

# WATER PR24 REFERENCES

## Final Determinations – Summary

10 March 2026

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# Summary

## Introduction

1. Every five years, Ofwat – the sector regulator – decides through a ‘price control’ how much revenue each of the 16 regional regulated water companies is allowed for providing and improving water and sewerage services in their area.
2. In England and Wales, water and wastewater services are provided by privately-owned regional monopolies. As a result, there is no competitive rivalry to drive down prices or increase service quality, and incentives to innovate or be more efficient are limited. Economic regulation exists to compensate for this absence of competition.
3. The price control determines the amount companies can recover from customer bills. This is based on the money Ofwat decides companies need to spend on supplying customers, investing in improving services, and to achieve important obligations such as reducing pollution, as well as an allowed return to investors. The price control includes mechanisms that are meant to incentivise good performance and penalise poor performance. The price control aims to protect the interests of current and future customers.
4. Any company that disagrees with Ofwat’s price control decisions – for example, because it considers it has been allowed insufficient revenue to meet its obligations – can ask for a ‘redetermination’ by the Competition and Markets Authority (**CMA**).
5. In December 2024, Ofwat published its final determinations for the 2024 price review (**PR24**) which sets price controls for each of the 16 regulated companies for the period 2025 to 2030 (with that time period referred to as asset management period 8 or **AMP8**).
6. Five of the 16 companies – Anglian Water Services Limited (**Anglian**), Northumbrian Water Limited (**Northumbrian**), South East Water Limited (**South East**), Southern Water Services Limited (**Southern**) and Wessex Water Services Limited (**Wessex**) (together the **Disputing Companies**) – rejected Ofwat’s price control decisions. The Disputing Companies supply approximately 7 million households<sup>1</sup> and have a combined annual revenue of around £5 billion. On 18 March 2025, Ofwat referred the price controls of these five companies to the CMA for redetermination (the **References**).
7. In February 2025, Thames Water Utilities Limited (**Thames Water**) also rejected its price control and has since been in discussion with Ofwat and others about its

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<sup>1</sup> The population (approximately 14 million people) served by the Disputing Companies is approximately double the number of households (7 million households).

position. Thames Water and Ofwat agreed that Ofwat would defer making the reference to the CMA, to allow time for these discussions. After extending the deferral twice, in July and October 2025, Ofwat agreed to Thames Water's request to defer making the reference to the CMA indefinitely.<sup>2</sup> For these References, Thames Water has been treated as a third party; our decisions do not apply to it.

8. The other ten regulated water companies accepted Ofwat's PR24 price control decisions in full. These other companies are also third parties to these References and our decisions do not apply to them.
9. The CMA is required by law to undertake these redeterminations. An independent panel of expert decision makers is appointed to take these decisions (the group). The full report of the group's final determinations, issued to Ofwat on 10 March 2026, will be published in due course, in accordance with applicable legal requirements.<sup>3</sup> On the day of issuing the full report of our final determinations to Ofwat, we have published this summary on our [case page](#) to provide an overview of the group's redeterminations of the price controls of the five Disputing Companies.

## Wider context

10. These redeterminations are taking place against a backdrop of extensive debate and plans for fundamental changes to the water sector and how it is regulated.
11. Ageing infrastructure, climate change, population growth, and environmental concerns all pose increasingly serious risks to the reliability, quality, and sustainability of water supply and wastewater treatment in the UK. The water sector faces significant challenges in managing and mitigating these impacts to ensure the needs of people, businesses, and the environment are met. Investment is needed to meet these challenges and support economic growth, placing pressure on affordability for customers. There has also been mounting concern about the financial resilience of some water companies, as well as the extent to which the management and financial structures of some companies may be properly serving the interests of current and future customers.
12. These concerns have led to several reviews of the water sector, most recently by the Independent Water Commission (**IWC**).<sup>4</sup> Its final report was published in July 2025 (**IWC Final Report**). It concluded that a fundamental 'reset' of the water sector is needed to restore public confidence in the sector and its regulation, to

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<sup>2</sup> [Thames Water CMA Reference Deferral Update \(18 July 2025\)](#); [CMA Reference Deferral Update \(21 October 2025\)](#).

<sup>3</sup> The Water Industry Act 1991 requires Ofwat to send our full report to the Secretary of State. The full report of the CMA final determinations must be published no less than 14 days after it is received by the Secretary of State.

<sup>4</sup> IWC (2025) [Final Report](#). See also, for example: National Audit Office (2025) [Regulating for investment and outcomes in the water sector report](#); EA (2025) [New report finds systemic water company failure and underperformance](#) (accessed 2 September 2025); and House of Lords Industry and Regulators Committee (2023) [The affluent and the effluent: cleaning up failures in water and sewage regulation](#).

attract the investment needed to clean up the waterways of England and Wales, and to establish a framework that will meet the water demands of the future.

