WATER PR24 REFERENCES

Final Determinations Volume 5: Risk and return, Other issues, Company-specific chapters – Chapters 8-14

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Website: www.gov.uk/cma

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The Competition and Markets Authority has excluded from this published version of the final determinations information which the group considers should be excluded having regard to section 206 of the Water Industry Act 1991.

Any omissions are indicated by [✂]. Any non-sensitive replacement content is indicated in square brackets.

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8. Risk and return

Overview

8.1 In this chapter, we cover several other risk and return issues, in line with the scope we outlined in the CMA PR24 Approach document.[1]

Balance of risk and return

8.2 Disputing Companies have raised concerns about the overall balance of risk in the price control, arguing that the overall package is skewed to the downside. Our approach on the various building blocks has been to address issues at source where possible, taking into account that it is in customer interests to ensure efficient costs are funded and companies are incentivised to deliver service improvements.

8.3 In this chapter, we review Ofwat's approach to assessing the overall balance of risk, focusing on its assessment of the overall RoRE, a measure of return that is calculated relative to the notional capital structure, and how the resulting risk range for the notional company compares with the risk analysis presented by the Disputing Companies.[2]

8.4 We conclude that the overall package is broadly balanced:

(a) on costs, we conclude that there is no reason to assume the notional company would systematically over- or under-spend relative to allowances;

(b) on outcomes, we conclude that the ODI regime gives rise to a slight RoRE downside of less than -0.2%, given the design of some ODIs; and

(c) on finance, we conclude that exposure to inflation is likely to be asymmetric for the notional company, giving rise to some RoRE upside.

8.5 Estimating expected RoRE ranges is inevitably an uncertain and subjective exercise. While quantitative risk analysis can help to understand the broad range of possible returns, it is important to stand back and consider the evidence in the round. We conclude that the package overall is consistent with giving the notional company a fair opportunity to earn its cost of equity, with any inherent asymmetries on outcomes and inflation likely to be modest and broadly cancelling each other out.

[1] CMA PR24 Approach document, paragraph 2.
[2] RoRE is often presented as a variation from the allowed return on equity.

Aggregate risk sharing mechanisms and outcome adjustment mechanism

8.6 The PR24 price control includes a number of risk protections. We have reviewed the ASMs and the OAM as these are the only risk protection mechanisms which were raised by the Disputing Companies.

8.7 We maintain the conclusion we reached in the CMA PR24 PD and retain the ASMs and the OAM in their current form (ie as per Ofwat's PR24 FD). We have considered and where appropriate made changes to address the Disputing Companies' concerns around the balance of risk in the package at source, which is the approach preferred by all parties. The ASMs and the OAM provide greater protection against significant variation of returns compared to the previous price control, and we do not consider that there are good arguments to further reallocate risk away from shareholders to customers.

Cost recovery

8.8 We retain the approach to cost recovery as adopted by Ofwat in its PR24 FD.

Financeability

8.9 We are of the view that we have taken an approach to our wider redeterminations which properly takes account of the risks of setting allowances too high and too low. We have re-assessed the allowed return and wholesale totex requirements. Our view is that our revised totex allowances represent a reasonable level of costs for each of the Disputing Companies. We have also reduced some of the downside risks in the outcomes package relative to Ofwat's PR24 FD.

8.10 In line with regulatory practice, we have completed a financial ratio analysis and concluded that this supports the view that our determinations are financeable for each of the Disputing Companies, under the notional capital structure. Our base case ratio analysis produces ratios broadly consistent with a strong investment grade credit rating (BBB+/Baa1). We have also considered a range of downside sensitivities and conclude that each of the Disputing Companies, under the notional capital structure, can reasonably expect to maintain an investment grade credit rating.

Investability

8.11 In our view, our determinations provide an investable settlement for the Disputing Companies on a notional basis.

(a) We have assessed the allowed return afresh, reflecting the latest market data and evidence. We have also selected a point estimate for the allowed return on equity above the mid-point of our CAPM range. This is primarily to reduce the risk of the sector under-delivering on its large-scale capital programme

needed to improve services and resilience, given the potential welfare implications of underinvestment.

(b) We have updated the cost allowances and made some targeted adjustments to the outcomes package, to ensure efficient costs are funded and that performance targets are stretching but achievable.

(c) We have considered the arguments around the balance of risk and return, and have satisfied ourselves that the package is broadly balanced.

(d) We have tested the financeability of the notional company, including against reasonable downside scenarios, and have concluded that the notional company can maintain an investment grade credit rating.

(e) We have retained an assumption of a cash dividend yield of 4%, regardless of RCV growth. We have also funded equity issuance costs of 2.5% for notional company structures.

Tax

8.12 We have recalculated the tax allowances for the Disputing Companies and confirm that it is a zero allowance for all Disputing Companies, given the high level of capital expenditure in this price control.

Balance of risk and return

Introduction

8.13 In its PR24 FD, Ofwat said that it considered the balance of risk and return of the overall package in the round. In practice, Ofwat aimed to:

(a) align the interests of companies and investors to those of customers by setting the appropriate balance of risk and return;

(b) incentivise companies to deliver stretching levels of efficiency and levels of service that improve over time; and

(c) ensure that investor returns in 2025-30 fairly reflect the levels of service and cost efficiency that are delivered for customers.[3]

8.14 Ofwat recalibrated the allowed return, costs allowances and the outcomes package between PR24 DD and Ofwat's PR24 FD in response to companies' and investors' concerns.[4]

[3] Ofwat (2024) PR24 final determinations: Aligning risk and return, p14.
[4] Ofwat (2024) PR24 final determinations: Aligning risk and return, p2.

8.15 As part of the recalibration Ofwat took account of more recent data from the financial markets, the outturn performance and financial information reported by the companies in their 2024 Annual Performance Reports.[5] This resulted in increased funding for base and enhancement cost allowances which Ofwat considered to reduce the perceptions of risk compared to its PR24 DD.[6]

8.16 Ofwat noted that its PR24 FD provided greater protections to companies and customers than those which were in place for the 2020-25 period.[7] The significant changes made between AMP7 and AMP8 are presented in Table 8.1 below.

Table 8.1: Protections introduced between AMP7 and AMP8 to manage the balance of risk and return

Amendments	Description
Protections for changes in costs over and above reflected in general inflation	Relative price effects which cover labour costs, energy, plant and material enhancement costs.
'Cost sharing'	Standard 50:50 'cost sharing' (ie cost overrun or underspend pass-through to customers) extended to bioresources and bespoke pass-through arrangements for expenditure on enhancements .
ASMs	The ASMs were introduced in PR24 for outcomes and wholesale cost allowances to reduce the impact on customer bills and equity returns in case of extreme levels of outperformance or underperformance.
OAM	The OAM was introduced in PR24 for the outcomes package to ensure that the package is balanced. The mechanism allows adjustment of returns of all companies should the sector performance be materially different to what is expected.
Extension of uncertainty mechanisms for cost items where there is insufficient certainty in the efficient costs allowances (eg PFAS)	These mechanisms were expanded to provide additional expenditure allowances should investment requirements arise, and ensuring the final package is broadly balanced for an efficient company.

Source: Ofwat (2024) PR24 final determinations: Aligning risk and return, pp3–4,16 and 19.

Ofwat's PR24 FD approach

8.17 To assess the overall 'balance of risk' implied by its PR24 FD, Ofwat considered the distribution of the RoRE for a notionally efficient water company in AMP8 (ie the probability of different levels of RoRE occurring over the period).[8] This exercise involved estimating plausible distributions of realised outcomes and expenditures (ie the probability of different levels of under-/outperformance occurring over the period), and simulating the resulting distribution of RoRE given the incentive schemes and risk mitigations built into the PR24 settlement. Ofwat concluded that the risk around the central estimate was broadly balanced, and that

[5] Ofwat (2024) PR24 final determinations: Aligning risk and return, p2.
[6] Ofwat (2024) PR24 final determinations: Aligning risk and return, p2.
[7] Ofwat (2024) PR24 final determinations: Aligning risk and return, p2.
[8] Ofwat (2024) PR24 final determinations: Aligning risk and return - appendix, pp5–10 (section 1.1).

efficient companies had a reasonable prospect of earning the base allowed return on equity.[9]

Overview of Disputing Companies' submissions

8.18 In their statements of case, three of the Disputing Companies (Anglian, South East and Southern) submitted the results of an alternative RoRE simulation prepared by KPMG.[10] Using different assumptions, KPMG concluded that the notional WaSC can be expected to earn 2.35% less than the allowed return on equity in a base case scenario.[11] The other two Disputing Companies, Northumbrian and Wessex, broadly echoed the concerns raised by the three Disputing Companies which commissioned the KPMG analysis, either by directly referencing the KPMG analysis or expressing their concerns qualitatively.[12]

8.19 Some third parties similarly submitted that the risk and reward balance in Ofwat's PR24 FD was negatively skewed, driven by the imbalance in the outcomes package, a mis-calibrated WACC allowance and gaps in funding.[13] That view was not shared by all parties, with Pennon and CCW submitting that PR24 was a fair and balanced package.[14]

8.20 In the CMA PR24 PD, we focused on reviewing the KPMG analysis as this was the most extensive quantitative piece of work put to us on the balance of risk. Many other issues raised were largely related to issues with the underlying building blocks, which we had considered in other chapters.

8.21 We did not consider it necessary to conduct our own risk analysis as quantitative risk is only one aspect of considering the balance of risk. We were able to reach our own view on the balance of risk on the basis of KPMG's and Ofwat's risk modelling, and our overall reasoning on the individual building blocks.

8.22 We provisionally concluded that a significant driver of KPMG's assertion that the notional company was exposed to downside risk was an assumption that the notional company would be expected to overspend, miss the various PCL targets and incur higher debt costs than allowed for. We provisionally concluded that including such 'calibration risk' was inherently inconsistent with the purpose of the risk modelling, by effectively assuming that the various building blocks were mis-calibrated at source.

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[9] Ofwat (2024) PR24 final determinations: Aligning risk and return - appendix, p10.
[10] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company.
[11] CMA analysis of KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11).
[12] Wessex SoC, Annex A5, p160, paragraph 1.28 and Northumbrian SoC, pp110–113, paragraphs 395–406.
[13] Water UK (2025) Third party submission on the Water PR24 References, eg p4; Yorkshire Water (2025) Third party submission on the Water PR24 References, pp1–2; Thames Water Third party submission on the Water PR24 References, p4, paragraph 15; GIIA (2025) Third Party Submission on the Water PR24 References, p2.
[14] Pennon (2025) Third Party Submission on the Water PR24 References, p1; MCC Economics (2025) A review of Ofwat's PR24 Final Determination WACC allowance: a report for CCW, pp30–35, paragraphs 92–103.

8.23 The Disputing Companies and KPMG did not explicitly comment on this finding in their responses to the CMA PR24 PD. Thames Investor Group submitted that while it acknowledged that KPMG had made a strong assumption that there would be a similar level of underperformance as in the past without definitive analysis of why this would be the case, it also submitted that Ofwat was equally, if not more, guilty in this regard by assuming the notional firm would exactly perform to the level of cost allowances and precise PCLs set, without offering any evidence why this was right. [15]

8.24 We remain of the view that the purpose of the risk analysis is to identify any inherent (design) skews in the package and to get a broad sense of the potential range of performance for the notional company. We do not agree that expecting the notional firm to underperform in the base case is valid. To the extent that performance in previous AMPs is relevant to setting future allowances, we have considered this in the calibration of the individual building blocks.

8.25 Overall, in the CMA PR24 PD, our provisional conclusion was that the package was broadly balanced. In their responses, the Disputing Companies recognised that in some areas the CMA PR24 PD represented an improvement to the balance of risk and return compared to Ofwat's PR24 FD[16] but continued to make representations on areas of the price control where they considered further changes were needed. We have considered the responses to specific issues with regard to the building blocks in the preceding chapters.

8.26 Regarding our views on Ofwat's and KPMG's risk modelling, Disputing Companies welcomed our recognition that there was an inherent downside skew in the outcomes package. However, the Disputing Companies did not agree that it would be offset by potential upside from financing and submitted that further action was needed to improve the balance of risk, such as further aiming up on the cost of equity.[17]

8.27 In the rest of this section, consistent with the approach taken in the CMA PR24 PD, we focus on a review of Ofwat's and KPMG's risk modelling, taking into account the comments provided in response to the CMA PR24 PD.

Summary of Ofwat's and KPMG's analysis

8.28 We start by summarising the RoRE risk ranges estimated by Ofwat and KPMG (in the analysis supporting the statements of case). Table 8.2 and Table 8.3 below show the contribution of different risk factors to the RoRE distribution under Ofwat's and KPMG's analyses for a notional WaSC and a notional WoC,

[15] Thames Investor Group (2025) Response to CMA PR24 PD - Annex 1, paragraphs 5.9–5.10, p457.
[16] Anglian (2025) Response to CMA PR24 PD, pp204-205, paragraphs 570 and 573; Northumbrian (2025) Response to CMA PR24 PD, p3, paragraph 3; South East (2025) Response to CMA PR24 PD, p96, paragraph 7.3.
[17] Anglian (2025) Response to CMA PR24 PD, p204, paragraphs 571–572, 574; South East (2025) Response to CMA PR24 PD, p97, paragraph 7.6; Southern (2025) Response to CMA PR24 PD, p7, paragraphs 1.25–1.27.

respectively. The presentation of 'risk ranges' in both Ofwat's and KPMG's results focuses on three points in the estimated distribution of RoRE, which can be interpreted as follows:[18]

(a) the 'worst case' or 'P10' scenario: the notional company is expected to earn a return below the RoRE reported for that scenario with a 10% probability, and above with 90% probability;

(b) the 'best case' or 'P90' scenario: the notional company is expected to earn a return below the RoRE reported for that scenario with a 90% probability, and above with 10% probability; and

(c) the 'base case' scenario, which is defined slightly differently by Ofwat and KPMG: for Ofwat, the outcome reported for the base case scenario is simply the mid-point between the outcomes for the worst case and best case scenarios; whereas for KPMG, the base case scenario is based on the median or P50 scenario (that is, the notional company is expected to earn a return below the RoRE reported for that scenario with a 50% probability, and above with 50% probability).

8.29 By way of example, in Ofwat's analysis, the RoRE outcomes for the notional WaSC are: 0.03% in the base case scenario, -5.84% in the worst case scenario, and 5.90% in the best case scenario (Table 8.2 below). This means that in the case the notional firm is broadly expected to earn its cost of equity, and that there is a 10% chance that its return on equity will be at least 5.84% below the allowed level, and a 10% chance that it will be at least 5.90% above the allowed level.

8.30 Much of the discussion in the submissions to us on the balance of risk has focused on the base case scenario. Table 8.2 and Table 8.3 below show that, under KPMG's original approach, the two primary contributors of downside risk are the risk of underperformance against enhancement expenditure allowances and the risk of underperformance against ODIs. There is also an important divergence of view between Ofwat and KPMG with respect to the risk implications of financing activities: Ofwat expects that financing activities will generate a small upside skew in the base case (which offsets the small downside skew generated by ODI schemes), whereas KPMG expects that financing activities will generate a small downside skew even in the base case scenario. Accordingly, in the CMA PR24 PD, we focused our assessment on these three risk factors: enhancement expenditure, ODIs, and financing. We maintain the same approach in the final determinations, commenting on the additional submissions provided by the parties

[18] Risk ranges in Ofwat's PR24 FD are described as P10, P90, and midpoint. Consistent with the KPMG report, we refer to these as the worst-case, best-case, and base-case, respectively. See KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 2, footnote 5; Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p25.

in their responses to the CMA PR24 PD, as appropriate. We briefly discuss the risk associated with base expenditure below.

Table 8.2: Notional WaSC RoRE risk ranges: Ofwat PR24 FD compared to the KPMG original analysis

	Ofwat PR24 FD risk ranges			KPMG risk ranges		
	Worst case	**Base case**	**Best case**	**Worst case**	**Base case**	**Best case**
Totex	-2.83%	0.00%	2.83%	-2.76%	-1.55%	-0.07%
Base costs allowances	-2.41%	*0.00%*	*2.41%*	*-2.27%*	*-0.14%*	*0.85%*
Enhancement costs allowances	-0.42%	0.00%	0.42%	-2.64%	-1.08%	-0.07%
Retail	-0.30%	0.00%	0.30%	-1.21%	-0.20%	0.78%
ODIs + MeXes	-1.91%	-0.22%	1.48%	-1.74%	-0.69%	0.24%
Financing	-0.75%	0.28%	1.30%	-1.92%	-0.08%	1.66%
Revenue & Other	-0.05%	-0.03%	0.00%	-0.05%	-0.03%	0.00%
RoRE (additive)	**-5.84%**	**0.03%**	**5.90%**	**-7.68%**	**-2.54%**	**2.61%**
RoRE (simulated)	**N/A**	**N/A**	**N/A**	**-4.96%**	**-2.35%**	**0.23%**

Source: CMA analysis of Ofwat (2024) PR24 final determinations: PR24 RoRE model, PR24-FD-RR04-PR24-RoRE (version 2.1), tabs 'Table – PR24 FD RoRE' and 'Chart – PR24 FD RoRE' and KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). For Enhancement costs allowances, Retail and Financing risk we use KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11, Table 12, and Table 17 (which was submitted as eg Southern SoC, supporting document SOC-1-0001, and Northumbrian SoC, Appendix SOC573).
Note 1: KPMG's enhancement expenditure risk includes cost performance risk, non-delivery PCD risk and time incentive PCD risk, whereas Ofwat's enhancement expenditure risk includes only time incentive PCD risk.
Note 2: Ofwat identifies the median across all WaSCs and WoCs using the average of the 8th- and 9th-ranked companies (Hafren Dyfrdwy and Wessex), with the ranking based on overall mid-point of the RoRE risk range. The CMA applies the same approach to identify the median separately for the WaSC and WoC, finding the median WaSC is Hafren Dyfrdwy and the median WoC is South Staffordshire Water.
Note 3: KPMG revised its RCV data subsequent to the publication of KPMG (2025) PR24 Final Determinations – risk analysis for a notional company (see Northumbrian response to Northumbrian RFI02, Q1, paragraph 5). This changes the results in KPMG's report. For this reason, we re-run KPMG's 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11) and use these revised results.

