. That is what this judgment does. To be clear, however, before reaching my decision, I considered all the submissions made on behalf of the parties (including those I do not specifically address in this judgment) and all the material they referred me to or they otherwise asked me to take into account.

Ground 1: on the proper construction of the CE exception, Ofwat does not have a discretion, but rather, so long as, having made an evaluative judgment, Ofwat is satisfied that the preconditions for the operation of the CE exception are met, it must relieve a water company of all the consequences of its underperformance caused by the civil emergency in question. In the result, in construing the CE exception, Ofwat misdirected itself and made an error of law

59. At trial, NWL's case on ground 1 was as follows:

    i) for the CE exception to operate, a water company must satisfy Ofwat that (and Ofwat must make an evaluative judgment about whether) (i) there has been a civil emergency and (ii) the civil emergency was not caused by the water supply interruptions in issue;

    ii) in a departure from its pre-claim position (and by reference to the phrase "on the basis of" in the CE exception), a water company may apply to Ofwat to relieve it from reporting particular days, hours, and/or minutes of water supply interruptions relating to a civil emergency where the water supply was interrupted during those periods of time through no fault of the water company ("No Fault interruptions"). In other words, on the proper construction of the CE exception, NWL was not permitted to apply to Ofwat to relieve it of (and the CE exception did not apply to) the water supply interruptions relating to Storm Arwen when NWL's response "could have been more robust" (which NWL values at £3.375 million);

    iii) subject to Ofwat making the evaluative judgment I have just referred to, on such an application by a water company Ofwat must relieve that company from reporting, as underperformance, water supply interruptions relating to the civil emergency in question;

    iv) in construing the CE exception otherwise, Ofwat misdirected itself and made an error of law.

60. Ofwat's case on the construction point is as it was pre-claim; namely, that once it has made the evaluative judgment I have just referred to, it must consider exercising the CE exception discretion.

61. This ground turns therefore on the proper construction of the CE exception.

62. The parties are agreed about the process of construing the CE exception. They agreed that I should follow the approach (at least by analogy, and recognising that the CE exception is not primary legislation) explained by Lord Hodge in *R (O) v. Secretary of State for the Home Department* [2023] AC 255, in particular at [29]-[31]:

> "The courts in conducting statutory interpretation are "seeking the meaning of the words which Parliament used": *Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, 613 per Lord Reid. More recently, Lord Nicholls of Birkenhead stated: "Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context." (*R v. Secretary of State for the Environment, Transport and the Regions, ex p. Spath Holme Ltd.* [2001] 2 AC 349, 396.) Words and passages in a statute derive their meaning from their context. A phrase or passage must be read in the context of the section as a whole and in the wider context of a relevant group of sections. Other provisions in a statute and the statute as a whole may provide the relevant context. They are the words which Parliament has chosen to enact as an expression of the purpose of the legislation and are therefore the primary source by which meaning is ascertained. There is an important constitutional reason for having regard primarily to the statutory context as Lord Nicholls explained in *Spath Holme*, p.397: "Citizens, with the assistance of their advisers, are intended to be able to understand parliamentary enactments, so that they can regulate their conduct accordingly. They should be able to rely upon what they read in an Act of Parliament."
>
> External aids to interpretation therefore must play a secondary role. Explanatory Notes, prepared under the authority of Parliament, may cast light on the meaning of particular statutory provisions. Other sources, such as Law Commission reports, reports of Royal Commissions and advisory committees, and Government White Papers may disclose the background to a statute and assist the court to identify not only the mischief which it addresses but also the purpose of the legislation, thereby assisting a purposive interpretation of a particular statutory provision. The context disclosed by such materials is relevant to assist the court to ascertain the meaning of the statute, whether or not there is ambiguity and uncertainty, and indeed may reveal ambiguity or uncertainty: Bennion, Bailey and Norbury on Statutory Interpretation, 8th ed (2020), para.11.2. But none of these external aids displace the meanings conveyed by the words of a statute that, after consideration of that context, are clear and unambiguous and which do not produce absurdity…

> Statutory interpretation involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory words which are being considered. Lord Nicholls, again in *Spath Holme* [2001] 2 AC 349, 396, in an important passage stated:
>
> > "The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the "intention of Parliament" is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House…Thus, when courts say that such-and-such a meaning "cannot be what Parliament intended", they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning.""