13. During its nine-month review, the IWC heard evidence about a very wide range of issues – from infrastructure development to the oversight of company finances. Its 88 recommendations cover a diverse range of areas, including: the strategic direction for the water system; planning; the legislative framework; regulator and regulation reform; company structures, ownership, governance and management; and infrastructure and asset health.
14. In response to the IWC Final Report, on 20 January 2026 the UK government published a White Paper which outlines its ‘action plan’ for what it describes as ‘a once in a generation opportunity’ to reform the water sector and the wider water system in England (**Defra White Paper**).<sup>5</sup> Amongst other changes, the UK government intends to abolish Ofwat and create a new single regulator in England, bringing together economic regulation and the water functions of the Environment Agency (**EA**), Natural England and the Drinking Water Inspectorate (**DWI**), moving to a more ‘supervisory approach’.<sup>6</sup> A Transition Plan will be published later in 2026 providing a roadmap for the transformation of the water industry regulatory framework and setting out how Ofwat will deliver the requirements of the PR24 price control during the transition to a single regulator. This will be supported by an interim Strategic Policy Statement (**SPS**) to provide direction for regulators during the transition. The UK government intends to introduce a water reform bill during this Parliament to implement these changes.<sup>7</sup>

## Scope of our role

15. We are required to redetermine the price control decisions for the five Disputing Companies by 17 March 2026. Whilst we are aware of the broader context in which our redeterminations take place, we are required by law to take our decisions within the confines of the existing regulatory framework.
16. We are required to make our redetermination decisions in accordance with the principles that apply to Ofwat, including its various statutory duties and in light of the UK government’s existing SPS for Ofwat.<sup>8</sup> However, we are not bound to follow the same approach as Ofwat. We must also consider whether new information is available that we should take into account. The redeterminations are highly complex, and it is not feasible or appropriate in one year to replicate all the

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<sup>5</sup> Defra (2026) [A new vision for water \(Defra White Paper\)](#).

<sup>6</sup> ‘Supervision’ is described in the Defra White Paper as operating through teams with company-specific expertise, who are responsible for oversight and funding decisions relating to each water company.

<sup>7</sup> We also note the Defra White Paper’s proposal to move from redeterminations to appeals where the regulator’s decisions are challenged, but this does not affect our task in these references.

<sup>8</sup> See ‘February 2022: The government’s strategic priorities for Ofwat’ at [Strategic policy statement for Ofwat - GOV.UK](#)

work done by Ofwat in its price controls over four years. Our decisions also apply to only a minority – five of the 16 – of regulated water companies.

17. Fundamental decisions about the structure of the water sector in England and how it is regulated, including the implementation of the IWC Final Report's recommendations and subsequent Defra White Paper proposals, are necessarily for the UK government and UK Parliament. The IWC's terms of reference were clear that its recommendations would be for future economic regulation, not for PR24 and the current price control period. The Defra White Paper also states that the planned new guidance on priorities for the water sector is to inform the next price review in 2029 (PR29). Notwithstanding this, where relevant and appropriate – bearing in mind the limited scope and timeframe for the redeterminations – we have taken into account submissions from the Disputing Companies and Ofwat on certain matters covered in the IWC Final Report and Defra White Paper.
18. Within that context, we have sought to carry out the redeterminations fairly, efficiently and at proportionate cost within the statutory timeframes.<sup>9</sup>

## Ofwat's PR24 price control decisions for the water sector

19. Ofwat used three basic 'building blocks' for developing the PR24 price control: (i) assessments of the companies' costs to determine their **expenditure allowances**; (ii) an **Outcomes framework** to incentivise delivery and performance and penalise non-delivery and underperformance; and (iii) an assessment of what **balance of risk and return** should attract the investment required. Together these building blocks form 'the package' of the overall price control.

### Expenditure allowances

20. In its PR24 final determinations (Ofwat's **PR24 FD**), Ofwat increased expenditure allowances for the water sector substantially to £104 billion (compared to £62 billion in the previous price control, PR19).<sup>10</sup> This included allowing around four times the amount of expenditure on improvement projects (known as 'enhancement expenditure') than in the PR19 price control. Ofwat's view was that a step change in investment was required, largely to meet new legal requirements (for example, in water resource management plans and the environmental programmes of the EA and the DWI).<sup>11</sup>

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<sup>9</sup> This objective is described as the CMA's 'overriding objective' in [Competition and Markets Authority Water Reference Rules \(CMA204\)](#), December 2024 (**Rules**), Rule 4.1. The Rules set a framework for how we conduct water references.

<sup>10</sup> Both amounts in 2022/23 prices. The previous price control period was 2020–2025.