Table 8.3: Notional WoC RoRE risk ranges: Ofwat PR24 FD compared to the KPMG analysis

	Ofwat PR24 FD risk ranges			KPMG risk ranges		
	Worst case	**Base case**	**Best case**	**Worst case**	**Base case**	**Best case**
Totex	-2.75%	0.00%	2.75%	-3.58%	-0.69%	2.16%
Base costs allowances	*-2.25%*	*0.00%*	*2.25%*	*-4.52%*	*-0.07%*	*2.77%*
Enhancement costs allowances	*-0.50%*	*0.00%*	*0.50%*	*-1.38%*	*-0.51%*	*0.09%*
Retail	-0.30%	0.00%	0.30%	-1.21%	-0.20%	0.78%
ODIs + MeXes	-2.37%	-0.25%	1.87%	-2.55%	-0.78%	0.70%
Financing	-0.75%	0.28%	1.30%	-1.92%	-0.08%	1.66%
Revenue & Other	-0.05%	-0.03%	0.00%	-0.05%	-0.03%	0.00%
RoRE (additive)	**-6.21%**	**0.00%**	**6.21%**	**-9.31%**	**-1.76%**	**5.31%**
RoRE (simulated)	**N/A**	**N/A**	**N/A**	**-5.86%**	**-1.94%**	**1.75%**

Source: CMA analysis of Ofwat (2024) PR24 final determinations: PR24 RoRE model, PR24-FD-RR04-PR24-RoRE (version 2.1), tabs 'Table – PR24 FD RoRE' and 'Chart – PR24 FD RoRE' and KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). For Enhancement costs allowances, Retail and Financing risk we use KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11, Table 12, and Table 17.
Note 1: KPMG's enhancement expenditure risk includes cost performance risk, non-delivery PCD risk, and time incentive PCD risk, whereas Ofwat's enhancement expenditure risk includes only time incentive PCD risk.

Note 2: Ofwat identifies the median across all WaSCs and WoCs using the average of the 8th- and 9th-ranked companies (Hafren Dyfrdwy and Wessex), with the ranking based on overall mid-point of the RoRE risk range. The CMA applies the same approach to identify the median separately for the WaSC and WoC, finding the median WaSC is Hafren Dyfrdwy and the median WoC is South Staffordshire Water.
Note 3: KPMG revised its RCV data subsequent to the publication of KPMG (2025) PR24 Final Determinations – risk analysis for a notional company (see Northumbrian response to Northumbrian RFI02, Q1, paragraph 5). This changes the results in KPMG's report. For this reason, we re-run KPMG's 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11) and use these revised results.

Base cost risk

8.31 KPMG's original results indicated that water companies also incur a small downside risk with respect to base expenditure: the RoRE loss attributable to base expenditure is 0.14% for the notional WaSC and 0.07% for the notional WoC. This result arises because KPMG's simulation uses a distribution of base expenditure centred on the median of PR24 DD forecasts submitted by the companies.[19] Because Ofwat's PR24 FD allowances for the median company are below the median companies' forecasts, this assumption mechanically generates a RoRE loss in the base case scenario.[20]

8.32 In the CMA PR24 PD, we explained why we did not consider this to be a valid approach. The purpose of the risk modelling exercise is to model the RoRE risk faced by a notionally efficient company, and in the CMA PR24 PD we concluded that it would not be coherent to assume that the notionally efficient company would overspend its allowance in expectation.

8.33 We continue to maintain that KPMG's approach is not a robust basis for assessing base costs risk. Between the CMA PR24 PD and the CMA PR24 FD, we have continued to assess the appropriate level of base costs, including claims of underfunding: see chapter 4 (Base costs). We conclude in that chapter that our allowances are set at an appropriate level and that the evidence does not support claims of underfunding. We therefore maintain our conclusion that the risks around base costs are broadly balanced.

Enhancement cost risk

8.34 The vast majority of the totex cost risk estimated by KPMG in its original report arises from enhancement cost risk. Enhancement cost risk may arise either from differences between actual and allowed costs (ie cost performance) or from incentive schemes involving rewards and penalties, particularly non-delivery PCDs

[19] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.2.
[20] CMA analysis of (i) Base totex distribution parameters found in KPMG's 'PR24 notional company risk model', tab 'C_Distribution', rows 291 and 292 provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). The notional company expected baseline is found in KPMG's 'PR24 notional company risk model', tab 'C_AMP8', rows 30, 32, and 34 provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11), and (ii) Ofwat FD allowance found in KPMG's 'PR24 notional company risk model', tab 'C_AMP8', rows 31, 33, and 35 provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11).

and time incentive PCDs. Below we review the implications of these three factors (cost performance, non-delivery incentives, and time incentives).

Cost performance risk

8.35 In its PR24 FD, Ofwat acknowledged that enhancement expenditure can be more uncertain than base expenditure, notably because enhancement schemes can be more bespoke.[21] In its simulation, Ofwat used a risk range of ±8.5% for totex overspend/underspend, which reflected the widest outturn cost performance range of any five-year period from 2000 to 2020.[22]

8.36 In contrast, KPMG's assumptions regarding cost performance were primarily derived from its analysis of a separate database of 56 infrastructure projects initiated between 1989 and 2022. For each project, the database contained information on planned and actual durations, planned and actual costs, and an indicator of complexity. KPMG applied a K-means clustering algorithm to group projects based on their characteristics (forecast costs, planned duration, and complexity).[23] The subset of projects that most closely resemble the characteristics of future AMP8 enhancement projects was used to estimate AMP8 cost performance risk.[24] This cluster contained 27 projects, of which 12 were water infrastructure projects, with other projects belonging to other sectors such as transport, energy, healthcare, and education. Of the 27 projects, 25 were UK projects; More than 90% of the 27 projects were started in 2015 or later.[25] KPMG said that non-water infrastructure projects were included to account for the significant size and complexity of investment in AMP8.[26] [27]

8.37 Using this sample of 27 projects, KPMG estimated a distribution of cost overspend for infrastructure projects. It submitted that this fitted distribution implied that cost overspends are between -10% and 36%, with a base case of 6%.[28] As a cross-check, KPMG also estimated a distribution of overspend for completed enhancement projects in AMP7 for four water companies, which it submitted showed a base case overspend of 8%.[29] The distribution for infrastructure projects was then used to conduct a Monte Carlo simulation of the impact of enhancement

[21] Ofwat (2024) PR24 final determinations: Expenditure allowances, p6.
[22] Ofwat (2024) PR24 final determinations: Aligning risk and return - appendix, p19.
[23] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.3 (including Table 23).
[24] KPMG estimates the characteristics of future AMP8 projects as follows: (i) planned duration is estimated based on direct engagement with the companies that commissioned the KPMG report (South East, Anglian, Southern, and Thames Water); (ii) Complexity is estimated using enhancement cases submitted in companies' PR24 Business Plans; (iii) planned cost is estimated based on the observed composition of enhancement allowances across the sector. See Disputing Companies response to Disputing Companies RFI03, Q1, paragraphs 19, 20, and 23.
[25] Disputing Companies response to Disputing Companies RFI03, Q1, paragraph 43 and Table 1.
[26] Disputing Companies response to Disputing Companies RFI03, Q1, Table 1.
[27] A step change in enhancement expenditure is discussed in: Ofwat (2024) PR24 final determinations: Expenditure allowances, p5; Anglian SoC, p15, paragraph 52; Northumbrian SoC, pp46–47, paragraph 146; South East SoC, p33, paragraph 4.1; Southern SoC, Chapter 3, paragraph 1; and Wessex SoC, p23, paragraph 4.16.
[28] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 24.
[29] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 24.

overspend on RoRE.[30] The simulation involved taking multiple draws from the estimated distribution of expenditure outcomes, and, for each draw, computing the resulting RoRE outcome.

8.38 Table 8.4 below shows KPMG's estimated cost performance risk ranges.[31]

Table 8.4: Cost performance risk (%RoRE) for WaSCs and WoCs, KPMG

Percentile	WaSCs	WoCs
P10	-2.09%	-1.35%
P50	-0.63%	-0.48%
P90	0.21%	0.12%

Source: KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11. Ofwat did not place weight on KPMG's analysis of its project infrastructure database in its PR24 FD.[32] Ofwat conducted an analysis of 3,842 AMP8 and 1,359 AMP7 enhancement schemes across 15 companies, finding that the average cost of KPMG's project differed to that of AMP7 and AMP8 enhancement projects.[33] In particular, the average cost of projects was £36 million in KPMG's set of comparators, and under £10 million for water projects in AMP7 and AMP8.[34] Also, Ofwat said the activities that companies will need to carry out in AMP8 are similar to those carried out in AMP7,[35] and show that the median and average cost per scheme across these activities in AMP7 is similar to that in AMP8.[36]

Our assessment and decisions

8.39 On behalf of Anglian, Northumbrian, South East and Southern, KPMG argued, in summary, that because infrastructure companies tend to overspend their cost forecasts on large projects, we should assume that Disputing Companies will systematically overspend their enhancement allowances in AMP8.

8.40 In the CMA PR24 PD, we explained that we were not persuaded by this argument for two reasons.

(a) First, the sample of projects used by KPMG is small relative to the thousands of enhancement schemes and contains projects that are unlikely to be good comparators for enhancement schemes in AMP8, notably because they tend to be larger, and less than half of KPMG's 27 infrastructure projects belong to the water sector.

[30] For each enhancement scheme, KPMG calculates cost overspend as the percentage difference between actual and planned costs and fits a Gaussian distribution to this data. The 10th, 50th, and 90th percentiles from the Gaussian distribution are then used to create a Metalog distribution, from which simulated overspend percentages are drawn. These were converted into absolute overspend by applying the cost allowance for the AMP8 enhancement scheme of a notional firm, and then multiplied by the cost sharing rate to estimate the cost borne by the company. This cost was aggregated across all schemes to determine total cost performance risk. The process was repeated 10,000 times to generate a distribution of outcomes, from which the 10th, 50th, and 90th percentiles and the average were calculated. We note that KPMG made an adjustment to the distribution for large gated schemes.
[31] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11.
[32] Ofwat (2025) Response to common issues on risk and return, p12, paragraph 1.34 and p41, 2.56; Ofwat (2024) PR24 final determinations: Aligning risk and return - appendix, p22.
[33] Ofwat's analysis included only the following activities: water supply; supply interconnectors; storm overflows; and p-removal. Note AMP8 enhancement projects costs are from Ofwat's expenditure enhancement models.
[34] Ofwat (2025) Response to common issues on expenditure allowances, p221, paragraph 7.85.
[35] Ofwat (2025) Response to common issues on expenditure allowances, p220, paragraph 7.79.
[36] Ofwat (2025) Response to common issues on expenditure allowances, p222, paragraph 7.86, Table 24 and Table 25.

(b) Second, and more fundamentally, we see no reason to assume that the process for setting allowances for enhancement expenditures in PR24 generates a systematic bias. In the context of the water sector, the process for setting allowances for enhancement projects uses a combination of historical outturn data for similar projects (for modelled schemes), and the companies' own forecasts (for modelled and unmodelled schemes). It is not clear to us why this process would systematically understate the cost of delivering projects. The historical data used in the process is by construction not liable to any optimism bias. Two Disputing Companies also told us that they continually update cost forecasts to reflect the latest information (which we expect to include historical cost overruns).[37]

8.41 Having assessed all the Disputing Companies' claims with respect to enhancement allowances, including any further issues raised in response to the CMA PR24 PD, we remain of the view that we do not consider it appropriate to conclude that the resulting allowances are likely to systematically underestimate the cost of delivering projects, simply based on the observation that the cost of delivering a small sample of infrastructure projects – in other sectors and regulatory contexts – has tended to exceed forecasts.

8.42 We acknowledge that water companies have overspent their enhancement allowances in AMP7. However, AMP7 was affected by a series of exceptional cost shocks related to labour, energy, material, plant and equipment, and therefore the overspend observed for that period cannot be interpreted as evidence that the process for setting enhancement allowances systematically delivers allowances that are too low. Moreover, companies' exposure to enhancement overspend is reduced by PR24's ex-post RPE true-ups for labour, materials, plant, and equipment.[38]

8.43 For these reasons, we conclude that the regulatory regime for enhancement spend does not give rise to a systematic risk of overspend, and that any overspend that does occur would be partly mitigated by input price risk protections. That is, we do not consider that a notionally efficient WaSC or WoC can be expected to overspend its enhancement allowance in the base case scenario.

Non-delivery PCD risk

8.44 Ofwat used non-delivery PCDs in its final determinations to protect customers by returning funding where companies fail to deliver funded improvements by the end of AMP8 (see chapter 6 (Outcomes), paragraph 6.12(a)). Ofwat did not estimate

[37] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p26, lines 21–25; p27, lines 1–8.
[38] Ofwat (2024) PR24 final determinations: Expenditure allowances, pp6–7 and pp271–272.

the risk associated with non-delivery PCDs, as this mechanism is designed to leave the company no better or worse off.[39]

8.45 In contrast, in its original report KPMG considered that the non-delivery PCD mechanism generated a significant downside risk for companies, insofar as it enabled the clawback of allowances related to projects that had been started during AMP8 but had not been fully delivered by the cut-off date (3 months after the end of AMP8).[40]

8.46 For each enhancement category, KPMG estimated the PCD clawback by calculating the proportion of scope undelivered at the cut-off date (explained at paragraph 8.47 below) and applying this to enhancement spend subject to the non-delivery PCD. The resulting clawback was multiplied by the cost sharing rate to estimate the cost borne by the notional company, which was then converted into RoRE terms.

8.47 KPMG estimated the proportion of scope undelivered at the cut-off date as the share of projects delayed multiplied by the proportion of scope undelivered for delayed projects.[41] Based partly on its infrastructure database, KPMG assumed 10–70% of projects would be delayed, with 40% as the most likely value. Among delayed projects, the undelivered scope was expected to range from 6.6% to 75.8%, with a median of 25.2%. For example, if 40% of projects were delayed and 25% of their scope was undelivered, total undelivered scope is 10%.[42]

8.48 Table 8.5 below shows KPMG's estimated non-delivery PCD risk ranges.

Table 8.5: Non-delivery PCD risk (%RoRE) for WaSCs and WoCs, KPMG

Percentile	WaSCs	WoCs
P10	-0.83%	-0.03%
P50	-0.25%	-0.01%
P90	-0.04%	0.00%

Source: KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11.

[39] Ofwat (2025) Response to common issues on risk and return, p39, paragraph 2.50.
[40] Ofwat (2025) Response to common issues on expenditure allowances, p250, paragraph 8.36.
[41] KPMG calculated total proportion of scope undelivered by multiplying (1) the proportion of delayed projects and (2) the proportion of scope undelivered for those delayed projects. KPMG modelled proportion of delayed projects using a PertAlt distribution, assuming a range from 10% to 70% with a most likely value of 40%. KPMG suggested the 40% value is conservative compared to 55% from KPMG's infrastructure database and 46% from an industry data cross-check. KPMG modelled proportion of scope undelivered for those delayed projects by fitting an exponential distribution (with shift) to delay percentages for 27 infrastructure projects, measuring delay as the percentage difference between planned and actual durations. The parameters of the exponential distribution fitted to the delay data are found to be 31.4% with a shift of 3.46%. References: Northumbrian response to Northumbrian RFI01, Q1 (document 2 of 11), 'PR24 notional company enhancement cost risk model' tab 'C_Performance', row 79; KPMG (2025) Technical session on PR24 risk analysis for a notional company, p14; KPMG 'Infrastructure Project Database' provided in response to Northumbrian response to Northumbrian RFI01, Q1 (document 3 of 11); KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.3.
[42] This is an illustrative example. In general, the median of the product of two independent random variables is not equal to the product of their individual medians.

8.49 Ofwat submitted that KPMG's approach overestimated the risk of delay: KPMG assumed that 60% of projects were delivered on time,[43] but Ofwat's analysis of PR19 WINEP data indicated that 76% of schemes were delivered on time.[44] [45] Where time incentives were applied in PR19 (for Anglian, Bristol Water, SES, and South East) on-time delivery exceeded 88%.[46] Ofwat said that this was further supported by WRMP data (78% on time) and metering programme data (64% on time, although affected by COVID-19).

8.50 In response to the CMA PR24 PD, KPMG submitted that while the proposed PCD changes outlined in Ofwat's draft consultation on applying non-delivery PCD clawbacks are expected to deliver a net reduction in overall PCD risk, it would be important for the CMA to reconsider PCD risk in light of Ofwat's final guidance.[47]

Our assessment and decisions

8.51 We discuss the risks induced by the non-delivery PCD in the section titled 'Non-delivery PCDs and negative expected returns' in chapter 6 (Outcomes). Since the CMA PR24 PD, Ofwat has published its final guidance on how it expects to apply the clawback arrangements.[48] For reasons set out in the chapter 6 (Outcomes), paragraphs 6.92 to 6.96], we conclude that the guidance adequately addresses the risk highlighted by KPMG. We note that, under Ofwat's guidance, where a company has not delivered required outputs by the end of AMP8 but is still required to or plans to deliver those outputs, then even where clawback is applied, its effect on overall funding levels would be offset through the provision of equivalent funding (after relevant RPE adjustments) in AMP9 allowances.

Time incentive PCD risk

8.52 The Ofwat PR24 FD time incentive PCD is intended to encourage timely delivery by rewarding on-time and early delivery and penalising late delivery (see chapter 6 (Outcomes), paragraph 6.12(b)).[49] The net penalty is based on the proportion of planned output undelivered as of 30 March each year. Ofwat sets the underperformance rate with reference to the full WACC and the outperformance rate with reference to one-third of WACC. Under this structure, there is no penalty if 75% of output is delivered (25% undelivered) at 30 March each year, while

[43] Ofwat (2025) Response to common issues on expenditure allowances, p228, paragraph 7.83.
[44] Ofwat (2024) PR24 final determinations: Expenditure allowances, p311.
[45] Ofwat define 'on time' delivery as a scheme being delivered by the financial year when the regulatory date falls into. This is consistent with the incentive structure Ofwat are proposing to apply for time incentive PCDs in PR24.
[46] Ofwat (2025) Response to common issues on expenditure allowances, paragraph 7.81, Table 23.
[47] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraph 2.3.2.
[48] Updated November 2025 PCDs Guidance.
[49] Ofwat (2024) PR24 final determinations: Expenditure allowances, p306.

greater delays result in a penalty, and fewer delays result in a reward. The net penalty is calculated as:[50] [51]

$$Time\ incentive\ net\ penalty\ in\ year\ t = [\ WACC * P_t - \frac{WACC}{3} * (1 - P_t)] * C_t$$

Where P is the proportion of planned output undelivered at 30 March in year t and C_t is enhancement expenditure in year t.

