November 2025

Ofwat's response to the CMA's Provisional Determinations

Overview

Ofwat

Introduction

1.1 In March 2025, we referred our PR24 final determinations for five companies to the CMA, as requested by those companies. We welcome many of the CMA's provisional decisions and have focused our response on areas we think the CMA should consider further. These key considerations are summarised in this document, and explained in further detail in the remainder of our response.

1.2 To aid clarity and facilitate comparison, we have structured our response to mirror the format of the CMA’s provisional determinations. We set out our response within the following documents:

- this overview of our response;
- base and enhancement costs (covering volumes 1 and 2 of the provisional determinations);
- outcomes, including price control deliverables (volume 3); and
- allowed return, risk and return (volume 4).

1.3 In line with the CMA's guidance, we have focused on points arising from the provisional determinations, signposting to previous submissions where possible. For ease of reference, we have aligned where we can with the headings and structure used by the CMA in its documentation.

1.4 The CMA's provisional determinations have found that nearly 80% of additional revenue requests, over and above our final determinations, were unjustified.[1] Overall, the CMA finds its proposals are within 1% of our own decisions, when removing the impact of new information that was unavailable when we made our decisions.[2] The vast majority of the £556 million increase in revenues is due to a rise in the allowed return on capital.

1.5 We welcome that, after careful consideration of the evidence, the CMA has largely dismissed the five disputing companies' calls for higher bills and easier targets. In most areas, it has supported the strong focus we took at PR24 on ensuring customers do not pay for inefficiency, past underperformance or risky financing choices. It has also backed our measures to hold companies to account for delivering the biggest capital programme in the sector's history.

[OF-RTPD-085] CMA, Water PR24 References: Provisional Determinations – Summary, October 2025, p. 9, para 37.

[2] The CMA states that over half of the change to the allowed return on capital results from external market movements since our determinations. It has proposed an overall 2% increase in allowed revenues compared to our final determinations. We estimate that at least 90% of this increase is attributable to the allowed return. [OF-RTPD-085] CMA, Water PR24 References: Provisional Determinations – Summary, October 2025, p. 10, para 42.

1.6 Our PR24 determinations were the product of a collaborative, transparent and thorough four-year process, building on the experience of thirty years of price reviews and drawing on widespread engagement with a range of stakeholders. The CMA acknowledges that it is neither feasible nor appropriate to replicate this work in the time available, recognising the complexity of the process.[3]

1.7 However, the provisional determinations include some new methodological changes that – particularly if they were applied to all 16 companies at future price reviews – would not improve outcomes for customers and the environment. While we support most of the CMA's proposals, we ask that it gives further consideration to the implications of these changes. Overall, they would see customers of the five companies pay more than they would have under our assessment, over the 2025-30 period. We set out some of the key points for each area in the following sections.

1.8 We continue to be committed to giving the CMA all the assistance we can throughout the redetermination process, to help deliver the best outcomes for customers and the environment.

Base and enhancement costs

Base costs

1.9 We welcome the CMA's provisional adoption of the same overarching approach to assessing base expenditure as we took in our final determinations. This includes the use of econometric benchmarking models, as well as applying sector-wide cost adjustments, a compelling evidential bar for company-specific cost adjustment claims, and an upper quartile catch-up efficiency challenge.

1.10 We support the CMA's approach to deprioritisation on base costs, and its provisional decision that asset health related issues are best dealt with through our ongoing work on the Asset Health Roadmap and cost change process.[4] Moreover, we support the CMA's proposal to deprioritise or disallow all additional base cost adjustment claims.

1.11 Overall, the CMA's approach – if applied to the whole sector – **would have resulted in base allowances lower than our final determinations**.[5] We consider this reinforces the credibility of our determinations and demonstrates that our allowances are not unduly stretching. They are sufficient for an efficient

[3] [OF-RTPD-085] CMA, Water PR24 References: Provisional Determinations – Summary, October 2025, pp. 5-6, para 20.
[4] [OF-RTPD-013] CMA, Water PR24 References: Provisional Determinations Volume 1, p. 98, paras 4.228-4.229.
[5] [OF-RTPD-017] CMA, Water PR24 References: Provisional Determinations Volume 5, October 2025, p. 28, Table D.5.

company to maintain long-term asset health while delivering against performance commitment levels (PCLs).

1.12 The CMA has taken a pragmatic and proportionate approach to selecting base cost models. We welcome the CMA's clear stance that customers should not pay twice for improvements, and that companies should not defer necessary capital maintenance due to unforeseen cost pressures or inefficiencies.[6] In this light, we ask the CMA to reconsider its proposal to remove **under-delivery adjustments**.

Enhancement costs

1.13 We support the majority of the CMA's provisional decisions relating to **company-specific enhancements**, where it concludes that most additional requests were unjustified. The CMA has upheld the principle that customers should not pay twice for improvements, such as on South East Water's proposed additional funding for resilience interconnectors.