<sup>11</sup> Ofwat (2025) [PR24 final determinations: sector summary - republished 12 May 2025](#), pp3–5 and 9. Ofwat (2025) [PR24 final determinations: Expenditure allowances](#), p3; Ofwat (2025) [PR24 final determinations: Our approach](#), pp29–30; and Ofwat (2025) [PR24 final determinations – City briefing](#), p7.

## Outcomes framework

21. Alongside the increased funding provided to the companies in Ofwat's PR24 FD, Ofwat made significant changes to its framework of performance targets, incentives, penalties and clawback mechanisms (known as the 'Outcomes framework'). Under the Outcomes framework, companies return money to customers if the companies do not provide defined deliverables or achieve performance targets, but can earn more money if they outperform.
22. Ofwat's PR24 FD increased the specificity of required outputs, made greater use of common (rather than bespoke) performance commitments for areas important to all customers, and imposed stronger incentives and penalties to drive improvements in performance. It made these changes to help ensure that money from the increased customer bills is used to deliver the right outcomes for customers and that customers do not pay for the same thing twice because allowances in previous years have not been spent appropriately.

## Balance of risk and return

23. Companies require money upfront to fund investment, which is provided by debt and equity investors. Investors expect to earn a return which reflects the risk of their investment – otherwise they may invest their money elsewhere. Ofwat's PR24 FD provided for this return through an 'allowed rate of return'. This is not guaranteed and the actual return that companies receive depends on their performance.
24. Ofwat's PR24 FD included a real (ie excluding inflation) allowed rate of return of 4.03%. Ofwat also considered the appropriate balance of risk and return, ie how much potential for variation in investor returns is reasonable, given the risks the investors are taking. This included introducing specific mechanisms to limit the overall scope for returns to deviate from the allowed level.
25. The decisions Ofwat made on the three elements described above – expenditure allowances, the Outcomes framework and the management of the risk and return to investors – determined its PR24 price control. Ofwat's PR24 FD would have resulted in industry average increases in annual bills for customers of water and wastewater companies of £31 per year (before inflation) between 2024/25 and 2029/30.<sup>12</sup>

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<sup>12</sup> Ofwat (2024) [What the 2024 price review means for water customers](#).

## Reasons for Disputing Companies rejecting Ofwat's price control decisions

26. The Disputing Companies asked for further increases in revenue of £2.7 billion in total on top of the £26.6 billion allowed to them by Ofwat,<sup>13</sup> as well as changes to the Outcomes framework. While Anglian, Northumbrian, South East, Southern and Wessex each provided extensive and different reasons for rejecting Ofwat's price control decisions, some common themes in their arguments were that Ofwat had:
- (a) provided insufficient funding for maintaining and replacing the water companies' pipes and other assets;
  - (b) made mistakes in what it expected allowances for day-to-day expenditure to fund;
  - (c) set the allowed rate of return (the returns to investors) too low; and
  - (d) not appropriately balanced the risk and return for investors, including in its Outcomes framework, so that the water companies would not be able to raise finance for their activities.

## Our approach to the redeterminations

27. In a redetermination, the CMA can look at all aspects of the price control, not necessarily just those issues raised by the Disputing Companies. We are mindful of Disputing Companies' incentives to selectively raise areas where Ofwat's price control decisions might be unfavourable to them. However, a redetermination is not a 'one-way bet' – the CMA may choose to take a different approach to Ofwat, resulting in lower allowances or returns (ie it is not necessarily the case that a Disputing Company will benefit from a redetermination).
28. We set out our proposed approach to the redeterminations of the PR24 price controls (including what we were prioritising and deprioritising) on 28 May 2025.<sup>14</sup> The main parties and third parties had the opportunity to comment on our approach in consultations on this approach document, our provisional determinations (published on 9 October 2025) and our base cost modelling working paper (published on 18 December 2025). Our final decisions reflect new data where practicable and appropriate (including more recent financial market data and some actual performance data for 2024/25). We have also considered Ofwat's consultations and guidance introduced since our provisional determinations.

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<sup>13</sup> In Ofwat's PR24 FD, before any subsequent adjustment by Ofwat.

<sup>14</sup> CMA (2025) [Water PR24 Redetermination References: Approach and Prioritisation](#).