8.53 Ofwat's risk modelling assumes the proportion of planned output undelivered is in line with the calibration of the scheme, with a P10 of 60% on-time delivery, a P90 of 90%, and a mid-point of 75% (zero net penalty).[52] In contrast, KPMG estimated risk by proxying for 'proportion of planned output undelivered' with 'proportion of projects delivered late'[53] based on KPMG's infrastructure database. This implicitly assumed a 40% undelivered rate at the end of AMP8 for the median scenario and estimated the expected base case return to be -0.08% for WaSCs, and -0.02% for WoCs.[54] KPMG said that this does not make explicit judgements on interdependencies, for example how delays in early years may impact delivery in later years.[55]

8.54 In follow-up questions to Northumbrian, we pointed out that this approach appeared to be inconsistent with Ofwat's methodology. In response, KPMG, on behalf of Northumbrian, applied a different methodology ('Scenario 1'), which estimated risk for a measure of proportion of output undelivered rather than projects delayed.[56] This approach implicitly assumed 6.8% undelivered output in the median case at the end of AMP8.[57] Under this methodology, the notional WaSC would earn a net reward of 0.09% in the base case scenario, and the notional WoC would earn a net reward of 0.03%.

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[50] Ofwat calculation of net payment derived from Ofwat (2025) PCD RoRE impact model, tab 'RoRE Impact' & Ofwat (2024) draft determination: Expenditure allowances, p172, Table 41, Option 2 column.

[51] For example, if the WACC is 3% and the enhancement expenditure is £100, the underperformance rate would be £3 and the outperformance rate would be £1 (one-third of WACC). If a company delivers 70% of its outputs on time (meaning 30% are delivered late), it would receive a £0.70 reward (£1 × 0.7) for timely delivery and incur a £0.9 penalty (£3 × 0.30) for late delivery, resulting in a net penalty of £0.20.

[52] Ofwat (2025) PCD RoRE impact model, tab 'RoRE Impact', rows 23, 26 and 27.

[53] Northumbrian response to Northumbrian RFI05, Q1, paragraph 15.

[54] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 11.

[55] Northumbrian response to Northumbrian RFI05, Q1, paragraph 24.

[56] KPMG use the formula $proportion\ of\ planned\ output\ not\ delivered = D.\frac{E[delay\ |delay=1]}{1+E[delay\ |delay=1]}$, Where D = $Prob(delay = 1)$ ie the probability a project is delayed in that year, and $E[delay\ |delay = 1]$ is the expected delay if there is a delay.
See Northumbrian response to Northumbrian RFI05, 'RFI05-NWL-001 KPMG PR24 notional company enhancement cost risk model – sensitivity', tab 'C_Performance', rows 131–132.

[57] KPMG use the formula $proportion\ of\ planned\ output\ not\ delivered = D.\frac{E[delay\ |delay=1]}{1+E[delay\ |delay=1]}$. Where D = $Prob(delay = 1)$ ie the probability a project is delayed in that year, and $E[delay\ |delay = 1]$ is the expected delay if there is a delay. Both $E[delay\ |delay = 1]$ and D are random variables with their distributions described in footnote 41 above. We simulate 10,000 draws from these distributions and calculate the proportion of planned output not delivered (using the equation above) for each draw. We find the median of the resulting distribution (proportion of planned output not delivered) is 6.8%.

8.55 KPMG said 'Scenario 1' materially underestimates the risk, as no adjustment is made for delivery unit size and interdependency of annual delivery.[58] KPMG explained these risks as follows.[59]

(a) Larger delivery units (eg storm tanks) are costlier, slower, and more prone to partial delivery at assessment points, raising the risk of penalties, while smaller units (eg smart meters) are quicker and cheaper, reducing this risk.

(b) Interdependencies between annual stages mean that early delays (eg supply chain issues) can disrupt later delivery, compounding underperformance and penalty risks.

8.56 To capture these additional risk factors, KPMG applied a different methodology ('Scenario 2'), which estimated the proportion of scope undelivered accounting for how early delays may influence subsequent performance at future milestones. KPMG assumed that the proportion of delayed projects is 40% in the first year of AMP8 and increases each subsequent year.[60] This implicitly assumed 72.3% undelivered output at the end of AMP8 for the median scenario.[61] KPMG said that this may overestimate risk as it did not incorporate a reward for partial delivery on smaller unit schemes and may overstate the impact of 'interdependency of annual delivery'.[62] Under this methodology, the notional WaSC would earn a net penalty of 0.24% in the P50 scenario, and the notional WoC would earn a net penalty of 0.06%.

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[58] Northumbrian response to Northumbrian RFI05, Q2, paragraph 20.
[59] Northumbrian response to Northumbrian RFI05, Q1, paragraphs 5–13.
[60] CMA analysis of the ''RFI05-NWL-001 KPMG PR24 notional company enhancement cost risk model – sensitivity', tab 'C_Performance' finds that KPMG use the following formula:

$$proportion\ of\ planned\ output\ not\ delivered\ in\ year\ t = \frac{1-(1-D)^t}{5}$$

Where D = $Prob(delay = 1)$ ie the probability a project is delayed in that year.
[61] We have reviewed KPMG's Scenario 2 analysis and note that, although the proportion of planned output undelivered is calculated annually, the net penalty is assessed at the end of AMP8. It is therefore more appropriate to examine the equation used to estimate undelivered output at the end of the AMP8 period. We derive the closed-form solution to KPMG's proxy for this end-of-period value as follows:

$$proportion\ of\ planned\ output\ not\ delivered\ in\ year\ t = \frac{1-(1-D)^t}{5}$$

$Where\ D = Prob(delay = 1)\ i.e.$ the probability a project is delayed in that year
We sum over 5 years of AMP8:

$$S = \sum_{t=1}^{5} \frac{1-(1-D)^t}{5} = 1 - \frac{1}{5}\sum_{t=1}^{5}(1-D)^t$$

Using the sum of a geometric series: $\sum_{t=1}^{n} r^t = r.\frac{1-r^n}{1-r}\ where\ r = (1-D)\ and\ n = 5$, we find the closed form solution for the proportion of planned output undelivered at end of AMP8:

$$S = 1 - \frac{(1-D)(1-(1-D)^5)}{5D}$$

Inserting the median value for D of 40% (as stated in footnote 41), we find the median value for S (proportion of planned output undelivered at end of AMP8) is 72.3%. We have verified by simulating 10,000 draws from the distribution D and calculate S for each draw, finding the median of the resulting distribution for S.
[62] Northumbrian response to Northumbrian RFI05, Q2, paragraph 22.

Table 8.6: Time incentive PCD risk, KPMG

Percentile	WaSC			WoC		
	KPMG methodology	Scenario 1	Scenario 2	KPMG methodology	Scenario 1	Scenario 2
P10	-0.22%	0.03%	-0.33%	-0.06%	0.01%	-0.09%
P50	-0.08%	0.09%	-0.24%	-0.02%	0.03%	-0.06%
P90	0.06%	0.12%	-0.03%	0.02%	0.03%	-0.00%

Source: Northumbrian response to Northumbrian RFI05, Q2, Table 1.

Our assessment and decisions

8.57 Ofwat's framework for time incentive PCD penalties and rewards (which we continue to adopt in these determinations) links risk to the proportion of planned output undelivered. If the proportion exceeds Ofwat's 25% threshold, a penalty applies; if it is below, a reward is earned. We therefore assess the expected proportion of planned output undelivered.

8.58 Ofwat's WINEP data indicates that the proportion of output undelivered at the end of AMP7 was 24%[63] and those with bespoke WINEP commitments (Anglian, Bristol, SES, South East) delivered at most 12% of schemes late.[64]

8.59 In the CMA PR24 PD, we considered that KPMG's initial methodology for estimating time incentive PCD risk, which proxied the proportion of undelivered output using the proportion of projects delayed, was inconsistent with Ofwat's net penalty calculation and overstated risk in the base case by assuming 40% undelivered output. KPMG's Scenario 1 is consistent with Ofwat's framework and implies 6.8% undelivered output which is broadly aligned with WINEP evidence where there is a time incentive PCD, but potentially overstate the net reward (as 6.8% is below 12%). KPMG's Scenario 2 assumed compounding delays leading to 72.3% undelivered output in the median case. There is no evidence of historical interdependency between annual delivery stages and unit size affecting delivery performance to such a large extent in the base case, therefore we consider Scenario 2 substantially overstates risk and the net penalty.

8.60 Given that historical undelivered output in AMP7 has been less than 24% at the median, and that stronger time incentive mechanisms in AMP8 may reduce this further, consistent with our provisional view, we conclude that the most reasonable assumption for the median scenario is that undelivered output will be at or below Ofwat's 25% breakeven threshold (for example, Scenario 1), implying no net penalty or a small net reward.

[63] Ofwat (2025) Response to common issues on expenditure allowances, p225, paragraph 7.81.
[64] Ofwat (2025) Response to common issues on expenditure allowances, p225, paragraph 7.81 and Table 23.

ODI risk

8.61 The ODI framework imposes financial penalties when companies fail to meet performance targets and offers financial rewards for outperformance. As performance is inherently uncertain, this creates a risk to companies' financial returns.

Ofwat's PR24 FD approach

8.62 In its PR24 FD, Ofwat estimated ODI risk as the payments earned or lost from a range of performance values around the PCLs in 2025-30.[65] Ofwat used a Monte Carlo simulation as its main approach to estimate this risk. Ofwat's Monte Carlo model simulates how a company might perform across all performance commitments in a given year as follows.

(a) Using all available historical data, Ofwat calculated the difference between actual performance and the PCL for each company, year, and performance commitment.[66]

(b) Ofwat fitted a truncated normal distribution to these performance differences (except for water supply interruptions where it used a log-normal distribution), shifting the mean of the distribution to zero.[67] Ofwat said that it had set the mean performance difference from the PCL to zero to ensure that any historical stretch, where the PCL may have been easier or harder to achieve in the past than in the future, was not carried forward into future performance estimates.[68]

(c) For each company, year, and performance commitment, Ofwat used its fitted distribution to generate 1,000 random draws ('simulations') representing deviations from the PCL.[69]

(d) Ofwat incorporated correlations between performance commitments for two groups:[70] 'Group 1', comprised of internal sewer flooding, external sewer

[65] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p5.
[66] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p6. Ofwat uses the absolute difference between actual performance and the PCL for biodiversity, bathing water quality, the compliance risk index, and serious pollution incidents. For all other performance commitments, Ofwat uses the percentage difference between actual performance and the PCL.
[67] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p13. Where a truncation is applied, Ofwat said it is set at the natural limit of performance or at the performance commitment-specific industry frontier with an uplift. Ofwat additionally apply several company-specific changes to the standard deviation and truncation points of some performance commitments to more closely align with historical performance data. See CMA teach-in on 20 February 2025, slides 48–49.
[68] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p8.
[69] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p7.
[70] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p23. This is based on Ofwat's analysis of correlations between performance commitments using historical data.

flooding, and total pollution incidents; and 'Group 2', comprised of compliance risk index and water quality contacts.

(e) For each simulation, the deviation from the PCL was applied to the PR24 PCL ('anchor point') to produce predicted performance levels for each simulation, company, year, and performance commitment.[71] Using the PR24 PCL anchor point assumed that companies would achieve the PR24 PCL in the average scenario.

(f) Predicted performance levels were converted into annual total ODI payments using the PR24 ODI rates, caps, collars, and deadbands.[72] These were then summed across performance commitments and years to calculate the total ODI payment for each company.

(g) Ofwat calculated the P10 and P90 total ODI payments for each company.[73] The P10 and P90 payments were converted into percentage changes in RoRE by dividing by regulated equity.[74] The expected payment from ODIs was calculated as the mid-point between the P10 and P90 RoRE values.[75]

8.63 Ofwat also estimated the risk arising from measures of experience (C-MeX, D-MeX, BR-MeX and BCEW[76]). Ofwat said that the outcome of customer satisfaction score can be subjective, so estimating future performance was difficult especially as there was a limited pool of four years of historical data.[77] For this reason, Ofwat said that for C-MeX and D-MeX it had assumed that an efficient company earned the collar of payments at the P10, the cap at the P90 and earned payments of zero at the P50.[78] For BR-MeX, as payments were based on relative rankings to other companies, Ofwat assumed the P10 and P90 were set at the upper and lower bound of payments that companies could earn. For BCEW, Ofwat calculated the P10 and P90 values by taking the maximum percentage difference between performance and the PCL observed during PR19 and applied it in both the outperformance and underperformance directions to the average PR24 PCL, setting the P50 to be at the PR24 PCL.[79]

[71] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p21. Ofwat noted that for CRI and Serious Pollution Incidents the mean performance was set to the deadband rather than the PCL. See CMA teach-in on 20 February 2025, slide 71.
[72] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p7.
[73] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p7.
[74] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p7.
[75] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p2.
[76] This performance commitment applies to customers of non-household premises using the supply system of a company operating wholly or mainly in Wales. For the purposes of this performance commitment 'non-household premises' are premises other than 'household premises' (as defined by section 17C of the Act). See Ofwat (2024) Business customers experience in Wales – PC definition.
[77] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p31.
[78] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p31.
[79] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, pp31–32.

8.64 For each bespoke performance commitment, Ofwat estimated a suitable best case and worst case annual performance (P10 and P90). Ofwat set the P50 estimate to be at the PR24 PCL.[80]

8.65 Ofwat's Monte Carlo model (inclusive of the MeX and bespoke performance commitment payments) estimated a return of between -1.90% and 1.52% with an expected payment of -0.17%.[81] Ofwat said that the small negative skew was primarily caused by underperformance-only performance commitments and water supply interruptions which had a large tail of underperformance and a limited potential for outperformance.[82] Ofwat also estimated a simpler additive model as a sense check which showed broadly consistent results.[83]

KPMG's approach

8.66 KPMG's analysis, which accompanied statements of case, had the following key differences to Ofwat's approach.[84]

(a) Range of historical performance data used: KPMG used only AMP7 data, whereas Ofwat used all available historical data which includes AMP7 and AMP6 data.[85] KPMG said that AMP6 data was a poorer proxy for AMP8 risk than AMP7 data because in AMP6 there were fewer common ODIs set with less stretching targets, different performance commitment definitions, fewer extreme weather events, and a smaller, simpler capital programme. In response to follow-up questions KPMG (on behalf of the Disputing Companies) submitted analysis which it stated showed that the range of historical data changed the outcomes base case risk results by 1 basis point for WaSCs and 14 basis points for WoCs.[86]

(b) Choice of performance distribution: KPMG fitted Metalog distributions to the performance data, whereas Ofwat used mainly truncated normal distributions. KPMG said that its Metalog distribution was flexible and captured asymmetry.[87]

(c) Central estimate of performance (or 'anchor point'): KPMG set its anchor point using AMP7 historical data and business plan forecasts, whereas Ofwat used the PR24 PCL.[88]

[80] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p32.
[81] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p33, Table 11.
[82] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p33.
[83] Ofwat (2025) PR24 final determinations: Outcomes approach to risk modelling appendix, p33, Table 11.
[84] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 5.2.
[85] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 2.
[86] Disputing Companies response to Disputing Companies RFI03, Q3, paragraphs 79–80.
[87] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.1.
[88] KPMG calculated the anchor for year t in AMP8 as the midpoint between (1) the average of yearly median actual performance across firms in AMP7, and (2) the median business plan forecast for year t in AMP8.

(d) Choice of correlations: KPMG's correlations broadly aligned with Ofwat's for wastewater performance commitments influenced by precipitation but differed for water performance commitments. Ofwat observed a link between the CRI and water quality contacts, which it stated that KPMG's data did not support, while KPMG identified additional relationships not noted by Ofwat. Overall, KPMG's analysis suggested a higher concentration of risk on water performance commitments, with a similar concentration of risk on wastewater performance commitments.[89]

8.67 KPMG decomposed its base case estimate into: (i) calibration risk, the risk from under- or overperforming Ofwat's PR24 PCL target in the base case; and (ii) design risk, the risk purely from the regulatory incentive mechanisms (assuming base case performance meets the target).[90] KPMG found the design risk for ODIs and MeXes for the base case to be -0.29% for WaSCs and -0.33% for WoCs.[91] KPMG found the calibration risk for ODIs and MeXes for the base case to be -0.40% for WaSCs and -0.45% for WoCs.[92]

8.68 In Ofwat's Response, Ofwat said as follows.

(a) KPMG's anchor point risked capturing historical poor performance and did not sufficiently build in expected performance improvements particularly from companies' cost allowances for final determinations.[93]

(b) Using only PR19 data provided limited information to define the shape of a performance distribution, which Ofwat did not consider to be sufficiently robust. Instead Ofwat managed this uncertainty by adjusting the distribution parameters in its model on a company specific level.[94]

(c) Correlations were used sparingly in Ofwat's model compared to the KPMG model because there had been limited availability of data to inform statistically significant correlations. Ofwat said that it had also tested more extreme correlation scenarios, with results showing that negative skew did not increase from including extra correlations, as increases in payments were curtailed by risk protections.[95]

8.69 In response to the CMA PR24 PD, KPMG updated its analysis to include only 'design risk', with an updated base case of -0.33% for both WaSCs and WoCs,

[89] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.5.
[90] KPMG (2025) Technical session on PR24 risk analysis for a notional company, p32; KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 2.
[91] CMA analysis of KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). See Note 3 for Table 8.2 above for reasons for revisions to KPMG's originally published results.
[92] CMA analysis of KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). See Note 3 for Table 8.2 above for reasons for revisions to KPMG's originally published results.
[93] Ofwat (2025) Response to common issues on outcomes, paragraph 5.10.
[94] Ofwat (2025) Response to common issues on outcomes, pp42–43, paragraph 5.9.
[95] Ofwat (2025) Response to common issues on outcomes, p43, paragraph 5.12.

and with 2 additional sensitivities which did not materially change the estimated skew.[96] We understand that the main reason the skew has slightly increased since KPMG's original analysis was the inclusion of additional Ofwat's risk ranges for ODIs not previously modelled by KPMG.[97]

Our assessment and decisions

8.70 To assess the risk implications of ODIs, it is useful to follow the distinction between 'calibration risk' and 'design risk' introduced by KPMG.