63. The parties also referred me to, and invited me to apply, what Lord Carnwath said in *Lambeth LBC v. Secretary of State for Housing, Communities and Local Government* [2019] 1 WLR 4317, at [15]-[19], in a case relating to the proper construction of a planning permission (a circumstance which, the parties agreed, is similar to this case):

> "We have received extensive submissions and citations from recent judgments of this court on the correct approach to interpretation. Most relevant in that context is *Trump International Golf Club Scotland Ltd v. Scottish Ministers* [2016] 1 WLR 85. An issue in that case related to the interpretation of a condition in a statutory authorisation for an offshore wind farm, requiring the developer to submit a detailed design statement for approval by Ministers. One question was whether the condition should be read as subject to an implied term that the development would be constructed in accordance with the design so approved.
>
> In the leading judgment Lord Hodge JSC, at paras.33–37, spoke of the modern tendency in the law to break down divisions in the interpretation of different kinds of document, private or public, and to look for more general rules. He summarised the correct approach to the interpretation of such a condition, at para.34:
>
> > "When the court is concerned with the interpretation of words in a condition in a public document such as a section 36 consent, it asks itself what a reasonable reader would understand the words to mean when reading the condition in the context of the other conditions and of the consent as a

> whole. This is an objective exercise in which the court will have regard to the natural and ordinary meaning of the relevant words, the overall purpose of the consent, any other conditions which cast light on the purpose of the relevant words, and common sense."

He rejected a submission that implication had no place in this context:

> "[Counsel] submits that the court should follow the approach which Sullivan J adopted to planning conditions in *Sevenoaks District Council v. First Secretary of State* [2005] 1 P & CR 186 and hold that there is no room for implying into condition 14 a further obligation that the developer must construct the development in accordance with the design statement. In agreement with Lord Carnwath JSC, I am not persuaded that there is a complete bar on implying terms into the conditions in planning permissions…
>
> "While the court will, understandably, exercise great restraint in implying terms into public documents which have criminal sanctions, I see no principled reason for excluding implication altogether."

In the instant case, had it been necessary to do so, he would, at para.37, have "readily drawn the inference that the conditions of the consent read as a whole required the developer to conform to the design statement in the construction of the windfarm".

In my own concurring judgment, having reviewed certain judgments in the lower courts which had sought to lay down "lists of principles" for the interpretation of planning conditions, I commented, at para.53:

> "…I see dangers in an approach which may lead to the impression that there is a special set of rules applying to planning conditions, as compared to other legal documents, or that the process is one of great complexity."

Later in the same judgment, I added, at para.66:

> "Any such document of course must be interpreted in its particular legal and factual context. One aspect of that context is that a planning permission is a public document which may be relied on by parties unrelated to those originally involved…It must also be borne in mind that planning conditions may be used to support criminal proceedings. Those are good reasons for a relatively cautious approach, for example in the well established rules limiting the categories of documents which may be used in

> interpreting a planning permission…But such considerations arise from the legal framework within which planning permissions are granted. They do not require the adoption of a completely different approach to their interpretation."
>
> In summary, whatever the legal character of the document in question, the starting point - and usually the end point - is to find "the natural and ordinary meaning" of the words there used, viewed in their particular context (statutory or otherwise) and in the light of common sense."

64. Before the hearing, NWL had advanced a case that, on the grounds of water companies' legitimate expectation (derived from matters it identified), the proper construction of the CE exception was as NWL now contends. I confess that I do not see how what might have been the subjective intention of water companies or their subjective interpretation of the CE exception is relevant to the proper construction of the CE exception, which is an objective exercise. As it happens, perhaps because NWL may have tacitly accepted at the hearing that, at the time of the Representation, it believed that Ofwat has a CE exception discretion, NWL's legitimate expectation argument was not pursued (and Mr de la Mare did not dissent when I pointed out to Mr Beal that I understood that the legitimate expectation argument was not being pursued).

65. I need to deal first with NWL's contention that, under the CE exception, water companies can only apply for relief for No Fault interruptions. As I have said, this contention is derived from the phrase, in the CE exception: "on the basis of".

66. I have concluded that that phrase, on the proper construction of the CE exception, does not carry the meaning NWL contended for, for the following reasons.

67. The CE exception was not apparently drafted by lawyers and it is not clear from the Reporting Guidance that it was intended to make what may be a fine distinction between No Fault interruptions and fault-based interruptions which have prolonged a customer's loss of service. In any event, the phrase "on the basis of" is equally capable of meaning "but for" rather than the meaning NWL ascribed to it, so that water supply interruptions which would not have occurred but for the civil emergency, including those where the water company is at fault, could, on that construction, be the subject of a representation for a reporting exception. Further, if NWL's contention was right, there would be hardly any need for the phrase, in the CE exception: "where the supply interruption is not the cause of the emergency", because it is difficult to conceive of a situation (and none was suggested) where a water supply interruption might occur without any fault on the part of a water company but which is so catastrophic as to cause a civil emergency. Where a water supply interruption occurs, in respect of which a water company is at fault, which causes a civil emergency, on NWL's case the interruption would be excluded as a fault-based interruption in any event by the phrase: "on the basis of", meaning the further phrase is unnecessary. It seems to me, also, that, for water companies to seek a reporting exception for all water supply interruptions which would not have occurred but for a civil emergency (subject to a water supply interruption not being the cause of the civil emergency), distinguishing in its representation, or on enquiry, between No-Fault, and fault-based, interruptions, with Ofwat then publishing its determination setting out its

response (whether or not being an exercise of a discretion) is more likely to advance a stated purpose of the Reporting Guidance – that is, to allow water companies to compare and contrast performance – than if a water company did not need to provide information about fault-based water supply interruptions other than as part and parcel of general reporting of water supply interruptions. In other words, a construction of the CE exception which allows for a water company to apply for a reporting exception for all water supply interruptions which would not have occurred but for a civil emergency (subject as I have said), leaving it to Ofwat to respond as it might be entitled to do, is most likely to result in the publication of granular information.