29. We have reviewed extensive evidence from the Disputing Companies, Ofwat and over 50 third parties including the Consumer Council for Water (**CCW**), representatives of investors, environmental groups, other consumer groups, business and domestic customers, and other water companies which have accepted Ofwat's PR24 price control decisions.
30. We carefully considered the interests of customers in our approach – both in terms of the levels of bills and affordability and in relation to critical outcomes (such as a reliable water supply and reduced leakage), now and in future. We scrutinised the evidence to decide if the spending proposed is necessary to deliver the right outcomes for customers, and whether the amount requested represented efficient costs (so customers do not pay for inefficiency or more than is needed). We have looked carefully at the efficiency challenges within the price control for the Disputing Companies: to encourage less efficient Disputing Companies to catch up with their more efficient peers ('catch up efficiency'); to reflect sector wide general expected efficiency improvements (known as the 'frontier shift'); and to adjust estimated expenditure for projects where evidence of efficient costs is lacking. We have also sought to ensure that customers genuinely benefit from any bill increases they are bearing and are not funding improvements for which they have already paid.
31. We have sought to ensure that the Disputing Companies have enough funding for what they are expected – often legally mandated – to achieve. We also sought to ensure that returns to investors reflect the risk in the PR24 price control as a whole, so that the companies are able to raise the substantial finance required for investment at a time of challenges and instability in the water sector. We have considered the impact of our decisions for each Disputing Company individually, including ensuring that each company is expected to remain financeable, provided its capital structure is in line with what we consider to be efficient.
32. We have reached each Disputing Company's redetermination in accordance with the statutory principles that apply to Ofwat, including various statutory duties. Our decisions reflect our judgement on how these principles should be balanced. We have also considered the overall price control in the round for each Disputing Company and decided that each is consistent with the relevant statutory principles.

## **Overview of our decisions**

33. The overall impact of our decisions on Disputing Companies' allowed revenue is set out in Table 1 below.

**Table 1: Impact of our redeterminations on total allowed revenue**

| Disputing Company | Ofwat's PR24 FD AMP8 allowed revenue | Disputing company statement of case AMP8 allowed revenue |  |  | Ofwat's updated PR24 AMP8 allowed revenue * | CMA redeterminations AMP8 allowed revenue |  |  |
|-------------------|--------------------------------------|--|--|--|---|---|--|--|
|                   |                                      | AMP8 allowed revenue                                     | Change from Ofwat's PR24 FD AMP8 allowed revenue | Change from Ofwat's PR24 FD AMP8 allowed revenue |   | AMP8 allowed revenue                      | Change from Ofwat's updated PR24 AMP8 allowed revenue ** | Change from Ofwat's updated PR24 AMP8 allowed revenue ** |
|                   |                                      |  |  |  |   |   |  |  |
| Anglian           | £9,634                               | £10,552  | £918   | 9.5%   | £9,647                                      | £9,797                                    | £150   | 1.6%   |
| Northumbrian      | £5,205                               | £5,495   | £290   | 5.6%   | £5,199                                      | £5,190                                    | -\$9   | -0.2%  |
| South East†       | £1,679                               | £1,960   | £282   | 16.8%  | £1,679                                      | £1,740                                    | £62  | 3.7%   |
| Southern          | £6,466                               | £7,416   | £949   | 14.7%  | £6,491                                      | £6,646                                    | £155   | 2.4%   |
| Wessex            | £3,632                               | £3,875   | £243   | 6.7%   | £3,628                                      | £3,734                                    | £106   | 2.9%   |

Source: CMA analysis; 'Ofwat's PR24 FD AMP8 allowed revenue' from Ofwat (2024) [PR24 Key Dataset 2 Costs Past Delivery and Risk and Return data](#), 'Allowed Revenue' sheet (in 2022/23 CPIH real prices); and 'Disputing company statement of case [...]Change from Ofwat's PR24 FD AMP8 allowed revenue' from Disputing Companies responses to Disputing Companies RFI08.

Note: £ million, 2022/23 CPIH real prices.

\* 'Ofwat's updated PR24 AMP8 allowed revenue' includes adjustments which Ofwat has made to the Disputing Companies' allowances following its PR24 FD.

\*\* The final two columns ('Change from Ofwat's updated PR24 AMP8 allowed revenue') show the difference between the CMA redeterminations AMP8 allowed revenue and 'Ofwat's updated PR24 AMP8 allowed revenue'.

† South East is a water only company (WoC); each of the other four Disputing Companies is a water and sewerage company (WaSC).

34. Our redeterminations allow a total increase of £463 million in confirmed revenue for the Disputing Companies (17% of what they collectively sought) compared with Ofwat's PR24 FD (adjusted for updates it has made to its decision since December 2024).<sup>15</sup> In addition, we have included six enhancement schemes in 'gated' processes, where additional allowances can be released during the price control when required funding becomes clearer.<sup>16</sup>
35. The following factors have together resulted in the overall changes in confirmed allowances for the Disputing Companies, compared with Ofwat's PR24 FD.
- (a) We have slightly reduced base expenditure allowances by £32 million compared to Ofwat's PR24 FD, from £14,524 million to £14,492 million. The reduction reflects both the CMA's changes to base cost modelling and decisions on cost adjustment claims for individual Disputing Companies.