Calibration risk

8.71 Calibration risk arises if PCLs are too stretching, in the sense that a notional company would underperform at least some of its PCLs even in the base case scenario. Ofwat essentially 'assumes away' calibration risk by centring performance distributions around zero, while KPMG essentially assumes that performance distributions for AMP8 will partially reflect those observed for AMP7, implying a significant level of underperformance even in the base case scenario. In other words, KPMG essentially argues that, because water companies tended to underperform their targets in AMP7, we should assume that they will also systematically underperform their targets in AMP8.

8.72 Consistent with the view expressed in the CMA PR24 PD, we consider that KPMG's approach is not valid. We consider that the underperformance observed in AMP7 does not amount to evidence that the process for setting performance commitments systematically overestimates the level of performance that can be achieved by efficient companies. Moreover, the PCL calibration for AMP8 is largely anchored in evidence of AMP7 outturn performance and company forecasts of what was achievable in AMP8, as discussed in more detail in chapter 6 (Outcomes).

8.73 We have reviewed the specific requests submitted by Disputing Companies regarding their PCLs, and we have made some adjustments in response. This is consistent with their submissions to us that we should fix any downside skew at source.[98] In particular, we have applied less demanding PCLs for external sewer flooding (for Anglian), water supply interruptions (common PCL for all companies and company-specific PCL for South East), and leakage (for Anglian and South East) (see chapter 6 (Outcomes), paragraphs 6.235 to 6.241, 6.320, 6.392 and 6.429 (together with Table 6.16)). As a result of our review, we see no basis for concluding that the resulting PCLs remain systematically too ambitious, and we

[96] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), Table 1, p7.
[97] Southern response to Southern RFI15, Q2, pp3-5.
[98] (Non-confidential) transcript of the hearing for Outcomes on 30 June 2025, p10, lines 19–22. See also Anglian SoC, p187, paragraph 707; Southern SoC, p367; Northumbrian SoC, pp112–113, paragraphs 404–408; South East SoC, pp75–76, paragraph 5.48–5.52; and Wessex SoC, pp8–9, paragraph 2.47.

have seen no evidence that the remaining PCLs for which Disputing Companies have not made specific requests are wrongly calibrated. For these reasons, we maintain the conclusion set out in the CMA PR24 PD that our determinations do not give rise to any significant calibration risk in relation to ODIs.

Design risk

8.74 Design risk arises because, for some ODIs, companies face a risk of penalties on the downside that is not compensated by an equivalent probability of rewards on the upside. It is common ground between Ofwat and KPMG that design risk implies a negative skew in expected returns. However, Ofwat and KPMG diverge in terms of their quantitative evaluation of this risk: Ofwat's risk modelling indicated a design risk of –0.22% for WaSCs and –0.25% for WoCs,[99] whereas KPMG's original risk modelling indicated a base case design risk of –0.29% for WaSCs and –0.33% for WoCs,[100] That is, KPMG estimated that the impact on RoRE was roughly 8bps stronger compared to Ofwat. This divergence in overall results is underpinned by differences in assumed distributions, and different assessments regarding the range of ODIs that should be viewed as giving rise to design risk. Table 8.7 below shows the contribution of different ODIs to design risk in KPMG's analysis.

[99] CMA analysis of Ofwat (2024) PR24 final determinations: PR24 RoRE model, PR24-FD-RR04-PR24-RoRE, tab 'Table – PR24 FD RoRE'. As set out in Note 2 for Table 8.2 above, Ofwat's base case risk estimate is the midpoint between its P10 and P90 estimates and is not a P50 estimate.
[100] CMA analysis of KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11). See Note 3 for Table 8.2 above.

Table 8.7: ODI design risk (%RoRE) for WaSCs and WoCs, KPMG

ODIs	KPMG	
	WaSC	WoC
Serious Pollution Incidents	-0.02%	0.00%
CRI	-0.02%	-0.09%
Discharge Compliance	0.00%	N/A
Water Supply Interruptions	-0.04%	-0.15%
Customer Contacts on Water Quality	0.00%	0.00%
Sewer Collapse	-0.01%	N/A
Total Pollution Incidents	-0.10%	N/A
Unplanned Outage	0.00%	0.00%
Internal Sewer Flooding	-0.03%	N/A
Business demand	-0.01%	-0.02%
Mains Repairs	0.01%	0.06%
Leakage	-0.03%	-0.15%
Per Capita Consumption	-0.01%	-0.03%
External Sewer Flooding	-0.03%	N/A
C-Mex	-0.03%	-0.03%
D-Mex	-0.01%	-0.01%

Source: CMA analysis of KPMG 'PR24 notional company risk model' provided in Northumbrian response to Northumbrian RFI01, Q1 (Document 1 of 11).
Note: We decompose design risk from the mean risk (rather than at the median), as the design risk at the P50 for each ODI is 0%. While this approach does not capture design risk at the median, the decomposition from the mean provides an indication of the key drivers of ODI risk.

8.75 In contrast to KPMG's estimates, in Ofwat's assessment, design risk was driven substantially by only four ODIs: serious pollution incidents; compliance risk index; discharge permit compliance; and water supply interruptions.[101] We consider there to be a well-founded basis for treating these four ODIs as giving rise to material design risk.

(a) For the first three of these ODIs, design risk is a 'mechanical' consequence of their structure, as they are 'one-sided' or penalty-only ODIs.[102]

(b) For water supply interruptions, design risk results from the PCL having been set (at 5:00 minutes) close to the 'natural' boundary of zero, in a context where there is a material probability of performance levels that are much worse than the PCL.[103]

8.76 We note that the ODI arrangements in Ofwat's PR24 FD included features that mitigate the impact of the characteristics described in paragraph 8.75(b) above on expected returns: collars were applied to the levels of penalty that can be incurred, and the opportunity to earn materially higher rewards per unit of outperformance was provided for some ODIs (including water supply interruptions) through the use

[101] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p53.
[102] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p53.
[103] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p53, pp84–89; Anglian SoC, paragraphs 549–553; Southern SoC, p387; and South East SoC, paragraph 5.20.

of enhanced ODI rates.[104] However, Ofwat found the characteristics of the water supply interruptions ODI to be such that it was a material source of design risk under its PR24 FD notwithstanding these mitigating features of the framework.[105]

8.77 While there may be scope for design risk stemming from other ODIs to offset this to some extent, we maintain the position we expressed in the CMA PR24 PD that we do not consider the KPMG report to have shown that the assumptions it adopted with respect to additional sources of negative skew were appropriate, or that Ofwat's estimate of design risk associated with its PR24 FD was likely to have been too high, for reasons including the following.

(a) We do not consider the evidence on C-MeX to support KPMG's assumption that there would be a negative skew in expected returns, in line with our assessment in chapter 6 (Outcomes).

(b) We do not consider the KPMG report to have shown that its assessment of AMP7 performance on leakage provides a reliable basis for assuming a negative skew in AMP8 leakage ODI returns, including because of the clawback role the ODI provided for in AMP7.

(c) We consider the KPMG report to have provided limited reasoning or evidence in support of the negative skew it treated as arising across a range of ODIs (including, for example, D-Mex and internal sewer flooding).

8.78 For these reasons, we put more weight on Ofwat's quantitative assessment of design risk and treat it as an upper bound. As set out in chapter 6 (Outcomes), for the water supply interruptions PCL, we have decided to set a less stringent common PCL for all Disputing Companies, to set a company-specific PCL for South East, and to reduce the size of South East's penalty collar to 1% RoRE (instead of 2% in Ofwat's PR24 FD). We expect these changes to reduce the extent of design risk under the ODI arrangements relative to Ofwat's PR24 FD. We therefore conclude that the ODI arrangements would give rise to a slight downside skew for the notional company of less than -0.2%.[106]

Finance risk

8.79 There are two main sources of finance risk to equity investors in the price control, as follows.[107]

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[104] Ofwat (2025) PR24 final determinations: Delivering outcomes for customers and the environment, pp5–6, p26, p28.
[105] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p53.
[106] Ofwat's base-case is stated to be –0.22% for WaSCs and –0.25% for WoCs in KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 2 and Table 3.
[107] In the PR24 final methodology, Ofwat also identified a third source of risk from revenue recovery. However, this is a relatively small risk compared to the inflation and interest rate risk, and therefore we do not cover this in detail in this chapter. Ofwat (2024) PR24 final determinations: Aligning risk and return, pp28–29 and p33. Ofwat's estimated RoRE range for revenue recovery risk is -0.05 to 0.00%.

(a) **Interest rate risk**: when raising new debt, companies may outperform or underperform relative to the benchmark used to set the cost of new debt allowance. According to Ofwat, companies do not face risk on embedded debt as it is expected that the embedded cost of debt allowance provides for efficiently incurred debt costs for a notional company.[108] The issue of embedded debt risk is an area of contention with the Disputing Companies, which we discuss below.

(b) **Inflation**: the RCV is indexed to CPIH but companies may raise nominal fixed, floating or indexed-linked debt (which could be linked to RPI or CPI rather than CPIH). Differences between outturn CPIH, as well as outturn RPI-CPIH and CPI-CPIH wedges, relative to the assumptions used in the price control will lead to deviations in outturn equity returns compared to expectation.

8.80 In its PR24 FD, Ofwat estimated the overall RoRE risk from finance to be in the range of -0.8% to 1.3%, with a mid-point of 0.3%.[109]

8.81 This range was calculated by adding up the risk ranges on inflation, the cost of new debt and the revenue recovery (see Table 8.8 below).[110]

Table 8.8: Ofwat PR24 Finance risk range

	P10	Mid-point	P90
Interest rate risk	-0.2%	N/A	0.3%
Inflation	-0.4%	N/A	0.9%
Revenue recovery	-0.05%	N/A	0%
Total finance risk range	-0.8%	0.3%	1.3%

Source: Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp28–29.

Summary of Disputing Companies' position

8.82 Disputing Companies submitted that Ofwat's PR24 FD is negatively skewed for the notional company, including with respect to the finance risk.[111] [112]

8.83 KPMG, advisers to Anglian, Northumbrian, South East and Southern, originally presented a range of finance risk between -1.92% and 1.66%, at P10 and P90 respectively. KPMG estimated the base case for a notional company on finance risk to be slightly negatively skewed at -0.08% (see Table 8.9 below).

[108] Ofwat (2024) PR24 final determinations: Aligning risk and return, pp28–29.
[109] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p10, Table 1.
[110] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp28–29.
[111] Anglian, Northumbrian, South East and Southern referenced the KPMG risk analysis in their statements of case, with the exception of Wessex who did not comment on finance risk specifically in their representations and focused on the imbalance of the package on Outcomes.
[112] Anglian SoC, p173, paragraph 653, and p174, Table 15; Northumbrian SoC, p111, paragraph 400, Figure 34, and p112, paragraph 403; South East SoC p77, paragraph 6; Southern SoC, pp71–72, paragraphs 83–84, Table 7; Wessex SoC, pp160–161, paragraphs 1.28–1.32.

8.84 To arrive at this risk range, KPMG identified correlations between financing risk components presenting its results on a simulation rather than an additive basis like Ofwat.[113]

Table 8.9: Finance risk range submitted by disputing companies

Finance risk range	P10	Base case	P90
Notional company	-1.92%	-0.08%	1.66%

Sources: Anglian SoC, p174; Southern SoC, p29; South East SoC, p86.

8.85 Table 8.10 below sets out KPMG's estimated financing risk faced by a notional company in AMP8.

Table 8.10: Financing AMP8 simulated risk, KPMG

Category	Worst case	Base case	Best case
Real interest rate, embedded debt	-0.56%	-0.06%	0.44%
Real interest rate, new debt	-0.53%	-0.10%	0.14%
CPIH impact on fixed debt, embedded and new	-1.27%	0.00%	1.29%
RPI-CPIH wedge impact on RPI-linked debt, embedded	-0.37%	0.05%	0.47%
CPI-CPIH wedge impact on CPI-linked debt, embedded and new	0.00%	0.06%	0.12%
Simulated financing risk	-1.92%	-0.08%	1.66%

Source: KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 17.

8.86 KPMG submitted that the key contributors to the negative risk exposure in the base case scenario is performance of the notional company against the allowances on embedded and new debt.[114] KPMG submitted that the cost of embedded debt allowance is lower than the all-in cost of embedded debt for the median company in the sector.[115]

8.87 In response to the CMA PR24 PD, KPMG submitted a revised financing risk range (see Table 8.11 below). The key differences between KPMG's original financing risk range and the response to the CMA PR24 PD's position stems from three changes to the analysis assumptions:

(a) inclusion of CMA PR24 PD long-term CPIH assumption of 2.4%;

(b) updating the cut-off period to CMA PR24 PD (30 June 2025); and

(c) exclusion of cost of embedded debt risk.

[113] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 8.2.7.
[114] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[115] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.

Table 8.11: KPMG revised financing risk range

	P10	*P50*	*P90*
Real interest rate, new debt	-0.19%	-0.10%	0.12%
CPIH impact on fixed debt, embedded and new	-1.27%	-0.25%	0.71%
RPI-CPIH wedge impact on RPI-linked debt, embedded	-0.41%	-0.08%	0.23%
CPI-CPIH wedge impact on CPI-linked debt, embedded and new	-0.09%	-0.04%	0.02%
Financing risk	**-1.83%**	**-0.44%**	**0.91%**

Source: KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), p12.

8.88 In Ofwat's Response, Ofwat submitted that it is unnecessary to use Monte Carlo analysis to understand finance risk, and that KPMG's suggested negative skew on finance risk for an efficient notional company does not match the reality of the underlying evidence base.

(a) Generally, in the past companies have benefited from financing over time. Ofwat noted that reports based on companies' Annual Performance Reports for 2015-20 (AMP6) the median large company reported 1.1% RoRE outperformance and the range of performance was 2.8% to -0.3% RoRE. For the latest period (2020-24) the median large company gained 1.4% and the range was 5.1% to -1.0% RoRE.

(b) Companies may expect to outperform or underperform the cost of debt allowance but this can be a consequence of a number of factors that link also to past financing choices and company performance. Historical evidence suggests that inflation has persistently been above the 2% inflation target set by the Bank of England and companies will continue to benefit from inflation where inflation is above the 2% long term inflation target used in Ofwat's determination.[116]

8.89 We now turn to the detailed submissions on each individual risk component. We discuss interest rate risk on embedded debt, interest rate risk on new debt and inflation risk in turn, before providing our overall conclusion on finance risk.

Interest rate risk on embedded debt

Ofwat's PR24 FD approach

8.90 Ofwat did not include any risk from embedded debt in its risk modelling. This is because Ofwat stated that the cost of embedded debt allowance provides appropriate remuneration for efficiently incurred embedded debt for the notional company. While actual company costs will deviate from the allowance, this deviation reflects past financing choices and is a known risk to equity investors,

[116] Ofwat (2025) Response to common issues on risk and return, pp37–38, paragraph 2.43.

which is not relevant to a forward-looking assessment of risk for a notional company.[117]

Disputing Companies submissions

8.91 In its original analysis, KPMG estimated an interest rate risk range for embedded debt by considering the differences between the sector's expected cost of debt performance 'all-in' cost of embedded debt by company to the allowance.[118]

Ofwat's response

8.92 On risk exposure from embedded debt, Ofwat submitted that the difference in cost between companies' embedded debt and the allowance must be allocated to companies and should not be part of the forward-looking assessment of returns at risk in setting price controls for a company with the notional capital structure.[119] Ofwat submitted that over the long term, the companies are responsible for their own financing strategies (including the quantum of debt raised, the type of debt raised and the duration).[120] This approach, Ofwat submitted, is consistent with previous determinations.[121]

Our assessment and decision

8.93 We maintain our provisional view on embedded debt risk and therefore assume it does not give rise to finance risk for the notional firm. We agree with Ofwat that for the notionally efficient firm the risk from embedded debt is not a risk which needs to be explicitly factored into the risk modelling. Individual companies will outperform or underperform relative to the allowance but there is no impact on the expected base return on equity for the notionally efficient firm. It is another form of 'calibration risk' in KPMG's model which should not be included in the risk modelling in our view.

Interest rate risk on new debt

Ofwat's PR24 FD approach

8.94 To estimate the risk range associated with raising new debt, Ofwat analysed water company bond issuances over the most recent five-year period to September 2024. Ofwat included 72 instruments issued by the water companies with an initial tenor of more than ten years between November 2019 and September 2024.

[117] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp28–29.
[118] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, Table 7 and section 6.3.5.
[119] Ofwat (2025) Response to common issues on risk and return, p34, paragraph 2.32.
[120] Ofwat (2025) Response to common issues on risk and return, p34, paragraph 2.32.
[121] Ofwat (2025) Response to common issues on risk and return, p34, paragraph 2.33.