68. In this context, if I am entitled to take into account that I would have concluded in any event, for the reasons I give below, that there is a CE exception discretion, the conclusion I have already reached may be reinforced, because it is consistent with Ofwat being able to respond differently to No-Fault, and fault-based, interruptions.

69. If I am entitled to take into account the conclusion I have reached, that water companies may include fault-based interruptions in their CE exception representations, that reinforces the conclusion which I would have reached in any event, that there is a CE exception discretion, because it would not be commonsensical, taking into account all I discuss below on this ground, if Ofwat, in its response, could not then distinguish between No-Fault, and fault-based, interruptions.

70. Turning then to the main question of construction, as Mr de la Mare accepted, the CE exception does not expressly set out how Ofwat is to respond to a representation for a reporting exception to be granted. Inevitably, how Ofwat can respond is a matter of implication.

71. Mr de la Mare pointed to a number of particular factors which he said favour NWL's case. Save for one, I have concluded that, in fact, they favour Ofwat's case, or are neutral. It is helpful to deal with those factors now.

72. Mr de la Mare submitted that, by licence condition B12.7 properly construed, in responding to a representation for a reporting exception to be granted, Ofwat can only take into account a water company's No-Fault performance of its supply interruption Performance Commitments relating to the civil emergency in question. In such circumstances, he submitted, because the water company will not have been at fault in relation to underperformance it wishes to be excepted from reporting, there would be no basis for Ofwat to deprive it of revenue from charges to customers, which means, in turn, that for there to exist a CE exception discretion is illogical and one should be rejected. (He could have made an equivalent argument on the basis that No-Fault, and fault-based, interruptions are to be reported, because, in that case, he could argue that it is only in relation to fault-based interruptions that Ofwat could legitimately deprive a water company of revenue because of underperformance).

73. There are a number of flaws with this submission.

74. First, it assumes that Ofwat takes away revenue from water companies under the CE exception (or imposes a "penalty" to use NWL's language). That is not how the CE exception works. By it, Ofwat is able to relieve a water company of an automatic price reduction effected by the Performance Commitments for underperformance.

Understood in this way, if, following a representation, Ofwat could relieve a water company by reference only to its performance of supply interruption Performance Commitments relating to a civil emergency, it is difficult to conceive how Ofwat could ever give such relief, because the whole reason for a representation is that there has been underperformance.

75. Secondly, as Mr Beal explained, Mr de la Mare's argument only works if licence condition B12.7 is a restricting, or limiting, provision, permitting Ofwat to take into account "only" performance. That is not what the licence condition says and is not consistent with the more open-textured language of licence condition B12.5, which is, in fact, the basis (the parties agreed) for an in-period determination by Ofwat of which a representation for the operation of the CE exception is part.

76. I agree with Mr Beal that if, as the parties have agreed, Ofwat's power to make in-period determinations is derived from this part of the licence, the power is to be found in licence condition B12.5. Licence condition B12.5 contains no limit on what Ofwat may take into account when making an in-period determination. I also agree with Mr Beal that Ofwat's duties under s.2 of the Act are engaged when it exercises the power conferred by licence condition B12.5; that is, when it makes an in-period determination, because that is what s.2(1) of the Act says.

77. The parties agreeing that the duties under s.2 of the Act are, or may be, in tension, it seems to me that the fact that, in making an in-period determination, Ofwat must comply with those duties points to there being a CE exception discretion which thereby allows Ofwat to balance its statutory duties. Further, that, in making an in-period determination, Ofwat must comply with its statutory duties, means that there are limitations on how a CE exception discretion may be exercised.

78. Mr de la Mare objected that water companies would be shocked to learn that, in making in-period determinations, Ofwat had to have regard to, and comply with, its statutory duties. I do not understand why. First, as I have said, that is what s.2 of the Act says. Secondly, in most instances, the requirement for Ofwat to comply with its statutory duties is unlikely to lead to any uncertainty for water companies (which I think was Mr de la Mare's concern). As the parties explained to me, most of the exceptions to reporting underperformance of Performance Commitments are more, or less, mechanistic. It must follow that, in making the PR19 settlement, Ofwat determined that, for the five year period covered by the settlement, during which, it must have appreciated, there were likely to be changes of circumstance, it was most consistent with its statutory duties for most underperformance to be dealt with mechanistically and in the way set out in the Performance Commitments. It is unlikely, therefore, that, in relation to those Performance Commitments, Ofwat could rationally depart from that approach.