1.14 We also welcome the CMA's use of **econometric benchmarking models** to help set enhancement allowances. Broadly, the CMA's alternative models place more weight on forecast costs provided by companies. We are concerned that this means that the **supply interconnectors** model is likely capturing inefficiencies rather than genuine cost pressures. On **phosphorus removal**, while we broadly support the proposed allowances, we think the approach would risk incentivising companies to simply forecast higher costs at future price reviews.

1.15 The CMA's models prioritise statistical fit, and the CMA considers them to be more robust than those we used. At PR19, the CMA concluded it is more appropriate to set the efficiency challenge based on the quality of econometric modelling, rather than seek specific outcomes.[7] Therefore, if the CMA retains these models, we recommend that it applies a **more stretching cost-efficiency challenge**, to reflect improved model fit and mitigate the risk of inefficiency.

Frontier shift efficiency

1.16 We acknowledge the CMA's intent to ground **frontier shift** in recent sector evidence and to test alternative methods. We support its provisional decision to apply frontier shift efficiency to enhancement allowances. However, we have concerns with the CMA's proposed approach and the resulting 0.7% per year adjustment. Not only is this materially lower than the 1% adjustment applied in our final determinations, it is lower than the adjustment applied by several water

[6] [OF-RTPD-013] CMA, Water PR24 References: Provisional Determinations Volume 1, p. 123, para 4.317.
[7] [OF-OU-098] CMA, PR19 redeterminations: Final report, p. 232, para 4.493.

companies. This risks customers paying for inefficiency, and could reduce incentives to innovate, adopt new technologies and improve productivity.

Outcomes

1.17 We broadly welcome the CMA's provisional determinations on outcomes and PCDs. Generally, they reach a suitable balance between incentivising improvements in performance and protecting companies from excessive risk. The CMA has proposed to retain the main pillars of our outcomes framework, such as our top-down approach to setting ODI rates, our decisions regarding the data we use, and the allocation of risk. It has also adopted the PCDs from our final determinations, enabling us to hold companies to account for delivering the record level of investment required in 2025-30.

1.18 We support the CMA's view that the Environment Agency and Natural Resources Wales are better placed to determine the most appropriate measurement approach for **pollution incidents**, and that our consultation is the correct process to consider changes.[8] [9] However, reducing the incentives to cut pollution incidents in 2025-26 is at odds with the high importance placed on it by customers and the UK Government.

1.19 On **water supply interruptions**, weakening the common PCL lacks ambition and would create a windfall for Northumbrian Water and Wessex Water (£7 million and £3 million, respectively) at the expense of customers. An even weaker target for South East Water would lead to inconsistent service across regions, and reduce incentives in an area where it has been identified as lacking effective operational control and preparedness for interruption events.[10]

Allowed return, risk and return

1.20 We welcome most aspects of the CMA's provisional determinations on risk and return. They reflect a huge amount of work, particularly given the relatively short timetable and significant new analysis presented by disputing companies. We agree with the CMA's emphasis on ensuring the sector is sufficiently attractive to investors to fund the large-scale capital investment at PR24. We also agree

[8] [OF-RTPD-015] CMA, Water PR24 References: Provisional Determinations Volume 3, October 2025, p. 69, para 6.196.
[9] [OF-RTPD-065] Ofwat, Consultation on changes to three PR24 environmental performance commitments, October 2025.
[10] [OF-OU-048] DWI, Consolidated review of the widespread loss of supplies arising from the freeze/thaw event affecting England in December 2022, p. 20.

that the provisional determinations are financeable on the basis of the notional capital structure.

1.21 Further, we welcome the proposal to adopt the OBR’s 2.4% long-term forecast of CPIH. This is, nonetheless, a decision that is conservative in favour of companies, given evidence that favours CPIH being higher than 2.4% over 2025-30.

1.22 Many of the CMA's proposals align with our PR24 determinations, as well as the 2023 UKRN Cost of Capital Guidance. However, we are concerned that some inconsistencies with prior practice will store up difficulties for water regulation in future. Some proposals also look set to overcompensate investors.

1.23 **We are particularly concerned that some of the CMA's proposals cut across regulatory efforts to increase consistency in decision-making on the allowed return.** We note proposals which variously depart from established regulatory practice, the UKRN guidance, the CMA's decisions at PR19, and even other elements of the PR24 provisional determinations. In doing so, they challenge calls for greater predictability and consistency in setting the allowed return, including from the UK Government in 2022 and the Independent Water Commission in 2025.[11] [12] The CMA has argued that market conditions and/or practical developments in setting the allowed return can justify this inconsistency.[13] However, its different approach to setting the allowed return on equity seems entirely down to market conditions – a concern that has not been used even-handedly over time to deviate from prior practice.