8.95 Ofwat compared the rates achieved on these bonds to the average iBoxx benchmark value for the financial year in which the debt was issued to establish the P10, P50 and P90 range. It then added the 30bps benchmark adjustment (consistent with Ofwat's cost of new debt methodology). Based on this analysis, Ofwat estimated a risk range of -0.28% to 0.30%.[122]

Disputing Companies submissions

8.96 For cost of new debt risk, KPMG submitted that the allowance based on the iBoxx A/BBB indices is significantly lower than the cost of new debt issuances achieved by water companies in the last 12 months.[123]

8.97 KPMG carried out its risk analysis of the cost of new debt using 15 instruments issued by water companies between November 2022 and April 2024. KPMG selected the sample of 15 instruments by applying the following criteria:

(a) GBP denominated;

(b) fixed rate debt;

(c) instruments with no embedded derivatives (eg callable); and

(d) instruments issued between November 2022 and October 2024.[124]

8.98 KPMG controlled the instruments[125] both for the rating of the bond at issuance and the tenor of the bond by matching the tenor of the bond to the corresponding tenor on the relevant iBoxx index.[126] KPMG submitted that inclusion of instruments prior to November 2022 would not appear to be representative of future borrowing costs due to market distortions arising from large sections of the economy being shut down during COVID-19, with water and utility companies generally priced more favourably. KPMG stated that water companies had been able to issue bonds in line with the iBoxx benchmark until November 2022. Since then, nearly all new bonds had been issued at a cost above the benchmark, indicating that the iBoxx benchmark has become increasingly unachievable for water companies.[127]

8.99 In response to the CMA PR24 PD, KPMG updated its original analysis and submitted that using CMA's PR24 PD cut-off date (end of June 2025), the base case continues to show a negative skew of -10bps.[128] KPMG further submitted

[122] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p33.
[123] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[124] Southern response to Southern RFI05, Q5, p4.
[125] In its analysis KPMG compared each selected bond's yield at issuance to a simulated iBoxx yield curve (the hypothetical curve for iBoxx A and BBB) which corresponds to the bond's credit rating at the time of issue. Southern response to Southern RFI05, Q5, p4.
[126] Southern response to Southern RFI05, Q5, p4.
[127] Southern response to Southern RFI05, Q5, p4.
[128] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraph 2.2.9.

that the negative skew was primarily driven by the 9 out of 15 water sector bonds issued between November 2022 and June 2025 at yields greater than that of the tenor-adjusted benchmark iBoxx + 30bps.[129]

Ofwat's response

8.100 Ofwat submitted that it was not clear which data range KPMG had used (in KPMG's statement of case analysis) and that Ofwat did not publish its own analysis due to licensing reasons.[130] Ofwat also submitted that it was not clear how a perfect correlation between embedded and cost of new debt of 1 was derived by KPMG.[131] Ofwat submitted that it is not necessarily the case that companies with new debt above the benchmark will also have expensive embedded debt.[132] Companies' ability to raise debt can change over time and debt spreads to Ofwat's benchmark can also change over time.[133]

8.101 In response to the CMA's PR24 PD, Ofwat submitted that it agreed with the conclusion that the distribution of outcomes around a suitably calibrated allowance is balanced.[134] Ofwat submitted that rather than seek to understand the accuracy of calibration of the cost of new debt in previous determinations, we should consider the balance of risk by applying the notion that interest rates cannot be predicted (the trend in interest rates is a random walk), and therefore looking at a specific point in time to assess the accuracy of the calibration is not useful.[135]

8.102 Ofwat submitted that the risk should be relatively symmetrical if the allowance is appropriately set.[136] Ofwat noted that if the benchmark adjustment is based on best available evidence at a point in time, the risk that of the benchmark being too high or too low after that point should be roughly balanced.[137]

Our assessment and decision

8.103 In setting the cost of new debt allowance, we have sought to ensure that it appropriately remunerates the notional firm for efficiently incurred costs (see 'Cost of new debt' at chapter 7 (Allowed return) above). Therefore, our starting position is that interest rate risk on new debt should be broadly balanced for the notional firm on a forward-looking basis.

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[129] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraph 2.2.9.
[130] Ofwat (2025) Response to common issues on risk and return, p34, paragraph 2.34.
[131] Ofwat (2025) Response to common issues on risk and return, p34–35, paragraph 2.35.
[132] Ofwat (2025) Response to common issues on risk and return, pp34–35, paragraph 2.35. Ofwat used Thames Water as an example where in 2023 Thames Water issued a 17-year bond at 191bps more than the benchmark index but the cost of Thames Water's embedded debt is median in the industry.
[133] Ofwat (2025) Response to common issues on risk and return, pp34–35, paragraph 2.35.
[134] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 8.6.
[135] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 8.7.
[136] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 8.8.
[137] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 8.8.

8.104 While a backward-looking analysis of how companies would have performed under the chosen PR24 cost of debt allowance may have provided some useful context during the PR24 methodology development and as new information was emerging from the debt markets, we have given sufficient weight to recent debt issuance trends in setting the cost of new debt allowance. Therefore, we do not consider further analysis of historical issuances to be necessary to assess the risk on the cost of new debt.

8.105 We conclude in chapter 7 (Allowed return) above that our cost of new debt allowance is correctly calibrated (see section titled 'Cost of new debt' above). We therefore conclude that the risk to the notional firm of out- or underperforming on the cost of new debt is broadly balanced.

Inflation risk

Ofwat's PR24 FD approach

8.106 Ofwat based its assessment of inflation risk impacts using historical inflation data from 1997 when the Bank of England gained independence. Ofwat found overall that there was likely to be a positive skew from inflation with a risk range of -0.37% to 0.94%.[138]

8.107 This range is based on Ofwat's analysis which considered how the notional company would have performed on inflation against a series of modelled 5-year periods, starting from 1997 on a monthly basis, and found that on average companies would have more often benefitted rather than lost under the PR24 arrangements. However, Ofwat noted that these gains and losses were generally modest.[139]

Disputing Companies' submissions

8.108 On behalf of Anglian, Northumbrian, South East and Southern, KPMG originally submitted that Ofwat's PR24 FD provides some protection against deviations from the long-term CPIH assumption, since the variance to the long-term assumption in excess of ±1% requires the governor of the Bank of England to write a letter to the Chancellor.[140] However, KPMG submitted that historical series of CPIH from April 2000 suggested that variation in excess of the allowed threshold can occur with a worst case/best case of 0.9% to 4%.[141]

[138] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p33.
[139] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp31–32.
[140] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[141] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.

8.109 KPMG also submitted that companies face basis risk should the outturn RPI-CPIH wedge exceed the assumed long-term wedge of 0.90% in Ofwat's PR24 FD.[142] The basis risk primarily arises on embedded debt given that companies still have a significant portion of RPI-linked debt due to the limited availability of CPIH-linked debt in the market.[143]

8.110 KPMG submitted that Ofwat's PR24 FD incorrectly assumes that all non-CPIH index linked debt is linked to RPI despite 3% of current debt being indexed to CPI.[144] KPMG submitted that an efficient notional firm is exposed to the CPIH-CPI wedge because new debt issuances were likely to be CPI-linked as a result of a lack of liquidity in the CPIH market.[145]

8.111 KPMG submitted that the approach it had taken to estimating the forward-looking inflation was underpinned by academic literature and best captured the higher volatility in inflation which had been observed post-COVID-19.[146]

8.112 KPMG's approach to estimating inflationary risk for each inflation parameter (CPIH, RPI-CPIH and CPI-CPIH) used Monte Carlo simulations based on historical monthly data from March 1997.[147]

8.113 KPMG considered 11 distinct time series statistical models to model each inflation parameter and used the Akaike Information Criterion (**AIC**) to choose an optimal model for each.[148]

8.114 To estimate the CPIH inflation risk range, KPMG said that it chose to use the Brownian Motion Process with Mean Reversion and Jump Diffusion due to its common use of modelling continuous processes.[149] KPMG submitted that its choice of the model was based on the model's ability to account for possible material and sudden changes, such as jumps.[150] KPMG submitted that higher the volatility in the dataset, the higher the size of the jumps that occur across the forward-looking period.[151]

8.115 In response to the CMA PR24 PD, KPMG submitted a revised inflation analysis, updated for the long-term CPIH assumption from 2.0% to 2.4% and for the CMA PR24 PD cut-off date. KPMG submitted that its updated analysis showed a downward skew in inflation risk in the base case of -37bps (see Table 8.12 below) using KPMG's methodology and between -14bps and -50bps using Ofwat's

[142] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[143] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[144] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[145] KPMG (2025) PR24 Final Determinations – risk analysis for a notional company, section 6.3.5.
[146] Southern response to Disputing Companies RFI05, Q1–2.
[147] Southern response to Disputing Companies RFI05, Q1.
[148] Southern response to Disputing Companies RFI05, p8, Q9. AIC is a statistical measure used to estimate the relative quality of different models from a given set of data.
[149] Southern response to Disputing Companies RFI05, p2, Q2.
[150] Southern response to Disputing Companies RFI05, p2, Q2.
[151] Southern response to Disputing Companies RFI05, p2, Q2.

methodology (depending on whether the mid-point or the P50 is taken as the base case).

Table 8.12: Disputing Companies' RoRE impact of inflation calibration (reflecting CMA PR24 PD inflation assumption)

PD based on Ofwat FD approach				*KPMG*
Updated to reflect 2.4% long-term CPIH assumption		**Updated cut-off to June 2025**		**Updated to reflect 2.4% long-term CPIH assumption and cut-off to June 2025**
Mid-point	**P50**	**Mid-point**	**P50**	**P50**
-20bps	-55bps	-14bps	-50bps	-37bps

Source: KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), Table 2, p10.

8.116 KPMG submitted that it would be more appropriate to measure the central tendency for inflation using the median rather than the mid-point (as used by Ofwat) to ensure that the impact of the skew in the dataset is captured.[152] It noted that Ofwat's PR24 FD analysis showed a positive mid-point of inflation RoRE whereas the median (P50) was negative.[153]

Ofwat's response

8.117 Ofwat submitted that it considered it unnecessary to use Monte Carlo analysis to understand finance risk.[154] Ofwat submitted that it was not clear how the correlation assumptions were arrived at by KPMG for individual elements of inflation modelled through the Monte Carlo simulation.[155]

8.118 Using historical RPI and CPIH data, Ofwat submitted that while the median value of both CPI and CPIH has been close to 2% but on average both have exceeded this value for the period since the Bank of England was given its independence (in May 1997).[156]

8.119 Ofwat submitted that in its PR24 DD and its PR24 FD finance risk modelling it did not include the CPIH-CPI wedge risk due to the small amount of CPI-linked debt issued by companies.[157] In response to the Disputing Companies, Ofwat performed analysis which assumed that 4% of debt was linked to CPI and found that the impact of the CPI to CPIH wedge was insignificant (see Table 8.13 below

[152] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraph 2.2.6.
[153] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraph 2.2.6.
[154] Ofwat (2025) Response to common issues on risk and return, p37, paragraph 2.43.
[155] Ofwat (2025) Response to common issues on risk and return, p35, paragraph 2.37.
[156] Ofwat (2025) Response to common issues on risk and return, p36, paragraph 2.40.
[157] Ofwat (2025) Response to common issues on risk and return, p36. paragraph 2.39.

noting that RoRE P10 and RoRE P90 rows in columns 'FD' and 'FD including CPI/CPIH wedge impact' are identical).[158]

8.120 Ofwat stated that inflation risk has a positive skew in the calculation of risk ranges, and that this result is not dependent on the specification of the notional company as it arises in any situation where fixed rate debt is in place. Ofwat submitted that its analysis showed that the P90 was greater (in absolute terms) than the P10 for a large range of possible structures (see Table 8.13 below).[159]

Table 8.13: Ofwat's analysis of inflation RoRE risk including and excluding CPI-linked debt

			Sensitivities		
	FD	**FD including CPI/CPIH wedge impact**	**Higher gearing**	**Double indexed linked debt**	**Higher gearing and indexed linked debt**
Gearing	55%	55%	70%	55%	70%
RPI-linked	33%	29%	29%	58%	58%
CPI-linked	0%	4%	4%	8%	8%
Fixed	67%	67%	67%	34%	34%
Impact on equity from CPIH	82%	82%	156%	42%	79%
Impact on equity from RPI wedge	40%	36%	68%	71%	136%
Impact on equity from CPI wedge	0%	5%	9%	9%	18%
RORE 10	-0.4%	-0.4%	-0.7%	-0.2%	-0.4%
RORE 90	1.0%	1.0%	1.8%	0.6%	1.1%

Source: Ofwat (2025) Response to common issues on risk and return, Table 2.1, p37.

8.121 In response to the CMA PR24 PD, Ofwat submitted three reasons why it would not be appropriate to work on the previously held assumption that in the long term the inflation would broadly balance out. These are set out in more detail in chapter 7 (Allowed return), paragraph 7.58 above, but in short: refer to more volatile and sticky inflation post 2022; state that inflation post 2030 should not be expected to be below the OBR long-term forecast of 2.4%; and state that regulatory mechanisms may not mitigate this issue in the future.

Our assessment and decision

8.122 First, we consider this issue conceptually, before commenting on the specific modelling approaches.

8.123 In general, when firms make decisions about the optimal mix of debt financing (nominal vs index-linked) we do not expect equity investors to systematically 'benefit or lose' from these decisions. While treasury decisions will inevitably reflect particular expectations about inflation and interest rates, we do not expect company treasuries to be able to systematically 'beat the market'.

[158] Ofwat (2025) Response to common issues on risk and return, p36, paragraph 2.40.
[159] Ofwat (2025) Response to common issues on risk and return, pp36–37, paragraph 2.41.

8.124 Using similar reasoning, provided that the regulator's inflation assumptions in a price control are not systematically biased relative to market's inflation expectations, our starting point is that inflation should have a relatively neutral impact on the base expected return on equity, ie we do not expect a positive or a negative skew in returns. In other words, we conclude that there should be no calibration risk on inflation, similar to costs and ODIs.

8.125 We now move onto the question of whether design risk is present in the inflation risk (or put differently, whether inflation risk might be inherently asymmetric).

8.126 We note that sector regulators, including Ofwat, tend to anchor their long-term inflation forecasts around official inflation targets. This was also the case in Ofwat's PR24 FD where Ofwat assumed a long-term CPIH of 2% (based on the official Bank of England target of 2% for CPI and an assumption that CPIH would outturn at similar levels to CPI over the long-term).

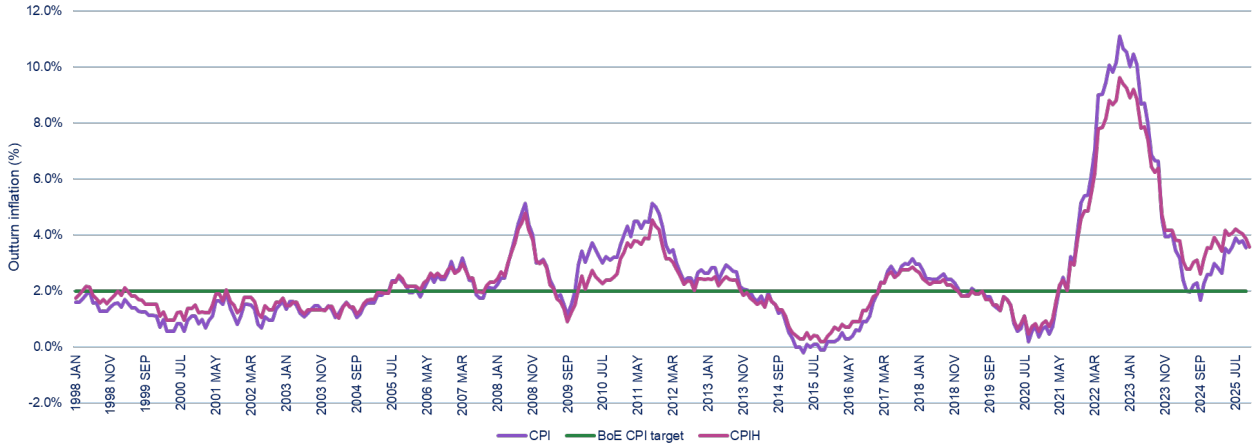
8.127 Our approach is to use a 2.4% long-term CPIH, rather than 2% (see chapter 7 (Allowed return)). We would also describe it as an approach rooted in official targets, as it is based on the OBR's official view of the long-term wedge between CPIH and CPI.

8.128 Intuitively we see merit in Ofwat's argument that inflation risk is likely to be asymmetric as inflation can overshoot official targets by a wide margin but deflation is relatively rare. This means that if the regulator's inflation assumption is anchored around official targets, gains to equity investors from outturn inflation being different to the regulator's assumption might be slightly more likely than losses.

8.129 For example, while historically the median value of both CPI and CPIH has been close to 2.0%, on average both measures of inflation have been higher than 2.0% (see Figure 8.1 below).[160] This means that although the probability of inflation being higher or lower than the target is broadly similar, when inflation deviates from target, the gains to equity tend to be larger than the losses.

[160] Over the period from January 1998 and November 2025, CPI and CPIH have averaged at 2.5%.

Figure 8.1: Historical CPI and CPIH outturn compared to Bank of England 2.0% CPI target



Source: CMA analysis of ONS data.

8.130 Updating the long-term CPIH assumption to 2.4% to better match the future inflation environment does not inherently affect this potential asymmetry in outturn inflation. Further, as noted earlier in chapter 7 (Allowed return), the inflation environment has changed since 2022, with higher volatility in inflation and with the tendency for inflation to be stickier. This has certainly been the case so far in 2025/26, the first year of AMP8. For the first 8 months of 2025/26 (ie April to November), CPI and CPIH have averaged at 3.6% and 4.0% respectively, well above the BoE's official target of 2.0% CPI and OBR's long-term CPIH assumption of 2.4%.[161] As shown in Table 7.2 in chapter 7 (Allowed return), CPI and CPIH are also forecast to exceed 2.0% and 2.4% respectively on average over AMP8.

8.131 When considering the design risk in the context of this price control, we think it is reasonable to assume that inflation risk is not symmetric and the upside to equity from the inflation being above our long-term forecast is likely to be higher than the downside from the inflation being below the forecast. This can give rise to a positive skew on RoRE.

8.132 Regarding the specifics of Ofwat's and KPMG's modelling approaches, we regard Ofwat's modelling as more intuitive, compared to KPMG's original Monte Carlo simulations submitted with the statements of case. In response to the CMA PR24 PD, KPMG presented an alternative calculation using Ofwat's modelling approach.

8.133 We observe that KPMG's updated inflation risk modelling, using Ofwat's approach, presents a negative skew (set out in Figure 8.1 above). The main drivers of the negative skew are the use of a 2.4% CPIH assumption throughout the analysis period and the focus on the median.

[161] ONS (2026) Consumer price inflation, UK: December 2025, Table 1. The average CPIH and CPI inflation figures quoted in the text reflect average inflation between April 2025 and November 2025 reflecting the beginning of the first year of AMP8 and our cutoff date (end of November 2025). Average CPI and CPIH for 2025 calendar year were 3.4% and 3.6% respectively.

8.134 We do not consider it reasonable to use a 2.4% forward-looking CPIH in this type of historical analysis, at least not over the full period. We recognise in chapter 7 (Allowed return) that a long-term CPIH of 2.4% is a break from the past and therefore assessing how companies may have fared historically under this revised inflation assumption is not particularly meaningful. This would have the effect of imposing our view of future inflation environment, which we recognise to be different from the past, onto historical data.

8.135 We also do not consider the median to be informative of the base case in this instance. For example, a median (P50) close to zero simply means that around half the time the RoRE impact from inflation will be positive and half the time the RoRE impact will be negative. What matters from a returns perspective and for the balance of risk is the expected RoRE impact, measured by the mean. As discussed in paragraph 8.129 above, average (mean) inflation has exceeded official targets since January 1998. This accords with the intuition that on average the RoRE upside to equity when inflation is above target is larger in absolute terms than the RoRE downside, giving rise to an upward skew.