79. In any event, on the face of it, Mr de la Mare's objection is the opposite of what NWL appears to have contended in para.63 of its Statement of Facts and Grounds, where NWL appears to accept that, in fulfilling its functions in relation to the CE exception, Ofwat must have regard to its statutory duties under s.2 of the Act.

80. Thirdly, although this is not a point made at the hearing, licence condition B12.7 may need to be read together with licence condition B12.1. Licence condition B12.1 allows Ofwat to make an in-period determination in relation to a specific Performance

Commitment. All licence condition B12.7 may contemplate is that, when deciding what determination it will make about a specific Performance Commitment, Ofwat should also take into account its determination in relation to related Performance Commitments.

81. Mr de la Mare submitted next that a CE exception discretion, by which a water company is not automatically relieved of the financial impact of No-Fault supply interruptions relating to a civil emergency, would be inconsistent with the purpose of the supply interruption Performance Commitments. I disagree. The expressed purpose of the commitments is to reduce water supply interruptions. Automatically relieving a water company of a price reduction even for No-Fault interruptions does not obviously achieve that purpose. The exercise of a CE exception discretion, on the other hand, allows Ofwat to calibrate the response to underperformance which it believes achieves that purpose. If, as I understood this argument to be, it is linked to the argument about inefficient investment, I have already explained why I cannot accept NWL's argument on the issue.

82. Mr de la Mare also submitted that, because the Reporting Guidance, including the CE exception, was devised by water industry representatives as part of the UKWIR working party, had a CE exception discretion been intended, express reference would have been made to one in the UKWIR report. Mr de la Mare engagingly suggested that an express reference to a CE exception discretion would have been expected in the UKWIR report because one was like "turkeys voting for Christmas".

83. This submission is substantially undermined by the fact that NWL believed that there was a CE exception discretion at the time of the Representation even though the UKWIR report does not refer to it in terms. In any event, as I have explained, the focus of the working party was on consistency of reporting, and not on the consequence of underperformance relating to civil emergencies. No weight can be attached to the absence of an express reference to a CE exception discretion in the UKWIR report. If I am right that, when making a representation for a CE exception to apply, a water company can seek relief in relation to fault-based water supply interruptions, section 4.2.3 of the report, relating to exclusions, may provide marginal support for Ofwat's case, because customers are unlikely reasonably to expect that water companies should be relieved from fault-based water supply interruptions. Rather, their expectation can be accommodated by a CE exception discretion.

84. Mr de la Mare submitted next that, because (apparently) the other instances when underperformance of Performance Commitments does not need to be reported, including those I have referred to, more or less operate mechanistically and are not subject to a discretion, the context supports the CE exception operating in the same way. Mr Beal contended, on the other hand, that, because the language of those other exceptions is (apparently) different to the CE exception and because those other exceptions are (apparently) expressed in similar language (e.g. certain underperformance "shall be excluded"), the context supports the existence, in this different situation, of a CE exception discretion. Both these contentions have merit and I do not regard one as more weighty than the other.

85. Both in relation to this ground and ground 3, Mr de la Mare also prayed in aid the regulatory approach in other regulated sectors. In relation to this ground, he contended

that, in no other field, does a regulator have as significant a power as Ofwat has if there is a CE exception discretion.

86. I know nothing about those other regulated sectors. I know nothing about the regulatory regimes which control those sectors. I know nothing about the framework of their regulators' powers and duties, and it does not follow, as a matter of logic, that what is appropriate in one regulated sector is appropriate in another. Further, as I have noted, although perhaps the rail sector is an outlier, in that sector Network Rail is apparently liable for all extreme weather events. For these reasons, I have concluded that NWL can get no support from what happens in other regulated sectors.

87. As I have mentioned,[4] the parties are agreed that water companies do not have the right to seek a re-determination, by the CMA, of an in-period determination. Mr Beal suggested that nothing turns on that, because the licence conditions permitting in-period determinations were inserted, as an amendment, by agreement. Mr de la Mare submitted that, because water companies do not have the right to have an in-period determination re-determined, that context supports NWL's case and weighs against a CE exception discretion.

88. Mr Beal's suggestion is not an answer to Mr de la Mare's submission. It does not follow from the fact that water companies agreed that in-period determinations cannot be re-determined that that cannot inform the construction issue I am considering. I agree with Mr de la Mare that the inability to have an in-period determination re-determined does support NWL's case.

89. Having dealt with Mr de la Mare's submissions on particular matters, I consider the construction question more generally.