- **Total market return (TMR):** The proposal to increase the degree of pass-through of interest rates to the allowed return on equity marks a departure from established practice in UK regulation for at least a decade. It is made in the face of clear recommendations to regulators in the 2023 UKRN guidance. At PR19, the CMA's final determination made no link between the then ultra-low interest rates and TMR. At PR24, in a higher interest rate environment, the CMA's provisional determinations reintroduce this link. We are concerned this manifests a 'one-way bet' for investors, where TMR tracks up in response to higher-than-average interest rates, but is capped in response to movements on the downside. This is likely to undermine legitimacy with customers, as well as future risk-sharing arrangements that depend on consistency over time. The CMA has ruled out indexing the risk-free rate on the grounds of this being a major policy change best implemented at

[OF-RTPD-075] Department for Business, Energy & Industrial Strategy, Economic Regulation Policy Paper, January 2022.
[2] [OF-RTPD-019] Independent Water Commission, Final Report, July 2025, pp. 219-221.
[3] [OF-RTPD-016] CMA, Water PR24 References: Provisional Determinations Volume 4, October 2025, p. 14, para 7.17.

industry level.[14] But its TMR proposal is arguably a much more significant change that offers no clear prospect of a more accurate estimate.

- **Equity beta:** The CMA places weight on the relatively higher beta data in the last three years of its analysis, increasing the cost of equity. This is at odds with its decision at PR19 to de-weight the period of low beta data at the end of its sample. While recognising this is partly driven by a wish to include Pennon, our 'Allowed return, risk and return' document sets out an alternative way of doing this without relying on a volatile and unreliable estimator of beta.
- **Benchmark index adjustment:** At PR19, the CMA did not apply a downward adjustment, despite good evidence that Baa1-rated companies could issue at a discount to the cost of new debt benchmark. At PR24, the CMA proposes a 30bps upward adjustment, even though the most recent data suggests a Baa1 company can raise debt below the benchmark.
- **Retail margin adjustment (RMA):** Despite applying an RMA at PR19, the CMA now proposes that no RMA is appropriate, due to an assumption that working capital is financed at the Appointee WACC. This is inconsistent with the CMA's approach in other areas, such as in calculating its issuance and liquidity costs allowance, and disregards company evidence on actual costs.
- **Financial ratios:** In terms of assessing financeability, the 'thresholds' the CMA has set out for AICR and FFO/net debt are significantly higher than the minimum guidance for the target credit rating provided by credit rating agencies. Given the level of flexibility and judgement applied by those agencies, these 'thresholds' imply a strong level of credit quality. They are also well above the levels proposed by companies themselves for assessing financial resilience. This could unduly influence future investor expectations, potentially at the expense of the customer interest.

1.24 **We are also concerned that these methodological changes risk double-counting relevant factors in the CMA's overall level of 'aiming up'.** The CMA states that its 30bps aiming up adjustment is justified by the need to attract investment due to the large PR24 capital programme. However, this justification is already used to justify the increased pass-through from interest rates to the TMR, and in part, the decision to place weight on short-run data for beta. The combined impact of these decisions significantly exceeds the CMA's headline 30bps adjustment, and does not seem to reflect recent evidence of improved investor sentiment. As a result, we would ask the CMA to revisit its parameter ranges for its final determinations, to ensure they are closely aligned with the available evidence.

[4] [OF-RTPD-016] CMA, Water PR24 References: Provisional Determinations Volume 4, October 2025, p. 33, para 7.116.

Cross-cutting issues

1.25 The CMA states it may decide to use additional or updated information to inform its final determinations.[15] We welcome the CMA's recognition that taking account of more recent data than was available to us during PR24 risks incentivising companies to seek a redetermination.[16] The effect of doing so is clear in the provisional determinations: the CMA states that over half of the increase in the allowed return is due to market movements since our final determinations.[17] If the CMA chooses to use updated data, it is important to alleviate the risk of an unbalanced or selective redetermination by updating all relevant parameters.

1.26 The CMA invites submissions and evidence on customer preferences for bill profiles.[18] Its provisional decision to profile bills so they remain constant in real terms over years two to five results in a large step up in year two. Where possible, our final determinations mirrored companies' proposed profiles, with bills rising in real terms over the period. We had also engaged with CCW on bill profiling, concluding that a phased approach to bill increases across the period would be the preferred approach to better support consumer affordability.

1.27 The CMA has recognised the role that financial levers such as PAYG and RCV run-off rates can have on cash flows and revenues across the period. It could consider using such levers to manage large bill increases where it identifies headroom in its financeability assessment.

[5] [OF-RTPD-016] CMA, Water PR24 References: Provisional Determinations Volume 4, October 2025, pp. 275-276, para 10.6.
[6] [OF-RTPD-013] CMA, Water PR24 References: Provisional Determinations Volume 1, October 2025, p. 38, para 3.47.
[7] [OF-RTPD-085] CMA, Water PR24 References: Provisional Determinations – Summary, October 2025, p. 19, para 42.
[8] [OF-RTPD-016] CMA, Water PR24 References: Provisional Determinations Volume 4, October 2025, p. 276, para 10.6.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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