8.136 In addition, observing current levels of inflation during the first year of AMP8, it is evident that the inflation is currently well above the inflation target. While inflation is forecast to come down by the end of the AMP, we consider that this is further evidence that inflation risk is likely to be asymmetric in this AMP.

8.137 In summary, we conclude that inflation upside is more likely than inflation downside. We do not quantify it precisely, but we note that each 0.1% upside in CPIH over the price control is worth about 8bps of RoRE.[162]

Conclusion on finance risk

8.138 Overall, the main issue on finance risk is whether intuitively and empirically a negative or a positive skew is more likely in the base case.

8.139 Our conclusion is that an assumption of a small positive skew on finance is reasonable, due to the impact of inflation. This is because we do not expect companies to systematically outperform or underperform the real cost of debt allowance, but we consider that there is a sound basis to assume that inflation risk is asymmetric, with potential gains to equity higher than potential losses when inflation deviates from our price control assumption.

[162] At 55% notional gearing and a 67/33 split between nominal and index-linked debt, the impact on RoRE for each 0.1% deviation of CPIH from 2.4% is worth 0.1%*55%*67% / (1-55%) = 0.082%. This is also shown in Table 8.13 above. The overall impact on RoRE will also depend on whether the outturn RPI-CPIH wedge and CPIH-CPI wedge deviate from our forecast.

Our assessment and decision

8.140 We conclude that the overall package is broadly balanced:

(a) on costs, we conclude that there is no reason to assume the notional company would systematically over- or under-spend relative to allowances;

(b) on outcomes, we conclude that the ODI regime gives rise to a slight RoRE downside of less than -0.2%, given the design of some ODIs; and

(c) on finance, we conclude that exposure to inflation is likely to be asymmetric for the notional company, giving rise to some RoRE upside.

8.141 Estimating expected RoRE ranges is inevitably an uncertain and subjective exercise. While quantitative risk analysis can help to understand the broad range of possible returns, it is important to stand back and consider the evidence in the round. We conclude that the package overall is consistent with giving the notional company a fair opportunity to earn its cost of equity, with any inherent asymmetries on outcomes and inflation likely to be modest and broadly cancelling each other out.

ASMs (ie Aggregate Sharing Mechanisms)

Ofwat's PR24 FD approach

8.142 In its PR24 FD, Ofwat introduced a separate ASM for outcomes and for wholesale cost allowances.[163] Ofwat noted that the inclusion of an aggregate sharing mechanism provides greater certainty to companies and investors about the overall range of the financial incentives for the 2025-30 period given the step change in investment that is required in AMP8.[164]

8.143 The thresholds proposed for totex and outcomes at PR24 DD were maintained in Ofwat's PR24 FD, with Ofwat concluding that they provide an appropriate balance between maintaining strong incentives for companies to improve services to customers (considering the whole of the real allowed return on equity is at risk in the event of material underperformance) and maintaining the principle of symmetry in the balance of risk and return where investors could earn double digit returns for exceptional levels of outperformance.[165]

[163] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.
[164] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.
[165] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.

Wholesale totex Aggregate Sharing Mechanism

8.144 The wholesale totex Aggregate Sharing Mechanism (**totex ASM**) applies to the costs incurred over the full 5 years of the price control where the net return on equity outperformance or underperformance due to wholesale costs performance exceeds a trigger of 200 bps of the RoRE over the 5 years.[166]

8.145 The totex ASM applies additional sharing of overspend or underspend with customers beyond the 'cost sharing' mechanism. A company will share 50% of the financial impact post-'cost sharing' greater than ±2% RoRE.[167]

8.146 The totex ASM will reduce the effect of outperformance or underperformance on equity returns by 50% once a 200bps return on equity trigger has been passed. There will be a single calculation across the five years for each company at the Appointee level across the wholesale price controls but will exclude any adjustments from PCDs.[168]

Outcomes Aggregate Sharing Mechanism

8.147 The Outcomes Aggregate Sharing Mechanism (**outcomes ASM**) is triggered on an annual basis where net ODI payments exceed a threshold of ±300bps of regulatory equity (at which point payments between 300 and 500bps are reduced by 50% ie the excess payments are shared between companies and customers on a 50:50 basis). In addition, if returns exceed ±500bps of regulatory equity in a year, the excess beyond this threshold would be reduced by 90% (ie with companies bearing 10% of the excess payments and customers 90%).[169] [170]

8.148 Ofwat stated that the higher threshold for outcomes than for costs was devised to maintain the relative strength of the incentives on companies to improve services to customers and the environment.[171]

8.149 For PR24, the outcomes ASM was designed to reduce the impact on customer bills and equity returns of extreme levels of out- and underperformance. The outcomes ASM covers the equity returns generated from the outcomes package, including C-MeX, D-MeX, BR-MeX and BCEW.[172]

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[166] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.
[167] Southern SoC, Annex 5, paragraph 8.
[168] Ofwat response to common issues on risk and return, p43, paragraph 2.64.
[169] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.
[170] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p48.
[171] Ofwat (2024) PR24 final determinations: Aligning risk and return, p20.
[172] Ofwat (2024) PR24 final determinations: Delivering outcomes for customers and the environment, p48.

Parties' submissions

Disputing Companies

8.150 Two Disputing Companies, South East and Southern, submitted that the current design of the ASMs (totex ASM and outcomes ASM) limits their effectiveness as a risk mitigation tool due to their wide thresholds.

8.151 Southern submitted that the ASM does not provide sufficient risk mitigation in a plausible downside scenario because the combined ASM thresholds are set at 500bps RoRE before any benefit is granted to the companies.[173]

8.152 Southern submitted that the thresholds set are a policy decision which leaves the entire cost of equity at risk and has no connection to the financeability assessment.[174] Southern noted that the combined ASM package allows for potentially 500bps RoRE (approximately £182 million each year) underperformance to occur before any protection is afforded to the companies.[175]

8.153 Southern submitted that there is an inconsistency in the approach to the design of the ASMs, with the totex ASM applying to both water and wastewater price controls but with the outcomes ASM applying separately to water and wastewater price control ODIs.[176] Southern submitted that such inconsistency may discriminate (positively or negatively) against companies based on whether they are a WoC or a WaSC.[177]

8.154 South East submitted that the ASM thresholds should be changed to support a notional company with financeability.[178]

8.155 Both South East and Southern submitted the following remedy:

(a) to amend the ASM thresholds across the totex ASM and outcomes ASM so that they sum to ±300bps with 50% sharing and ±400bps with 90% sharing:

(i) totex ASM: 50% sharing at ±150bps and 90% sharing at ±200bps; and

(ii) outcomes ASM: 50% sharing at ±150bps and 90% sharing at ±200bps.[179] [180]

[173] Southern SoC, Appendix 2, p559, paragraph 8.
[174] Southern SoC, p86, paragraph 169.
[175] Southern SoC, p86, paragraph 169.
[176] Southern SoC, p86, paragraph 170.
[177] Southern SoC, p86, paragraph 170.
[178] South East SoC, p90, paragraph 7.34(c) and footnote 136.
[179] Southern SoC, pp104–105, paragraph 281.
[180] South East SoC, p90, paragraph 7.34(c).

8.156 In addition, Southern proposed to separate the totex ASM between water and wastewater price controls to align with the outcomes ASM.[181]

8.157 Anglian and Wessex did not raise the ASM design as a concern in their statements of case. Northumbrian submitted that the ASM and the OAM are mitigants for the more extreme variations in operational performance but do not alter the inherent asymmetry in the package.[182]

Ofwat

8.158 Ofwat submitted that a recalibration of the ASM thresholds is neither necessary nor appropriate. Reducing the thresholds for the aggregate sharing mechanisms would have the effect of dialling down the incentives on poorer performing companies to deliver improved levels of service to customers.[183]

8.159 During hearings with the CMA, Ofwat noted that its Board wanted to ensure that the incentive regime was strong enough to drive companies and management to improve performance.[184] For companies to have the full base return at risk would only occur where a company is breaching both ASM thresholds on costs and outcomes, which is an extreme scenario.[185]

8.160 Ofwat also noted that should the totex ASM be split between water and wastewater, this would result in halving the impact of the incentive.[186] Ofwat also submitted that keeping the totex ASM as a whole would incentivise the companies to invest in areas where it is needed.[187]

8.161 Ofwat presented an example that should the totex ASM be split between water and wastewater, the incentives to overspend on a service on which a company was already overspending would increase. However, incentives to underspend on a service on which a company was not overspending would increase regardless of whether such investment was worthwhile.[188]

Disputing Companies' response

8.162 Disputing Companies noted during hearings with the CMA that there are many pressures and drivers that incentivise companies to perform, outside of the ASM

[181] Southern SoC, p104, paragraph 281.
[182] Northumbrian SoC, p47, paragraph 147.
[183] Ofwat response to common issues on risk and return, p44, paragraph 2.68.
[184] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p19, lines 2–3.
[185] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p19, lines 23–25.
[186] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p57, lines 7–9.
[187] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p57, lines 14–15.
[188] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p57, lines 7–13.

thresholds.[189] Disputing Companies submitted that doubling the penalties would not make them work harder to achieve a better outcome.[190]

8.163 Disputing Companies drew a comparison with Ofgem's RIIO-3 Draft Determination[191] in which Ofgem proposed to set the risk mechanism[192] at a level that ensures that effectively the equity return does not fall below the debt return and in a downside scenario the company would be protected from falling into a sub-investment grade credit rating.[193]

8.164 As to whether the totex ASM should be split between water and wastewater, the Disputing Companies submitted that a large proportion of the capital programme is covered by statutory requirements.[194] The Disputing Companies submitted that the separation between water and wastewater price control exists to equalise the incentives between water only and sewerage companies and the same should apply to the totex ASM.[195]

Disputing Companies' responses to the CMA PR24 PD

8.165 In response to the CMA PR24 PD, in which we provisionally retained the ASM in its current form, Southern continued to argue that changes to the ASMs' design are necessary but agreed that setting the ASMs' thresholds is a regulatory judgement and that the determination should not protect against risk in all scenarios. However, Southern argued that there had been a history of regulatory miscalibration over AMP7 for both ODIs and totex, and much of the AMP8 approach uses the same methodology. Southern submitted that its proposed ASMs thresholds create protections against this, particularly in an environment with such material step-change in capital delivery and very large equity requirements of the sector.[196]

8.166 Southern submitted that lowering the ASMs thresholds is one of the potential mechanisms to enable a notional company to maintain two investment grade credit ratings in a plausible downside scenario.[197]

8.167 Southern submitted that it provided various evidence that: (1) a plausible downside scenario exceeds 300bps on RoRE in aggregate and 200bps on totex; (2) that

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[189] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p20, lines 19–23.
[190] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p20, lines 23–24.
[191] Ofgem (2025) RIIO-3 Draft Determinations for the Electricity Transmission, Gas Distribution and Gas Transmission sectors.
[192] Ofgem introduced a risk protection mechanism for customers and investors in RIIO-2 called Regulatory Adjustment Mechanisms (**RAM**). The intention of the RAM is to protect customers and investors in the event that network company returns are significantly higher or lower than anticipated at the time of setting the price control. Ofgem (2025) RIIO-3 Draft Determinations for the Electricity Transmission, Gas Distribution and Gas Transmission sectors: Finance Annex, pp133–141.
[193] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p17, lines 18–19.
[194] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p58, lines 20–21.
[195] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p58, lines 22–25 to p59, line 1.
[196] Southern (2025) Response to CMA PR24 PD, paragraphs 2.83–2.85, p42.
[197] Southern (2025) Response to CMA PR24 PD, paragraph 1.21, p7.

there is insufficient downside protection in that scenario; and (3) performance in this plausible downside scenario would likely incur a loss of the investment grade credit rating for the notional company.[198]

8.168 Southern submitted that in comparison to the energy sector, should Southern overspend its totex allowance it would face a materially higher exposure than the median energy networks under AMP6 and AMP7 overspends, and 15-20bps higher exposure than for the median WaSC.[199] Southern submitted that lowering the totex ASM and introducing the additional 90% sharing threshold would reduce cross-sector risk inequality and improve investability.[200]

8.169 In response to our provisional decision not to split the totex ASM between water and wastewater, Southern submitted that:

(a) a combined price control totex ASM means the level of protection offered to water overspend is lower than wastewater and materially so for Southern;

(b) the majority of the enhancement schemes in AMP8 relate to regulatory requirements and companies will endeavour to deliver schemes across water and wastewater and cannot materially scale down delivery under one to prioritise another; and

(c) the sector is spending materially more on water than wastewater relative to RCV (95% compared to 88% respectively for WaSCs) and Southern's water capital intensity is 141%, the second largest behind only Hafren Dyfrdwy.[201]

Our assessment and decision

8.170 The totex and outcomes ASMs have been introduced as an additional risk mitigation tool for PR24, with broad support from stakeholders throughout the PR24 methodology development.[202] As no party suggested removing the ASMs, we retain the ASMs.

Separation of totex ASM between water and wastewater

8.171 In relation to the request to separate the totex ASM between water and wastewater we do not consider it necessary.

8.172 Totex ASM was introduced in PR24 to provide a symmetrical protection for both customers and companies in events of extreme over- or under-spend on totex. No

[198] Southern (2025) Response to CMA PR24 PD, paragraph 2.84, p42.
[199] Southern (2025) Response to CMA PR24 PD, paragraph 2.68, p37.
[200] Southern (2025) Response to CMA PR24 PD, paragraph 2.80–81, p42.
[201] Southern (2025) Response to CMA PR24 PD, paragraph 2.78, pp41–42.
[202] Ofwat (2022) PR24 Draft methodology: Appendix 8 – Outcome delivery incentives, pp47–48. Ofwat (2022) PR24 Final methodology: Appendix 8 – Outcome delivery incentives, pp57–60. Ofwat (2024) PR24 Draft determinations: Delivering outcomes for customers and the environment, p34.

such mechanism existed in previous price controls (Outcomes ASM was introduced in PR19[203]).

8.173 Additionally, the totex ASM threshold is set at ±200bps (2% RoRE), 100bps lower than the Outcomes ASM threshold (±300bps). We therefore consider that the lower threshold provides further protection for the companies, should they overspend, which historically was not available.

8.174 We agree with Ofwat and maintain our view from the CMA PR24 PD that splitting the mechanism would increase the risk protection for the Disputing Companies. A WaSC would then need to only overspend or underspend by more than the threshold on one of the services for the ASM to kick in, rather than in aggregate. This is because the RoRE impact of the overspend or underspend would be measured relative to the equity RCV for that service (water or wastewater), rather than combined wholesale equity RCV. As the purpose of the ASM is to provide protection against relatively extreme performance, we do not think that increasing the level of protection is necessary. We also do not consider that this approach discriminates between WaSCs and WoCs. We consider it an appropriate approach that cost overspends or underspends are considered relative to the overall equity RCV for that company (regardless of whether it is a WaSC or a WoC) as this is what reflects the total shareholder capital at risk.

8.175 Regarding Southern's argument around differences in capital intensity between water and wastewater, and in aggregate between companies, we consider that setting the threshold using wholesale equity RCV remains appropriate, as it provides the same level of protection to companies in RoRE terms at the overall wholesale business level. While the likelihood of breaching the threshold might be affected by the total size of the capital programme and therefore may not be the same for each company (or for each service), this is not a reason in our view to change the thresholds.

8.176 We also maintain the view that the split could have some impact on incentives depending on how the company was performing on water versus wastewater. For example, if a company overspends on water such that it breaches the ASM threshold, the impact of further overspend on the water service would be reduced by 50% relative to the impact on wastewater.

Calibration of ASMs thresholds

8.177 We understand that the main reason why Ofwat introduced the ASMs was to provide protection to customers and shareholders against extreme scenarios, and it is not expected to be triggered in most circumstances. It is also important to bear in mind that in general the risk of cost and outcome performance during the five-

[203] Ofwat (2019) PR19 Final Determinations Delivering outcomes for customers policy appendix, p177.

year price control is allocated to shareholders under the regulatory regime, after accounting for various risk protections in the price control such as cost sharing. This risk allocation has been long established and is reflected in observed betas for the listed water companies. The ASMs are an additional failsafe mechanism, but one that was not intended to fundamentally change that risk allocation.

8.178 We broadly agree with these overarching principles and consider that it is important to consider the requests on reducing the thresholds at which the ASM triggers in this context. This also appears to be similar to the motivation behind Ofgem's Regulatory Adjustments Mechanisms (**RAM**), in that Ofgem only expects the RAM to be triggered in very rare circumstances.[204]

8.179 Most of the submitted reasoning for reducing the ASMs thresholds is around the combined downside faced by companies, as well as comparability to other sectors.

Severe but plausible downside scenarios

8.180 First, we note that we conclude that the package is broadly balanced (see paragraph 8.140 above), and that in of itself makes the severe RoRE downside less likely compared to Disputing Companies' views. Second, we note that the choice of where to set the thresholds is ultimately a judgement. For example, it is not clear to us that setting it to expected P10/P90 or some other level is analytically justified, or that the threshold should be set in such a way as to ensure that the actual return on equity can never fall below the cost of debt. There also needs to be consistency with the level of risk which is compensated for through the beta, which draws on listed water companies which have accepted the Ofwat PR24 FD risk and return package as it is.

8.181 Ofwat's position is that the entire return on equity should be potentially at risk in a downside, while top performers should have reasonable prospects of earning double digit returns. This is consistent with the simple additive risk modelling produced by Ofwat and summarised in Table 8.14 below, which shows the overall P10 to P90 range of -5.84% and 5.90% (for a notional WaSC).

8.182 In practice, the simple addition of the risk ranges across totex, ODIs and financings is likely to overstate risk exposure as it is unlikely that a company would perform at the P10 or at the P90 across all three main building blocks.[205]

8.183 The risk modelling which the Disputing Companies prefer implies that significantly less of the return is at risk, accounting for the fact that risks are not simply additive. KPMG's revised modelling, which it describes as being more closely aligned to the CMA PR24 PD (mainly by removing calibration risk and aligning totex risk ranges

[204] Ofgem does not expect any of the companies to breach the RAM thresholds in RIIO3:. Ofgem (2025) RIIO-3 Draft Determinations Finance Annex, p136, paragraph 9.20.
[205] Ofwat (2024) PR24 final determinations: Aligning risk and return, p19, footnote 10.

with Ofwat's methodology), is shown in Table 8.14 below. The overall risk range for a notional WaSC estimated by KPMG is a -3.46% to 1.81% with a base case of -0.84%. The difference between the P50 and the P10 which can be thought of as KPMG's view of severe downside relative to the base case is around 2.6%.