90. Ofwat has statutory duties which are in tension. The whole purpose of PR19 and the combination, and setting, of Performance Commitments and Outcome Delivery Incentives was to allocate risk to the party Ofwat believed best able to manage it (in the case of weather, the water companies) and to improve water company performance and resilience in the water supply network. The clear direction of travel in PR19 (including the Reporting Guidance) was, unlike in earlier price control settlements, to limit reporting exceptions, in particular of water supply interruptions relating to severe weather. Ofwat's July 2017 report "Delivering Water 2020" was even clearer about Ofwat's intention than PR19 itself. The existence of a CE exception discretion is more consistent with all of this than is NWL's case.

91. Further, the absence of a CE exception discretion leads to a degree of absurdity. Assume there is no discretion, but, rather, that, so long as it is satisfied that there is a civil emergency which has not been caused by a water supply interruption, Ofwat must relieve a water company from reporting underperformance. In that case, if a severe weather event only marginally fails to be a civil emergency but there have only been No-Fault water supply interruptions, a water company obtains no relief from reporting underperformance. However, in that case, if a similar severe weather event only marginally is a civil emergency and the water supply interruptions have been prolonged by a water company's fault, the water company would be relieved from reporting all the underperformance. Even if, as NWL now contends, the CE exception only extends to No-Fault water supply interruptions, to a degree its case lacks

[4] See fn.2.

commonsense. Why should there obviously be an obverse response in reporting No-Fault water supply interruptions in a case where similar weather does, or does not, marginally pass the threshold for a civil emergency? I can think of no good reason for such a distinction.

92. For all these reasons, I have concluded that there is a CE exception discretion, that Ofwat did not misconstrue the CE exception and did not make an error of law, and that this ground must be dismissed.

Ground 2: This is a case where the duty of prescription applies. Because Ofwat did not have (as Ofwat agrees) or publish, in advance of the CMA's redetermination of PR19, a policy setting out how it proposed to exercise any discretion it has under the CE exception, the final determination must be quashed

93. In *R (ZLL) v. Secretary of State for Housing, Communities and Local Government* [2022] EWHC 85 (Admin), Fordham J, in a case where the claimant complained that the defendant was operating an unpublished policy in circumstances not involving fundamental rights, explained at [7(4)]:

> "The "duty of prescription" point. It is a recognised feature of public law that there are contexts in which it is legally necessary for public authority powers to be circumscribed by means of the issuing of prescriptive policy guidance. In HRA cases, this need for "prescription" familiarly falls within the "prescribed by law" (and equivalent) formulations found in the Convention rights. But a similar "duty of prescription" can arise at common law. As Lord Dyson said, in the context of statutory powers of executive immigration detention, in *R (Lumba) v. Secretary of State for the Home Department* [2011] UKSC 12 [2012] 1 AC 245 at para.34: "The rule of law calls for a transparent statement by the executive of the circumstances in which the broad statutory criteria will be exercised". As Lord Phillips said in Lumba at para.302: "under principles of public law, it was necessary for the Home Secretary to have policies in relation to the exercise of her powers of detention of immigrants"; "[t]his necessity springs from the standards of administration of public law requires"; "[u]nless there were uniformly applied practices, decisions would be inconsistent and arbitrary". As Sedley LJ had said, in the context of clawback of overpaid income support benefit, in *B v. Secretary of State for Work and Pensions* [2005] EWCA Civ 929 [2005] 1 WLR 3796: "It is axiomatic in modern government that a lawful policy is necessary if an executive discretion of the significance of the one now under consideration is to be exercised, as public law requires it to be exercised, consistently from case to case but adaptively to the facts of individual cases". As can be seen from those passages, the underpinning of the public law duty to issue prescriptive policy guidance guiding the exercise of discretionary powers is a recognition of the virtues of consistency and protection against arbitrariness."

94. *Lumba* was a case involving fundamental rights (the claim was for unlawful detention) where the defendant had operated an unpublished policy. Lord Dyson's remark which Fordham J quotes was made in the context of a discussion about fundamental rights (a police power of stop and search). The examples given by Lord Dyson of instances when the rule of law calls for a published policy were all instances involving fundamental rights which arose in circumstances where decisions might be made by many individuals (police officers and Home Office immigration caseworkers) on many occasions in similar circumstances when the private individual has no other advance warning about how a decision in their particular case might be made. As Lord Phillips explained, in his dissenting judgment, in the whole of [302], when agreeing with what Lord Dyson had said:

> "I agree with Lord Dyson JSC that, under principles of public law, it was necessary for the Secretary of State to have policies in relation to the exercise of her powers of detention of immigrants and that those policies had to be published. This necessity springs from the standards of administration that public law requires and by the requirement of article 5 that detention should be lawful and not arbitrary. Decisions as to the detention of immigrants had to be taken by a very large number of officials in relation to tens of thousands of immigrants. Unless there were uniformly applied practices, decisions would be inconsistent and arbitrary. Established principles of public law also required that the Secretary of State's policies should be published. Immigrants needed to be able to ascertain her policies in order to know whether or not the decisions that affected them were open to challenge."