<sup>15</sup> Ofwat adjusts companies' price controls through its 'blind year reconciliation' process, which it performs following the end of each AMP, to account for the difference between companies' actual performance and the forecast performance included in its final determinations once the outturn data for the final year of the previous AMP is available. [Blind year for 2024-25 - final determinations - Ofwat](#).

<sup>16</sup> Anglian, Southern and South East each have one scheme, and Northumbrian has three schemes, included in 'gated' processes.

These reductions in base funding slightly reduce allowed revenues compared to Ofwat's PR24 FD.

- (b) We have increased the Disputing Companies' enhancement expenditure allowances by a total of £289 million compared to Ofwat's PR24 FD. The increase reflects the CMA's changes to enhancement cost modelling and individual assessment of Disputing Companies' enhancement claims. Some of the increase in enhancement allowances is reflected in higher allowed revenues in this price control.<sup>17</sup>
- (c) We have increased the allowed rate of return from 4.03% to 4.20%. The increase in the allowed rate of return overall accounts for over half of the revenue increase compared to Ofwat's PR24 FD.<sup>18</sup> The increase is driven by a combination of market movements (primarily the increases in interest rates) since Ofwat set the allowed return, together with some targeted methodology changes.

36. Alongside these revised allowances, we have maintained clear penalties and incentives which are intended, within the confines of the existing regulatory system, to drive companies to deliver on time and to budget.

37. An indication of what the confirmed allowances would mean for average customer bills for each Disputing Company is laid out in Table 2 below.

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<sup>17</sup> More of enhancement expenditure is recovered over several price controls so changes in enhancement expenditure will have a smaller impact on allowed revenues in this price control, compared with changes in base expenditure.

<sup>18</sup> The impact of the increase in the allowed return on revenues is estimated after applying the changes in expenditure allowances.

**Table 2: Indicative impact of our redeterminations on average annual customer bills\***

| Disputing Company | Ofwat's PR24 FD                                   |                               |                                | Disputing Company statement of case average bill for AMP8 |   | Ofwat's updated PR24 AMP8 bills** | CMA redeterminations AMP8 average bill |  |
|-------------------|---|-------------------------------|--------------------------------|---|---|-----------------------------------|--|--|
|                   | Company average bill 2024/25 (final year of AMP7) | Company average bill for AMP8 | Change from final year of AMP7 | Company average bill for AMP8                             | Change from Ofwat's PR24 FD AMP8 average bill | Company average bill for AMP8     | Company average bill for AMP8          | Change from Ofwat's updated PR24 AMP8 average bill *** |
|                   | £   | £                             | %                              | £   | %   | £                                 | £                                      | %  |
| Anglian           | £491  | £591                          | 20.4%                          | £649  | 9.8%  | £592                              | £602                                   | 1.7%   |
| Northumbrian      | £422  | £488                          | 15.6%                          | £515  | 5.5%  | £488                              | £488                                   | 0.0%   |
| South East†       | £232  | £274                          | 18.1%                          | £322  | 17.5%   | £274                              | £284                                   | 3.7%   |
| Southern          | £420  | £620                          | 47.6%                          | £710  | 14.5%   | £626                              | £641                                   | 2.5%   |
| Wessex            | £508  | £594                          | 16.9%                          | £642  | 8.0%  | £594                              | £614                                   | 3.3%   |

Source: CMA analysis (for 'CMA redeterminations [...] Company average bill for AMP8'); Ofwat's PR24 FD financial models for 'Ofwat's PR24 FD'; and Disputing Companies responses to Disputing Companies RFI07 (which requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case) for all other columns.

\* These are indicative forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance. AMP7 is asset management period 7, a 5-year regulatory period used by Ofwat to set price controls for water companies, from 2020 to 2025.

\*\* 'Ofwat's updated PR24 AMP8 bills' includes adjustments which Ofwat has made to the Disputing Companies' bills following its PR24 FD.

\*\*\* 'Change from Ofwat's updated PR24 AMP8 average bill' shows the difference between the CMA redeterminations AMP8 average bill and 'Ofwat's updated PR24 AMP8' average bill).

† South East is a WoC; each of the other four Disputing Companies is a WaSC. Bills for South East therefore do not include the cost of wastewater services as it is a water-only company.

38. Ofwat's PR24 FD would have been expected to result in an increase in bills for customers of the Disputing Companies of 24% on average compared with 2024/25. Our redeterminations result in further increases of 2.2% on average (although this varies across the Disputing Companies).

39. We understand that household budgets are under pressure and that our decisions will result in a further increase in customer bills. However, we have concluded that some additional allowances are needed by the Disputing Companies. We consider that the allowances in our redeterminations will enable the Disputing Companies to attract investment and deliver the improvements in standards and performance that current and future customers need. The allowances will also allow them to meet their legal obligations, including those within water resource management plans and those imposed by regulators for drinking water quality and environmental matters.