Table 8.14: Notional WaSC RoRE risk ranges: Ofwat PR24 FD compared to KPMG revised analysis

	Ofwat PR24 FD risk ranges			KPMG risk ranges		
	Worst case	**Base case**	**Best case**	**Worst case**	**Base case**	**Best case**
Totex	-2.83%	0.00%	2.83%	-1.87%	0.00%	-1.84%
Retail	-0.30%	0.00%	0.30%	-0.30%	0.00%	0.30%
ODIs + MeXes	-1.91%	-0.22%	1.48%	-1.47%	-0.33%	0.71%
Financing	-0.75%	0.28%	1.30%	-1.83%	-0.44%	0.91%
Revenue & Other	-0.05%	-0.03%	0.00%	-0.07%	-0.00%	0.00%
RoRE (additive)	**-5.84%**	**0.03%**	**5.90%**	**N/A**	**N/A**	**N/A**
RoRE (simulated)	**N/A**	**N/A**	**N/A**	**-3.46%**	**-0.84%**	**1.81%**

Source: KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), Table 6, p16.

8.184 The estimated risk ranges for totex and ODIs do suggest a low likelihood of the ASM being triggered, However, we consider this to be consistent with the purpose of the mechanism.

8.185 Our approach to testing plausible downside scenarios from a financeabilty perspective is described at paragraphs 8.331 to 8.343 below. We find that the notional company can still maintain an investment grade credit rating in plausible downside scenarios (which do not need to coincide with the P10 for reasons explained in paragraph 8.335). This provides further support that tighter ASMs thresholds are not needed.

Comparability with other sectors

8.186 We accept that other regulated sectors can provide a helpful frame of reference when considering the overall balance of risk in the package. However, the RAM thresholds are only one aspect of the package in the energy sector, and we do not consider them to be directly relevant in assessing the appropriate thresholds for water.

8.187 Overall, we do not see any strong reasons to change the ASMs thresholds.

OAM (ie Outturn adjustment mechanism)

8.188 The OAM is a mechanism which is designed to recalibrate investor returns in the event there is systematic outperformance or underperformance across the sector, providing protection for customers and companies against the potential for

miscalibration of the outcomes package.[206] The OAM is applied separately for wholesale water and wastewater activities on an annual basis.[207]

Ofwat's PR24 FD approach

8.189 If the median ODI performance of the sector passes an equity return (RoRE) trigger threshold of ±50 basis points, Ofwat will apply an adjustment to all companies calculated as the difference between the median OAM benchmark and the trigger threshold.[208]

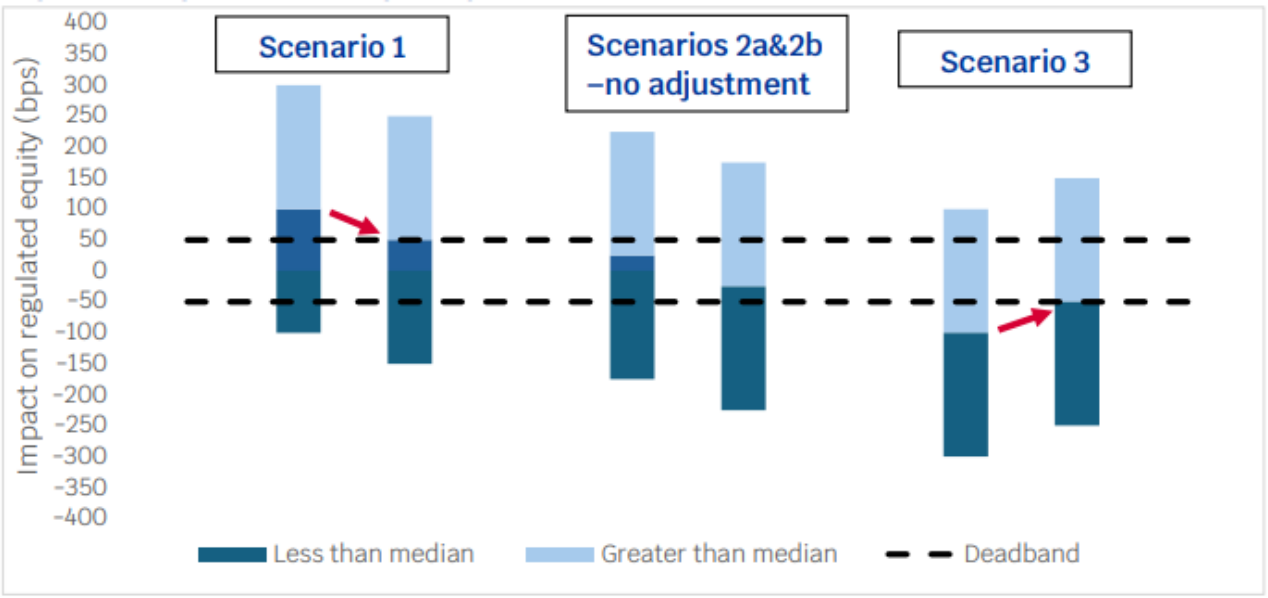
8.190 The OAM was introduced in Ofwat's PR24 FD following an October 2024 consultation. The design of the OAM changed between the consultation and Ofwat's PR24 FD, with Ofwat initially consulting on a mechanism which did not include a deadband. Following the consultation, and its recalibration of the outcomes package between the PR24 DD and its PR24 FD, Ofwat concluded that the OAM should be revised, and included a ±50bps trigger threshold.[209] Ofwat noted that the mechanism would only be triggered when outturns across the sector are significantly higher or lower than expected (see Figure 8.2).[210]

8.191 Ofwat's expectation was and remains that the OAM would be triggered infrequently and in a limited number of circumstances. Taking prior price controls as examples, Ofwat noted that if the OAM had been applied in AMP6 (2015-20) the mechanism would not have been triggered and in AMP7 (2020-25) it would have been triggered once for wastewater service and twice for water service.[211]

8.192 If the sector outperforms materially (at the median earning rewards of more than 0.5% RoRE), the OAM adjustment would reduce the returns of all companies. If all of the companies performed poorly (at the median earning penalties of more than 0.5% RoRE), the OAM would increase the returns of all companies.[212]

[206] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p12.
[207] Ofwat (2024) PR24 final determinations: Aligning risk and return, p22.
[208] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p16.
[209] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p16.
[210] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p16.
[211] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p17.
[212] Ofwat (2024) Consultation on outturn adjustment mechanism, pp9–10, paragraphs 2.10–2.11.

Figure 8.2: Illustration of the OAM included in Ofwat's final determinations (with scenario 1 representing an upside scenario and scenario 3 a downside scenario)



Source: Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p16 *(Figure 5).*

Parties' submissions

Disputing Companies

8.193 The Disputing Companies submitted that the deadband of ±50bps should be removed. [213] The Disputing Companies submitted that the inherent downward skew in the outcomes package is not addressed by the OAM and removal of the ±50bps deadband would go some way toward addressing the downward skew in the outcomes package.

8.194 Northumbrian submitted that without the deadband, the OAM would have avoided downside skew in the calibration of the outcomes package.[214] Northumbrian and Anglian submitted that without the deadband the skewed outturn would be avoided by adjusting every company's returns and resulting in the median performing company earning zero returns from ODIs, those who outperform earning positive returns, and poorer performing companies earning negative returns.[215]

8.195 Anglian submitted that it cautiously welcomed the OAM as described in Ofwat's October 2024 consultation.[216] Anglian noted that the OAM appeared to represent the core principle of yardstick regulation where relative performance should drive

[213] Anglian SoC, p18, paragraph 67. Northumbrian SoC, p138, paragraph 533. South East SoC, p10. Southern SoC, p42, paragraph 50. Anglian (2025) Response to CMA PR24 PD, 151. Northumbrian (2025) Response to CMA PR24 PD, paragraph 338, p99. South East (2025) Response to CMA PR24 PD, paragraph 742, pp102–103. Southern (2025) Response to CMA PR24 PD, paragraph 2.132, pp51–52. Wessex (2025) Response to CMA PR24 PD, paragraph 7.2, pp9–10.
[214] Northumbrian SoC, paragraph 533.
[215] Northumbrian SoC, p138, paragraph 533. Anglian SoC, p18, paragraph 67.
[216] Anglian SoC, p146, paragraph 559.

outperformance payments.[217] It submitted that yardstick regulation mimics competition by setting companies against one another.[218] It noted that even if the average industry returns are recalibrated each period, a true yardstick regime will still have very strong incentive properties because each company's individual performance will have little effect on overall industry performance.[219]

8.196 Anglian submitted that without a deadband, the OAM provides security by ensuring that common overperformance or underperformance by the industry does not result in across-the-board rewards or penalties.[220]

8.197 Anglian submitted that the OAM being based on the median company (rather than the industry's overall performance), does not harm the companies' incentives to outperform because each company will aim to be or beat the median company.[221]

8.198 Southern submitted analysis on OAM using AMP7 data which it considered suggested that if the OAM was applied in AMP7, with a deadband, adjustments to both wastewater (+0.36% RoRE) and water (+0.59% RoRE) price controls would have been made. However, without the deadband these adjustments would have been much greater at +0.98% RoRE for wastewater and +2.11% RoRE for water price controls.[222]

8.199 Southern submitted that introduction of the deadband undermined the intent of Ofwat's original proposal and kept the inherent downside skew in the outcomes package - which first needed to be solved at source and then by removing the OAM deadband.[223]

8.200 South East submitted the OAM deadband should be removed to address the expected underperformance.[224]

8.201 Wessex submitted that the OAM partly mitigates the impact of methodological flaws in the price control package on the overall balance of risk and return but it does not address the issues at source.[225]

8.202 In response to the CMA PR24 PD, the Disputing Companies continued to argue for the removal of the OAM deadband and justified their view from two distinct perspectives, that removal of the deadband is required:

[217] Anglian SoC, p146, paragraph 559.
[218] Anglian SoC, p146, paragraph 560.
[219] Anglian SoC, p146, paragraph 560.
[220] Anglian SoC, p146, paragraph 560.
[221] Anglian SoC, p146, paragraph 561.
[222] Southern SoC, p383, paragraph 87.
[223] Southern SoC, p383, paragraph 88.
[224] South East SoC, pp90–91, paragraph 7.34 (c).
[225] Wessex (2025) Response to CMA PR24 PD paragraph 7.2, pp 9–10.

(a) as a matter of principle because of the inherent difficulty of designing a well-calibrated package;[226] and

(b) to address the remaining negative skew on outcomes.[227]

8.203 Additionally, Anglian submitted that it understood in principle our provisional concern that the removal of the deadband could result in rewarding poor performance but disagreed that missing a PCL necessarily implied poor performance given what it considered to be unduly stretching targets.[228] Anglian submitted that the concern can be addressed by removing the deadband and creating a safeguard such that no upward financial adjustment would be applied across the industry insofar as median-performing companies face net ODI penalties from performing worse than the 2024/25 PCL baselines.[229]

8.204 Anglian noted that should the CMA continue to retain a deadband, a deadband of no more than 20bps (reflecting the remaining negative skew on ODI package) would be justified.[230]

Third party submissions

8.205 Water UK submitted that although in theory the OAM was designed to address excessive downside ODI risk, the mechanism still leaves companies exposed to errors made in calibrating individual performance commitments which have not been addressed in Ofwat's ODI methodology.[231] Water UK submitted that the introduction of the OAM at the final determinations was a positive step but the deadband of 50bps does not fully address the concerns around the balance of risk and reward in the ODI package.[232]

8.206 Water UK submitted its concerns that the OAM was:

(a) consulted on two months before the final determinations with limited time for companies to respond; and

(b) introduced as part of the final determinations (with a deadband) in a form that was not consulted on.[233]

[226] Northumbrian (2025) Response to CMA PR24 PD, paragraph 342, p100; Wessex (2025) Response to CMA PR24 PD paragraph 7.2, pp 9-10
[227] Anglian (2025) Response to CMA PR24 PD, paragraphs 417–421, p159; Southern (2025) Response to CMA PR24 PD, paragraph 2.132, pp51–52.
[228] Anglian (2025) Response to CMA PR24 PD, paragraph 424, p160.
[229] Anglian (2025) Response to CMA PR24 PD, paragraph 425, pp160–161.
[230] Anglian (2025) Response to CMA PR24 PD, paragraph 428, p161.
[231] Water UK (2025) Third party submission on the Water PR24 References, p7.
[232] Water UK (2025) Third party submission on the Water PR24 References, p47.
[233] Water UK (2025) Third party submission on the Water PR24 References, p17.

8.207 Water UK submitted a preference for the ODI package concerns to be addressed 'at source' rather than through adjustments to the ASM and the OAM.[234]

8.208 Severn Trent noted that any changes made by the CMA in favour of the Disputing Companies on ODIs and performance commitments would positively affect the Disputing Companies' overall ODI net payments in terms of RoRE but would negatively affect the 11 non-disputing companies through the OAM.[235]

8.209 Severn Trent proposed that Ofwat agrees to apply the OAM for the non-disputing companies and Disputing Companies on a broadly consistent basis in relation to targets set for PR24 final determinations.[236]

8.210 Pennon submitted that any changes to comparator-based mechanisms (like the OAM) would risk undermining confidence and weakening delivery incentives for non-disputing companies.[237] Pennon submitted that the threshold to amend a protection like the OAM should be high.[238]

8.211 In response to CMA PR24 PD, Pennon, Severn Trent and United Utilities all welcomed the CMA's recognition of the potential implications of changing PCLs and ODI rates on the application of the OAM for non-disputing companies.[239] All three companies noted that this point was essential in ensuring overall fairness of the process to all companies that are potentially impacted by the redeterminations.[240]

Ofwat

8.212 Ofwat submitted that the OAM with the deadband provides a more stable and predictable regulatory framework for investment to improve performance.[241] Ofwat said that not everyone shares the view that the median company will underperform:

(a) Barclays Capital expected Severn Trent to receive a 15bps downward adjustment post-OAM for AMP8 as a result of outperformance on outcomes; and

[234] Water UK (2025) Third party submission on the Water PR24 References, p48.
[235] Severn Trent (2025) Third party submission on the Water PR24 References, p1.
[236] Severn Trent (2025) Third party submission on the Water PR24 References, p1.
[237] Pennon (2025) Third party submission on the PR24 Water References, p3.
[238] Pennon (2025) Third party submission on the PR24 Water References, p8.
[239] Pennon (2025) Response to CMA PR24 PD p2. Severn Trent (2025) Response to CMA PR24 PD, p1. United Utilities (2025) Response to CMA PR24 PD, p6.
[240] Pennon (2025) Response to CMA PR24 PD p2. Severn Trent (2025) Response to CMA PR24 PD, p1. United Utilities (2025) Response to CMA PR24 PD, p6.
[241] Ofwat (2025) Response to common issues on risk and return, p46, paragraph 2.76.

(b) Moody's expected the median company to outperform, and without the deadband this would reduce ODI payments for all companies.[242]

8.213 Ofwat submitted that the removal of the deadband could have a negative impact on companies' incentives to outperform the median company. Ofwat submitted that if the majority of the companies were to focus on a median position, removing the deadband would reduce the incentives for all companies and in the worst-case could lead to companies bunching around similar poor performance.[243]

8.214 Ofwat submitted that the OAM with a deadband addresses the following concerns raised by CCW and Thames Water in response to the OAM consultation, that the original OAM proposal would:

(a) increase the uncertainty companies will face when assessing the impact of their performance on equity returns;

(b) risk diluting incentives to improve performance;

(c) risk customers paying for service improvements which may not materialise if the entire sector performs poorly;

(d) reduce transparency and increases complexity of the regime;

(e) increase the challenge for the sector to raise necessary levels of finance if half of companies would always be in penalty under the mechanism; and

(f) reduce incentives for companies to collaborate to share best practice as it would more strongly incentivise companies to outperform their peers.[244]

8.215 During hearings with the CMA, Ofwat noted that it had introduced the deadband at the stage of its PR24 FD because it did not expect the OAM to be triggered during the price control.[245] It also stated that removing the deadband just for the Disputing Companies might lead to complaints from non-disputing companies who would perceive there to be one rule for one set of companies and another rule for another.[246]

8.216 In response to the CMA PR24 PD, Ofwat submitted that the CMA's provisional changes to the PCLs were unlikely to make a significant difference, with the

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[242] Ofwat (2025) Response to common issues on risk and return, p46, paragraph 2.77. Reflecting on Severn Trent's capital markets day on 5 March 2025, Barclays stated 'Of note, we assume a 15bps downward OAM adjustment in our 1.1% estimate. With six referrals to the CMA there is potential for this OAM to increase, in our view': see Barclays Capital – Severn Trent CMD provides route to beating regulatory challenge increasingly good value, 6 March 2025, p1. Moody's noted that from an ODIs perspective it expects a median RoRE impact to be slight net reward but companies who will require to achieve targets that are a significant step up will performer worse: see Moody's Regulated Water Utilities – UK: Increased business risk weakens credit quality, despite improved settlement, 28 March 2025 (accessed 26 February 2026), p8.
[243] Ofwat (2025) Response to common issues on risk and return, p46, paragraph 2.78.
[244] Ofwat (2025) Response to common issues on risk and return, p44, paragraph 2.71.
[245] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p38, lines 14–15.
[246] (Non-confidential) transcript of the hearing for Risk & Return (day 2) on 2 July 2025, p43, lines 8–9.

likelihood of any impact being further reduced by Ofwat's alternative proposals.[247] It submitted that while there may be potential merits of distinguishing between Disputing Companies and non-disputing companies in the context of the OAM, the additional complexity should not be underestimated.[248] Therefore, Ofwat submitted that all companies should be subject to the same OAM.[249]

Our assessment and decision

Outcomes package is not a 'fair bet' which could be addressed through removal of the 50bps deadband

8.217 One of the key arguments which the Disputing Companies have used to argue for the removal of the deadband is to address the downside skew in the outcomes package. We have assessed the Disputing Companies' concerns regarding the outcomes package 'at source', in line with their preferences, and provisionally concluded that the remaining negative skew is small (see paragraphs 8.77 and 8.78 above). The remaining skew on outcomes is a 'design risk' issue which does not necessitate the removal of the deadband in our view.