95. *B* was a case where caseworkers in the Department of Work and Pensions were making multiple decisions in relation to individuals who were in receipt of income support where the question was whether overpayments, most likely already spent, ought to be clawed back. *B* was also a case where there was a departmental policy which had not been published. The circumstances of that case are very different from the present one.

96. Fordham J explained, in *ZLL*, at [45(1)]:

> "The situation where the common law recognises a "duty of prescription" is where there are broad discretionary powers needing a statement of criteria, in order to secure appropriate consistency, to protect against arbitrariness, to allow informed representations and to facilitate informed challenge…"

97. The present case is not a case where the duty of prescription applies and this ground must be dismissed for the following reasons.

98. I accept that the financial implications of how Ofwat might exercise the CE exception discretion are great. However, this is not a case where the discretion is completely unbounded. It must be exercised in accordance with Ofwat's statutory duties, the ambit of which provide a sufficient template for consistency in decision-making. Nor is this a case where multiple private individuals are subject to decisions in similar

circumstances by one of many caseworkers. There are only a small number of water companies. Circumstances when a CE exception discretion might be exercised are rare and can vary greatly. The final determination was made by a very senior, identified Ofwat official and there is no reason to think that future decisions will not be taken by equally senior officials. The draft determination was published and was consulted on, with further contributions open not only to NWL but more generally, so that NWL had the opportunity to challenge Ofwat's thinking about its particular case. In making the Representation and the Consultation Response, NWL, a sophisticated participant in the process, was able to call on lawyers and other specialists for support and knew, or ought to have known, that Ofwat would make its decision in accordance with its statutory duties.

99. Mr de la Mare suggested that a duty of prescription arises in this case because an in-period determination cannot be appealed or re-determined. I disagree. That is not a factor any of the judges to whom I have referred noted. In any event, the purpose of a published policy is "to secure appropriate consistency, to protect against arbitrariness, to allow informed representations and to facilitate informed challenge." If those needs are adequately met without a policy, as they are in this case, the fact that the decision in question is not appealable or open to re-determination does not itself require a policy to be published.

100. Mr de la Mare also submitted that a published policy would help to shape the conduct of water companies to meet the aims of PR19. I think he meant by this that a published policy would allow water companies to know what level of investment is required to minimise the risk of the CE exception discretion falling against them. This too is the type of factor that has not figured in the judgments to which I have referred. In any event, the submission assumes that, absent a published policy, a water company will invest inefficiently, which is a proposition I cannot accept, as I have already explained.

Ground 3(a): The final determination was made for an improper purpose, because Ofwat took into account irrelevant factors. Ofwat was only permitted to take into account NWL's performance of the supply interruption Performance Commitments in relation to Storm Arwen. Because it took into account other matters, the final determination must be quashed

101. As presented at the hearing by Mr de la Mare, ground 3 is actually in two distinct parts. He submitted, first, that Ofwat took into account irrelevant matters. I can deal with this part of ground 3 briefly.

102. Mr de la Mare's argument was founded principally on his submission that licence condition B12.7 limited Ofwat, when making the final determination, to considering NWL's performance of the supply interruption Performance Commitments in relation to Storm Arwen. I have already rejected Mr de la Mare's construction about the reach of licence condition B12.7 and, when doing so, I have explained that, in making an in-period determination, Ofwat must comply with all its duties under s.2 of the Act, which require Ofwat to further objectives much broader than might justify a single-minded focus on NWL's performance during Storm Arwen. So this part of ground 3 must fail.

Ground 3(b): The final determination was irrational and must therefore be quashed

103. Mr de la Mare accepted, at the hearing, that to succeed on this part of ground 3, NWL must clear a very high hurdle. It does not, for the following reasons, so that ground 3 must be dismissed.

104. To explain my decision on this ground most straightforwardly, I need to take Mr de la Mare's submissions slightly out of turn.

105. Mr de la Mare effectively submitted that Ofwat acted irrationally in concluding that the final determination retains "incentives on [NWL] to continue to strive to deliver the best possible service and response to supply interruptions", because, he argued, "there is nothing more NWL could reasonably have been expected to do". He also argued, in this context, that Ofwat failed to take into account "there are already ample incentives for efficient investment to address extreme weather…"

106. I do not accept that Ofwat acted irrationally in reaching the conclusion in question.

107. It does not follow from the fact that NWL argued that certain water supply interruptions relating to Storm Arwen were No-Fault interruptions that, in fact, they were water supply interruptions where NWL was not at fault, or that there was nothing more that NWL could have reasonably been expected to do to address them. Nor does it follow from the fact that there may already be ample incentives for efficient investment to address extreme weather that the final determination cannot also have acted as an incentive.