## Decisions on each building block

40. We used the same building blocks in our redeterminations as for Ofwat's price control (as described in paragraphs 19 to 25 above). The sections below provide more detail on what we have decided for each building block.

### Expenditure allowances

41. We looked at the amount of money that the Disputing Companies had been allowed by Ofwat for total expenditure. This consists of base costs and enhancement costs. **Base costs** are routine, year-on-year costs, which companies incur in the normal running of the business to provide a base level of service to customers and to maintain assets, such as water treatment works and water mains. **Enhancement costs** relate to expenditure required to achieve a step change in service levels, for example to meet new requirements or allow for growth in demand for water.
42. In its PR24 FD, Ofwat substantially increased industry base allowances by 19% compared to PR19, and by 7% more than was spent by all the water companies in the five years prior to its PR24 FD. However, the Disputing Companies argued that the **base cost allowances** in Ofwat's PR24 FD were insufficient to enable them to provide services and maintain their asset base.
43. As a starting point, Ofwat used a complex modelling approach to calculate the majority of base cost allowances for all companies. The purpose of this modelling was to predict efficient costs for companies to fund their day-to-day activities. Ofwat then made some adjustments where the particular circumstances of a company were not considered to be properly reflected in the modelled costs.
44. The Disputing Companies raised various concerns with Ofwat's models, arguing that the outputs of Ofwat's base cost models did not accurately represent the costs they would incur. The Disputing Companies also asked for additional allowances, which they argued were justified by their specific circumstances, and objected to the efficiency challenges imposed.
45. Having carefully considered different possible approaches to assessing base cost allowances, and taking into account the Disputing Companies' concerns with Ofwat's models, we decided to apply a single modelling framework. Our approach results in simpler, more accurate models that better explain companies' costs. We consider this provides an improved basis for setting base cost allowances for the Disputing Companies. Our models incorporate most of the cost drivers used by Ofwat and some, though not all, of the cost drivers put forward by the Disputing Companies. Ofwat was supportive of our use of this modelling approach.

46. Following concerns about our modelling raised by the Disputing Companies and certain third parties in response to our provisional determinations, we improved and refined our approach. We consulted on this adjusted approach through our base costs modelling working paper. After considering all the responses to our provisional determinations and working paper, we remain of the view that our modelling approach is appropriate for these redeterminations, in particular given our approach's ability to better explain companies' cost data compared to Ofwat's models.
47. We are aware of the current debate – reflected in the IWC Final Report and Defra White Paper – on how base costs should be assessed in future price controls (including with respect to the extent of reliance on econometric modelling and the development of appropriate models). In future, the approach to setting base cost allowances may be revised to reflect broader changes in the regulatory framework. However, the proposals in the Defra White Paper are aimed at future price controls. We are required to conduct these redeterminations under the current regulatory framework and within the confines of the statutory process. For the reasons explained above, we have adopted the most appropriate approach to assessing base costs for the Disputing Companies within the context of these redeterminations.
48. We considered what level of efficiency challenge should be applied to base costs included in the price control, to encourage inefficient companies to catch up with their more efficient peers. In its PR24 FD, Ofwat considered companies should catch up to the company performing at the upper quartile of the water sector (ie three quarters of the way up the range from least to most efficient). We decided to also set an upper quartile efficiency challenge, although our modelling approach results in a higher catch-up efficiency challenge in absolute terms than that in Ofwat's PR24 FD. Our judgement, based on the available evidence, is that an upper quartile challenge appropriately protects customers from the risk of inefficiency in the circumstances of this price control without putting at risk the resilience or quality of water supplies and wastewater services.
49. We also assessed a number of requests for additional funding where the Disputing Companies claimed for costs that they considered were not reflected in the base cost modelling. We adjusted the base cost models explicitly to capture two of the cost drivers underpinning these claims: differences in regional wages; and energy costs. We also changed the assessment of 'what base buys', which affects the allowance granted to companies to improve asset health. Of the remaining seven claims, we have decided to allow three claims for: coastal wastewater processing; the costs of operating smaller water treatment works; and Anglian replacing failed boundary boxes (which house customers' water meters). We rejected four base claims, as we considered that the Disputing Companies provided insufficient

evidence to support them, for example that they were needed or that the estimated costs were efficient.

50. There has been considerable debate about whether the level of funding in previous price controls has achieved the appropriate balance between keeping bills low and providing sufficient funding to maintain assets and improve performance. While we received submissions that more investment is needed, there is currently a lack of robust evidence about the condition of water companies' assets and the level of investment required.
51. We agree with the Defra White Paper that further work is urgently needed to assess the condition of water infrastructure and ensure that companies have sufficient funding to maintain and improve it going forward. We also note Ofwat's 'road map' on asset health and process that will allow all companies to access additional allowances in AMP8 if there is evidence this is needed. In our view, it is right that this issue is dealt with through industry-wide policy work, outside of these redeterminations, including those mechanisms recently introduced by Ofwat. Given this context, and after carefully considering the available evidence as well as these wider mechanisms, we are satisfied that our approach to base costs does not result in a material risk that companies will be unable to fund critical investments over AMP8.
52. Ofwat also used models to partly determine **enhancement cost allowances**. These models compared costs of similar schemes across the regulated companies to estimate the costs that a comparatively efficient company would be expected to incur for a particular type of project. If a proposed enhancement investment did not lend itself to this type of benchmarking, Ofwat carried out more detailed investigations of the relevant scheme. In deciding what costs to allow, Ofwat took into account what it expected to be incurred by an efficient company.
53. The Disputing Companies argued that the outputs of Ofwat's modelling did not give a realistic estimate of funding required for their specific circumstances. We have assessed 28 requests from Disputing Companies to increase allowances for planned enhancement schemes and projects which Ofwat had said in its PR24 FD were either unnecessary, already funded within base cost allowances expenditure or the previous price control, or for which estimated costs were too high and inefficient.
54. As with base costs, we have improved the modelling of certain enhancement scheme costs. This has changed some modelled allowances, for example for phosphorus removal schemes. We also looked in more detail at the plans and projected costs of several schemes where higher allowances were requested. For some of these schemes we decided that there was insufficient evidence that more funding was appropriate. In other cases, we have provided more funding, but applied an 'efficiency challenge', reducing requested cost allowances by 10 to

30%. We did this where we were not satisfied that the requested costs represented costs that would be incurred by an efficient company ('efficient costs').

55. Where we have allowed more funding for enhancements, this is to deliver on issues that matter to customers. Examples include funding to: reduce leakage, prevent water supply interruptions that can leave customers without water for prolonged periods (as recently occurred in the South East region), improve water quality, address pollution, and prevent environmental harm and safeguard aquatic ecosystems.
56. For some enhancement schemes, we have decided that the amount of money that would be needed is too uncertain at this point to provide a specific cost allowance. Instead, we decided that companies should use existing Ofwat mechanisms (such as the 'large scheme gated process') where companies can apply for funding as costs become clearer. This reduces the enhancement cost allowance at this point but, if the scheme progresses and the company can evidence that the funding is needed, revised allowances can be claimed later. The impact of this varies by Disputing Company. For example, we have added Northumbrian's Suffolk strategic network water supply interconnector scheme to the large scheme gated process, which reduces its immediate allowance by £147 million, but allows Northumbrian to access funding for this scheme in AMP8 once it has greater certainty over cost and timings.
57. In its PR24 FD, Ofwat also imposed a **frontier shift** on all companies. The frontier shift reflects the rate of efficiency improvements, across all expenditure allowances, that even the most efficient companies in the industry could be expected to achieve – and would be expected to do so in a competitive industry.
58. After refining our provisional determination approach through traditional productivity analysis and taking into account various relevant factors, we decided to set the frontier shift at 0.7% (which is lower than the 1.0% frontier shift set by Ofwat and in the range of 0.5% to 0.8% requested by the Disputing Companies in their statements of case). However, we have continued to apply the frontier shift to all expenditure allowances, except for costs that were mostly outside of company control and self-financing costs.
59. Taking account of the combined impact of the frontier shift and the catch-up efficiency challenge in our modelling, we carefully considered the risk of underfunding the Disputing Companies, which could result in the companies overspending their allowances or customers not receiving a high quality and resilient water supply. On the basis of the available evidence, we decided that the overall efficiency challenge is reasonable and does not undermine the ability of the Disputing Companies to carry out their functions and meet their obligations.

60. Taken together, our changes to expenditure allowances result in slightly lower confirmed allowances for one Disputing Company (Northumbrian), and higher allowances for the others (Anglian, South East, Southern and Wessex). Once additional funding in uncertainty mechanisms is taken into account, all Disputing Companies are likely to have higher allowances.