108. Taking a step back, this submission is an attempt to resurrect, under the umbrella of rationality, the point that was at the heart of NWL's case on ground 1; namely, that Ofwat could only respond in one way to No Fault interruptions, by relieving NWL of the financial impact of them. That would mean in the present context that, though Ofwat has a CE exception discretion, it can only be exercised one way, in favour of NWL. That is the very antithesis of a discretion, in particular the CE exception discretion which operates against the background of the default position in which water companies are liable for all water supply interruptions even if they have acted reasonably and which must be exercised in accordance with Ofwat's statutory duties which are in tension.

109. In any event, Ofwat's evaluative judgment, that its overall conclusion, that the financial impact of Storm Arwen should be split 50:50 between NWL and its customers, would support resilience improvements by NWL was an economic predictive judgment to which it is entitled to a wide margin of appreciation.

110. Mr de la Mare also submitted that it was irrational for Ofwat to conclude, in the final determination, that there should be a broad sharing of risk between NWL and its customers. He submitted that "the CE exception is designed to reduce the risk that would otherwise be borne by suppliers (as per the default position) in relation to certain events outside their control…[A] key reason for that…is to avoid giving signals to water companies that would lead them to make inefficient investments in resilience…Ofwat's approach of broad-brush "risk sharing"…substantially increases incentives on suppliers to invest inefficiently…"

111. Mr de la Mare's submission may be a two-part submission. It is clearly an argument that the final determination will, or is likely to, cause water companies to invest

inefficiently, but it may also be an objection to how, on the merits, Ofwat exercised the CE exception discretion. Although perhaps, on one reading, para.41 of NWL's skeleton argument might suggest otherwise, Mr de la Mare cannot have meant that it was irrational for Ofwat to consider how the Storm Arwen price reduction, which was the default position (or, it may be said, the risk of that price reduction), should actually be borne, because that is the very consequence of the necessary exercise of the CE exception discretion following the Representation, as his submission acknowledges and which was the very point which NWL made in the Representation (as I record, for example, at para.26 above).

112. Mr de la Mare's first point (about inefficient investment) is a matter I have already discussed and in respect of which I have already explained why I cannot, and should not, accept the submission.

113. If Mr de la Mare did make the second point, it faces a number of difficulties.

114. First, his complaint that Ofwat spoke, in the final determination, of a "broad sharing of risk" is no more than an impermissible attack on the form, rather than the substance, of the final determination. As, for example, Stuart-Smith LJ explained in *R (Milburn) v. The Local Government and Social Care Ombudsman* [2023] EWCA Civ 207, at [61]:

> "…[I]t is necessary to read both the decision of the Ombudsman and the reasoning of the [first instance] Judge fairly, in context and with a view to understanding what they meant rather than sedulously picking and criticising individual words or phrases."

As I have already explained, in substance, by the final determination Ofwat concluded that its focus should be on the financial impact on NWL of NWL's underperformance relating to Storm Arwen, but that it should also take into account the severe disruption to customers' water supply during Storm Arwen, and, having weighed up the matters it identified, and having made an evaluative judgment that its overall conclusion would support resilience improvements by NWL and was in line with the PR19 settlement as a whole, it concluded that the financial impact of Storm Arwen should be split, on a broad brush, rather than a strictly mathematical, approach 50:50 between customers and NWL. Its reference to a "**broad** sharing of risk" (emphasis added) was no more than a statement that it was taking a broad brush approach. The nature of the CE exception discretion as I have found it to be means that there cannot have been only one mathematically legitimate outcome to the Representation. A broad brush approach to the Representation cannot have been objectionable.

115. Secondly, the point fails as a merits challenge.

116. The CE exception discretion confers the relevant decision-making function on Ofwat. As the final determination clearly demonstrates, Ofwat correctly directed itself that that discretion must be exercised in accordance with its statutory duties. As to the matters it took into account in exercising that discretion:

i) NWL cannot object that Ofwat took into account ("carefully" considering and weighing) the financial impact of Storm Arwen on NWL and the other matters

NWL urged it to take into account;

ii) NWL cannot object to Ofwat taking into account, and giving weight to, the severe disruption to customers' water supply during Storm Arwen. By its statutory duties, Ofwat was required to take that fact into account, and the central aim of PR19 was to protect customers from water supply interruptions;

iii) I have already explained why I reject NWL's rationality challenge to Ofwat's conclusion that the final determination would support resilience improvements by NWL;

iv) Ofwat's evaluative judgment that its overall conclusion was in line with PR19 as a whole cannot have been irrational when (i) the default position is that all the financial implications of Storm Arwen fall on NWL but (ii) as part and parcel of PR19, the CE exception discretion allows for a departure from the default position and when (iii) there is no challenge to Ofwat's conclusion that "Storm Arwen's impact on ODI payments averaged over the [five year PR19] period is within the expected risk and return range in the company's overall price review package".