### **Outcomes framework**

61. The Disputing Companies argued that some target performance levels in Ofwat's PR24 FD were too stretching and unrealistic, and that what they regarded as inevitable and severe penalties would reduce their ability to make required improvements in performance. Overall, they argued that companies were subject to unacceptable downside risks, given the impact that likely penalties would have on returns to investors.
62. It is critical that companies have sufficient incentives to deliver the projects and outcomes for which they have been funded, and that they are held to account when they do not. Ofwat seeks to achieve this through its Outcomes framework. We note the criticisms of this approach in the IWC Final Report and the Defra White Paper. However, the proposed changes are aimed at future price controls. As noted above, we are required to conduct these redeterminations under the current regulatory framework and within the confines of the statutory process.
63. In this context, we have made some limited adjustments to certain performance targets and incentive rates within Ofwat's Outcomes framework, either because we consider that Ofwat did not use appropriate data or that the way the penalties were calculated would disincentivise efforts to improve performance. We have also in some cases amended penalty mechanisms to reflect new allowances or protect customers from under-delivery, and also where we considered it appropriate to reflect new performance data.
64. Our analysis indicates that the overall impact of our decisions is to slightly lower the risk of underperformance for the Disputing Companies in some areas. However, we retain important drivers to improve performance and (where necessary) penalise poor performance in areas that are critical to current and future customers. This includes storm overflows (which lead to pollution), external sewer flooding and water supply interruptions.
65. We also looked at the penalties for failure to deliver agreed investments on time. The Disputing Companies claimed that these penalties introduce excessive risk. We do not share that view. We consider these penalties important to help ensure (as far as possible within the current regime) that companies deliver the new infrastructure that customers pay for. We also took into account new guidance issued by Ofwat, which improves clarity for the companies on how such penalties may be applied.

## Balance of risk and return

66. The allowed rate of return for investors is a key component for ensuring that companies can access the finance they need to deliver the outcomes for current and future customers. In deciding on the appropriate methodology and assessing the available evidence, we kept in mind the following considerations.
- (a) **Maintaining consistency:** Consistency and predictability over time of regulatory cost of capital decisions are likely to have a positive impact on the overall attractiveness of UK water infrastructure to investors. This, in turn, is expected to benefit customers by lowering the costs of financing investment needed to deliver services and improvements.
  - (b) **Reducing regulatory complexity:** While the cost of capital methodology should be theoretically robust, it also needs to be transparent and practicable to implement.
  - (c) **Recognising uncertainty:** There is significant uncertainty around the expected cost of capital. It is important to consider the evidence in the round, and it is generally desirable to limit the number of more subjective adjustments to the underlying market data.
67. We acknowledge the growing calls for consistency in cost of capital methodologies and regulators' efforts through the UK Regulators Network to achieve this, as well as the precedent value afforded by stakeholders to previous CMA decisions on cost of capital. While maintaining consistency is important, approaches can evolve over time, in response to market conditions and new evidence, without undermining the desire for consistency. Our approach in these redeterminations has been to appropriately balance the consistency considerations with the principles we have adopted of reducing regulatory complexity and recognising uncertainty, as set out above.
68. We used the Capital Asset Pricing Model to estimate the allowed return to equity investors, and we considered each of the parameters of the Capital Asset Pricing Model in turn, using updated market data in our calculations.
69. A combination of market movements (primarily the increases in interest rates) since Ofwat set the allowed return, together with some targeted methodology changes, has meant that our decision has led to a higher allowed return on equity compared with Ofwat (an increase from 5.10% to 5.70%). The increase has been partially offset by a reduction in the real allowed cost of debt (from 3.15% to 2.97%), where we have taken into account changes in expected inflation.
70. Overall, we have increased the allowed return from 4.03% to 4.20%. Around half of this change since Ofwat's PR24 FD results from external market movements (primarily the increases in interest rates) since Ofwat's decision in December

2024, with the rest stemming from targeted methodological changes (the allowed rate of return is lower than in our provisional determinations in October 2025 – this is almost entirely as a result of subsequent financial market movements).

71. As well as looking at individual elements of the price control, we considered the balance of risk and return in the overall price control for each Disputing Company.
72. The Disputing Companies submitted analysis suggesting that Ofwat's PR24 FD as a whole would be likely to result in a significantly lower equity return than the specified allowed return – particularly given the downside risks of underperformance and subsequent penalties.
73. We have reviewed this analysis and consider that the assumptions are not consistent with the purpose of modelling the risk faced by an efficient company. We therefore do not place any weight on it. Overall, we consider that our redeterminations result in balanced price controls or a 'fair bet', in the sense that the risks for an efficient company of earning more or less than the specified allowed return are broadly similar.
74. The Disputing Companies also asked us to review two mechanisms introduced by Ofwat in its PR24 FD to manage the extent of downside and upside variation of equity returns for investors – the Aggregate Sharing Mechanism (**ASM**) and the Outturn Adjustment Mechanism (**OAM**). We have concluded that, taken together, the ASM and OAM provide a sufficient level of downside risk protection and therefore both should be retained in their current form.
75. For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. The key aspect of this is ensuring that the price control allows for a reasonable rate of return, and we are satisfied that the allowed return we estimate is consistent with this. In line with standard regulatory practice, we have also performed financial ratio analysis, including in plausible downside scenarios. We are satisfied that each of the Disputing Companies, under the notional capital structure, can reasonably expect to maintain an investment grade credit rating over the price control.