It follows, therefore, that, as explained by Lightman J in *Cellcom*, a challenge to the outcome of the final determination cannot succeed on rationality grounds, subject to Mr de la Mare's two final submissions, which I address now.

117. Mr de la Mare submitted next that, in making the final determination, it was irrational for Ofwat to take into account that water companies might obtain fortuitous benefits from other parts of the PR19 settlement which Ofwat might not know about because of information asymmetry. He said that:

> "It makes no sense to rely on "fortuitous benefits" in assessing the CE exception in principle where (a) the size of the (downside) risk involved in [civil emergencies] is much greater than ordinary (upside and downside) risks in the PR19 package generally; and (b) the idea of such benefits is speculative and based on highly occasional events…"

118. As I have explained the final determination above, I am doubtful that, in making its decision, Ofwat did take into account either fortuitous benefits water companies might obtain under PR19 or information asymmetry. However, Ofwat proceeded at the hearing on the basis that it did take those factors into account in making its decision, and so will I.

119. Mr de la Mare's submission cannot succeed. It is a challenge to an economic conclusion reached by Ofwat, and for the same reasons, as it happens, that I cannot, and should not, determine whether or not the final determination will result in inefficient investment, I cannot, and should not, determine whether the financial implications of a civil emergency are (rather than may be) greater than the profitability of PR19 for a water company, which is what the quote above really amounts to.

120. Mr de la Mare also argued in this context that it was "doubly wrong" for Ofwat to take into account that water companies might obtain fortuitous benefits from other parts of PR19, because water companies not facing a civil emergency are allowed to "keep" such benefits rather than having them "clawed back" as has happened (he argued) in this case.

121. This submission is flawed for at least two reasons (which may, in fact, be the same reason articulated differently). First, there is no question of the final determination "clawing back" any fortuitous benefits NWL has enjoyed from PR19. There is no question that, even following the final determination, NWL keeps those fortuitous benefits. As I have explained, the CE exception discretion is a relieving provision. By the final determination, Ofwat has made an economic decision about the extent to which NWL should be relieved of the Storm Arwen price reduction and, to the extent it has given such relief, Ofwat has done no more than take into account the possibility that, under PR19, NWL may enjoy fortuitous benefits. Secondly, water companies not facing a civil emergency do not "keep" any fortuitous benefits they enjoy under PR19 any more than NWL does by virtue of the final determination. To the contrary, because any price reductions which those other water companies face which result from water supply interruptions cannot be relieved by an exercise of the CE exception discretion, those water companies may be worse off than NWL which, by the final determination, has obtained some relief.

122. Mr de la Mare submitted finally that the relief Ofwat granted NWL by the final determination – relieving it of only £12.894 million of the £25.79 million Storm Arwen price reduction – was manifestly disproportionate, and so irrational. He relied, in this regard, on the response (or, in the case of Ofgem, the assumed response) to Storm Arwen of other regulators; in particular, the Environment Agency, which relieved NWL of all the consequences NWL might have otherwise faced for pollution incidents relating to Storm Arwen, and, as I have just mentioned, Ofgem in relation to Northern Powergrid.

123. Mr Beal accepted that a reasonable decision-maker would struggle to defend as rational a decision which is manifestly disproportionate.

124. I cannot accept Mr de la Mare's submission.

125. It is not in dispute that the Storm Arwen price reduction that NWL continues to be subject to following the final determination is a significant sum of money, but it is not suggested (and it does not follow) that, thereby, the final determination was manifestly disproportionate.

126. As I have already explained when considering ground 1, I know nothing about other regulated sectors. I know nothing about the regulatory regimes which control those sectors. I know nothing about the framework of the regulators' powers and duties and, as I have already noted, not all regulators adopt the same approach to extreme weather. Further, I do not know, in detail, why other regulators responded as they did to Storm Arwen. Also, just because other regulators may have responded more generously to their regulated companies than Ofwat may be said to have done as a result of Storm Arwen, it does not follow that the decisions of those other regulators were necessarily proportionate or that those decisions did not overly favour the regulated companies. To be clear, I am not saying at all that other regulators did

overly favour their regulated companies. I am only saying that it does not follow from the fact that they may have made particular decisions, that those decisions are proportionate ones or that, comparatively, Ofwat's decision was disproportionate, let alone manifestly disproportionate.

127. For these reasons, NWL cannot establish that the final determination was manifestly disproportionate.

128. More broadly, as I have said, Ofwat clearly had its statutory duties in mind when it made the final determination and no point made on NWL's behalf has persuaded me that the final determination was irrational in any way.

Outcome

129. Taking into account all I have said, the claim more than meets the low threshold for giving permission for it to proceed, save perhaps in relation to ground 3(b). I do, though, give permission for the claim to proceed on that ground, as on the other grounds, because, on reflection, having considered that ground substantively, it too does meet the low threshold (albeit perhaps only just) for giving permission. However, for the reasons I have given, the claim must be dismissed.