Removing the deadband as a matter of principle

8.218 In regard to the argument that the deadband should be removed to acknowledge the inherent problems of designing a well-calibrated package, we understand the argument in principle. However, we view the OAM as a mechanism to reallocate risk from shareholders to customers. The appropriate risk allocation is a matter of regulatory judgement and the introduction of OAM is in itself already a step towards re-allocating risk to customers in AMP8 compared to AMP7. While the risk of mis-calibrating the outcomes package remains, we do not consider that that we need to protect companies from that risk further.

8.219 The small negative skew in the ODI package is not a reason to remove the deadband or to calibrate the deadband at the level of the skew (20bps) as suggested by Anglian. As we discuss earlier, the downward skew is explained by the asymmetric nature of some of the ODIs – this is not evidence that the outcomes package is mis-calibrated.

Other consequences of removing the deadband

8.220 In its PR24 FD, Ofwat raised several potential concerns about not having a deadband, of which the most material appear to us to be:

[247] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 9.5.
[248] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 9.6.
[249] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 9.6.

(a) impact on incentives;

(b) increasing the challenge to raise finance;

(c) companies being rewarded despite poor performance; and

(d) reducing incentives to collaborate to share best practice.

8.221 With regard to impact on incentives, it is not clear to us that there would be a material impact on marginal incentives to improve performance, were the deadband to be removed, as the marginal financial impact from improving performance would stay the same irrespective of whether a deadband was in place. We broadly agree with the Disputing Companies that they should still have strong incentives to outperform. However, we are mindful of concerns raised by some of the non-disputing companies that changes to comparator-based mechanisms could risk undermining confidence in the mechanism more broadly.

8.222 The impact of a deadband on the ability of companies to raise finance is also not clear in our view. It might depend on whether certain companies are consistently in the bottom half of performance on outcomes, but it is not obvious that this should be the case.

8.223 On rewarding poor performance, if the deadband was to be removed for the Disputing Companies, we are of the view that removing the deadband may result in instances where a company which has not met its performance targets could still achieve a net positive position on ODI payment (ie would receive a reward, rather than a penalty), and that these rewards could be significant (as demonstrated by Southern's AMP7 example). This would not be a fair outcome for customers. We agree that Anglian's proposal could mitigate this issue to some extent, by only triggering the OAM as long as the median-performing company at least continues to meet the 2024/25 PCL target. However, removal of the deadband in itself would result in greater protection for underperforming companies through lowering financial impact from ODIs underperformance. We have not seen evidence that this further protection is necessary. It would also reduce the scope for companies to earn ODI rewards from out-performance.

8.224 On sharing best practice, we do not consider this to be a major concern.[250] Companies are routinely compared to each other throughout the regulatory regime

[250] When asked about the extent of collaboration between companies and tangible benefits of collaboration Ofwat could not provide quantitative evidence of collaboration, but noted instances where lack of collaboration has resulted in beneficial outcomes either being missed or delayed. The examples of missed or delayed benefits were the comments by the NIC in 2018 about lack of progress made by water companies; in April 2025 a statement from Spring (responsible for delivering innovation strategy by water companies) noted the urgency of finding new approaches, tools and techniques which need to be created in collaboration as well as acknowledging that collaboration is growing across the sector, Ofwat response to Ofwat RFI05, Q10.

to set costs and targets – it is not clear that adding one more relative comparison would fundamentally change incentives to collaborate.

Conclusion

8.225 We find that the majority of the factors above are relatively weak arguments against removing the deadband. However, we are concerned that the removal of the deadband could result in potentially rewarding poor performance across the industry.

8.226 More importantly, we have addressed the Disputing Companies' concerns around the outcomes package 'at source' We therefore conclude that the OAM is only needed to guard against significant miscalibration of the package. Removing the deadband would be a material change in the risk and reward balance – in favour of the Disputing Companies and to the disadvantage of customers, which does not seem necessary or appropriate.

8.227 We conclude that it is appropriate to retain the OAM and to retain the ±50bps deadband.

8.228 We note that while we are not amending the design of the OAM, we have made two common adjustments to the outcomes package (see chapter 6 (Outcomes)): we are setting a less stretching target for the water supply interruption common PCL, and we are reducing the ODI rate for the total pollution incidents.

8.229 Consistent with the view stated in the CMA PR24 PD, we consider that this might have some impact on the relative performance of Disputing Companies versus non-disputing companies and whether the OAM deadband is triggered or not.[251]

8.230 While the application of the OAM for non-disputing companies is a matter for Ofwat, rather than the CMA, we remain of the view that a coherent approach would calculate the OAM separately for the Disputing Companies and the non-disputing companies. For Disputing Companies, the OAM could be calculated using our revised PCLs and ODI rates for all 16 companies in the sector, while for the non-disputing companies it could be based on the Ofwat PR24 FD package for all companies.

8.231 However, we recognise that in practice, there might not be much difference between the two since the OAM considers performance across the whole outcomes package, and we have by and large retained Ofwat's PCLs and ODI rates. It will be a decision for Ofwat how best to balance out the potential additional complexity against a more robust calibration of the OAM.

[251] As noted in Pennon (2025) Third party submission on the PR24 Water References, p3.

Cost recovery

8.232 Totex allowances determine how much expenditure companies can recover from customers. This expenditure is recovered through allowed revenues in two ways:

(a) expenditure can be recovered in customer bills in the year it is incurred through pay-as-you-go (**PAYG**); or

(b) expenditure can be added to the RCV and then recovered over a number of years through **RCV run-off**.

8.233 PAYG and RCV run-off rates set the speed at which companies recover their costs from customers and therefore determine the proportion of costs which are borne by current and future customers. Typically, PAYG remunerates companies for operating costs and RCV run-off covers capital expenditure.

PAYG rates

8.234 In its PR24 final methodology, Ofwat stated that its starting point for the assessment of companies' PAYG rates would be the 'natural rate' (ie the proportion of net operating costs to net totex).[252] However, companies could choose to include infrastructure renewals expenditure (**IRE**) in the calculation of PAYG, provided they evidenced the reasons why, with Ofwat noting that the recovery of IRE both through PAYG or the RCV run-off would still be consistent with its PR24 methodology.[253] The approach of including IRE in the PAYG calculation increases the revenues that can be recovered in year and reduces the level of totex added to the RCV.

Ofwat's PR24 FD approach

8.235 For four Disputing Companies (Anglian, Northumbrian, South East and Southern) Ofwat set PAYG rates to reflect net operating costs as a proportion of net totex.[254]

8.236 For Wessex, Ofwat set PAYG rates reflecting operating costs plus IRE,[255] as a proportion of net totex. Ofwat stated that Wessex's proposals allow Wessex to recover the majority of its capital maintenance expenditure in year, which it said was consistent with the approach for Wessex at previous price reviews. Wessex's approach was also consistent with ensuring the total bill rise over AMP8 did not exceed the 30% limit Wessex set out in its original business plan.[256] Ofwat's PR24 FD allowed two other companies to include IRE in PAYG.

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[252] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p3.
[253] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p31.
[254] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p45.
[255] Ofwat stated that Wessex was permitted to recover 85% of its IRE costs through PAYG.
[256] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp44–45.

8.237 Table 8.15 below sets out Ofwat's PAYG rates for each Disputing Company.

Table 8.15: Ofwat final determination PAYG rates

Company	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*
Anglian	32.1%	41.2%	33.2%	49.9%
Northumbrian	68.5%	46.4%	25.8%	34.8%
South East	81.3%	41.9%	N/A	N/A
Southern	42.8%	40.6%	28.3%	36.8%
Wessex	48.8%	62.4%	31.0%	38.1%

Source: Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, Tables 12–15 (pp101–103).

Parties' submissions

Disputing Companies

8.238 South East submitted that it did not consider PAYG and run-off rates to be in dispute but that the CMA may wish to consider them as part of its financeability assessment and to update them as necessary in light of its redetermined costs.[257]

8.239 Southern submitted that it may ask the CMA to assess the financeability of its final settlement and adjust cashflow levers such as PAYG and run-off rates to ensure the notional company can finance its operations.[258]

8.240 Wessex stated that, as set out in its response to Ofwat's PR24 DD, it had set PAYG ratios to recover opex and infrastructure capitalised renewals expenditure as fast money. Wessex added that it considered this approach should be maintained by the CMA, and any change would necessitate a review of RCV run-off rates to maintain an internally consistent set of modelling assumptions.[259]

8.241 Wessex submitted that its Board was committed to a maximum bill rise, in real terms, of less than 30% by 2030, providing this is financeable. Wessex stated that affordability levers (such as PAYG and RCV run-off rates) could be used to limit the actual rise in bills to less than 30%.[260]

Ofwat

8.242 Ofwat stated that it supported adjustments to Wessex's cost recovery rates to limit bill increases to 30%.[261]

8.243 In response to the CMA PR24 PD, Ofwat stated that its PR24 FD assumed that a company's capitalised IRE set out in its PR24 Business Plan was subject to the

[257] South East SoC, p11, paragraph 1.33(e).
[258] Southern SoC, p575, paragraph 11.
[259] Wessex (2025) Response to CMA PR24 PD, paragraphs 9.65–9.66.
[260] Wessex SoC, p11, paragraphs 2.53–2.55.
[261] Ofwat (2025) Response to common issues on risk and return, p148, paragraph 8.12.

base cost challenge. Ofwat added that this efficient view of capitalised IRE was then added to operating expenditure to determine the applied PAYG rate.[262]

Our assessment and final decisions

8.244 In the CMA PR24 PD, for four of the Disputing Companies (Anglian, Northumbrian, South East and Southern) we calculated the PAYG rates as a proportion of operating costs to totex. We retain this approach in our final determinations.

8.245 In the CMA PR24 PD, we calculated Wessex's PAYG rates as follows.

(a) For the totex allowed in Ofwat's PR24 FD (£3,904 million)[263] we retained Ofwat's final determination PAYG rate (which is calculated as net operating costs plus IRE divided by net totex),

(b) For additional totex included due to our cost determination (approximately £300 million) we included this at a PAYG rate calculated as net operating costs as a proportion of net totex. We considered there might be benefits from applying a consistent approach across all totex. Therefore we indicated that, depending on the responses from parties, we would consider revising this assumption for the CMA's final determination.

8.246 In our final determination for Wessex, we have updated our PAYG calculations to align with Ofwat's PR24 FD methodology. We calculate Wessex's PAYG rates as follows.

(a) Operating costs are recovered through PAYG revenues.

(b) IRE is also recovered through PAYG revenues. We determine the level of IRE by applying our base cost efficiency challenge for Wessex, of 14.0%, to the capitalised IRE set out in Wessex's original business plan.

8.247 We note that under this approach Wessex's bill increase from 2024/25 to 2025–30 is 31.6%, which is above Wessex's proposed cap of 30%. In Wessex's response to the CMA PR24 PD Wessex stated that, in the context of the CMA PR24 PD, it considered it possible to broadly align with the 30% proposed cap.[264] We do not adjust PAYG rates to reduce Wessex's bill increase from 2024/25 to 2025-30 to below 30%. The increases in Wessex's revenues due to our final determination for Wessex will only apply to customer bills in the final three years of the price control, which will result in a higher 2029/30 bill than if our determination was applied across the five years of AMP8. We consider the 31.6% increase in the CMA PR24 FD to broadly align with Wessex's 30% cap commitment and, as discussed in

[262] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 10.6.
[263] Wessex's net totex for PAYG from Ofwat FD Wessex financial model, 'PAYG calc' sheet, rows 11–14.
[264] Wessex (2025) Response to CMA PR24 PD, paragraph 9.1.

chapter 9 (Other issues) at paragraph 9.26, we profile bills over AMP8 in line with customer preferences.

8.248 Table 8.16 below sets out our PAYG rates for each Disputing Company.

Table 8.16: CMA PAYG rates

	Water resources	*Water network plus*	*Wastewater network plus*	*Bioresources*
Anglian	30.4%	40.9%	33.2%	50.4%
Northumbrian	69.8%	47.9%	23.6%	34.2%
South East	81.0%	40.5%	N/A	N/A
Southern	42.3%	40.4%	29.1%	36.8%
Wessex	46.5%	60.6%	28.3%	36.0%

Source: CMA analysis. Note: Southern PAYG rates shown excluding additional delivery mechanism totex.

RCV run-off rates

Ofwat's PR24 FD approach

8.249 Ofwat set out a framework for determining RCV run-off rates which considered intergenerational fairness between current and future customers, affordability, financeability and its guidance on upper limits for run-off.[265] Ofwat stated that for most companies it applied the RCV run-off rates proposed in company representations in its final determinations.[266]

8.250 Ofwat reduced Southern's overall RCV run-off rate from 4.49% to 4.36%, in line with Southern's representations. Ofwat stated that this approach aligned with its assessment framework, and it concluded that Southern had sufficient headroom in its financeability assessment of the notional company. Ofwat also noted that its final determination RCV run-off rate aligned with Southern's historic cost depreciation rate across 2020–24.[267]

8.251 Table 8.17 and Table 8.18 immediately below set out Ofwat's PR24 FD RCV run-off rates for each Disputing Company.

[265] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p46.
[266] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p53.
[267] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p55.

Table 8.17: Ofwat PR24 FD pre-2025 RCV run-off rates (ie applied to opening RCV)

	Water resources	*Water network plus*	*Wastewater network plus*	*Bioresources*
Anglian	4.29%	3.73%	4.29%	5.72%
Northumbrian	4.50%	4.50%	4.50%	7.28%
South East	4.08%	3.80%	N/A	N/A
Southern	4.37%	4.23%	4.29%	6.19%
Wessex	4.50%	3.57%	3.81%	8.00%

Source: Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, Tables 16–19 (pp104–107).

Table 8.18: Ofwat PR24 FD post-2025 RCV run-off rates (ie applied to AMP8 additions)

	Water resources	*Water network plus*	*Wastewater network plus*	*Bioresources*
Anglian	4.29%	3.73%	4.29%	5.72%
Northumbrian	3.23%	3.23%	1.67%	3.88%
South East	4.08%	3.80%	N/A	N/A
Southern	4.37%	4.23%	4.29%	6.19%
Wessex	4.50%	4.50%	3.24%	8.00%

Source: Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, Tables 16–19 (pp104–107).

Parties' submissions

Disputing Companies

8.252 Anglian submitted that its RCV run-off rates in Ofwat's PR24 FD were too low. Anglian stated that at PR19 it reduced its RCV run-off rates to limit customer bill impacts but anticipated increasing rates back to their 'natural rate' at PR24. However, Ofwat introduced new requirements at PR24 which meant Anglian reduced its RCV run-off rates further to comply with Ofwat's guidance.[268]

8.253 Anglian noted that it did not challenge Ofwat's RCV run-off rates proposals in its business plan or PR24 DD representations but that due to the changes in required credit metrics from rating agencies (specifically funds from operation (**FFO/net debt**), an increase in RCV run-off rates is required to achieve a BBB+/Baa1 rating. Anglian stated that the CMA should increase its RCV run-off rates to PR19 levels to achieve the required level of financeability for the notional company.[269]

8.254 Southern submitted that in the CMA's final determination we should revert to the RCV run-off rates it proposed in its statement of case as this would reduce the financeability gap and improve intergenerational fairness.[270] Southern also requested that the CMA assess financeability on the basis of totex included within the delivery mechanism and all other contingent allowances eg Large Scheme Gated.[271]

[268] Anglian SoC, pp204–205, paragraphs 795–796.
[269] Anglian SoC, p205, paragraph 797.
[270] Southern (2025) Response to CMA PR24 PD, paragraphs 2.94.
[271] Southern (2025) Response to CMA PR24 PD, paragraphs 2.95.

Ofwat

8.255 Ofwat also stated that it considered the RCV run-off rates set in its PR24 FD achieved a fair allocation of costs between current and future customers, while maintaining adequate levels of financial headroom in its financeability assessment.[272]

Third parties

8.256 MCC Economics, on behalf of CCW, stated that the adopted RCV run-off rates imply a remaining asset life of approximately 25 years. MCC noted that this seemed low for water assets and suggested that owners are receiving their capital back at an accelerated rate. MCC also noted that RCV run-off rates generally exceed historical cost depreciation by a material margin and that a RCV run-off rate based on the historical cost depreciation would be more than adequate for the price determination.[273]

Our assessment and decision

8.257 We note MCC's observation that RCV run-off rates exceed companies' historical cost depreciation rates. The RCV represents totex additions in previous periods, inflation, and performance adjustments for ODIs and cost over/underspends. This results in divergence between companies' fixed assets and the RCV. There are also other relevant factors which Ofwat considered in setting its framework for RCV run-off rates such as intertemporal fairness, affordability for customers, and financeability.[274] We therefore do not consider it appropriate to estimate the RCV run-off rates solely based on historical cost depreciation rates in the CMA PR24 FD.

8.258 We also note that the IWC Final Report included this recommendation: 'Following the establishment of a new methodology for assessing asset condition and expected life, the regulator should consider the merits of linking RCV run-off more closely to the economic depreciation of assets. This applies to England and Wales'.[275] Although we can see a benefit in estimating RCV run-off rates more closely linked to economic depreciation relating to a revised approach to assessing asset condition, this would need to be implemented in parallel with future work on asset health.

8.259 In relation to Anglian's and Southern's concerns around the need to increase RCV run-off rates to improve financeability, our assessment in the next section does not

[272] Ofwat (2025) Response to common issues on risk and return, paragraph 8.16.
[273] MCC Economics (2025) A review of Ofwat's PR24 Final Determination WACC allowance: a report for CCW, p35, paragraphs 102–103.
[274] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p3.
[275] IWC Final Report, Recommendation 20, p208.

demonstrate that this is necessary. Consistent with Ofwat's approach, we have also considered financeability when including Southern's delivery mechanism totex.[276] We therefore retain the RCV run-off rates set by Ofwat in its PR24 FD (and as presented in Table 8.17 and Table 8.18 above).

Financeability

8.260 In this section we assess the financeability of the Disputing Companies under our determinations. One of the five primary duties under section 2(2A) of the Act requires Ofwat, and therefore the CMA, to exercise its functions in the manner which it considers best calculated to secure that each company is able to finance the proper carrying out of its functions (in particular, by securing reasonable returns on its capital). This is often referred to as the Finance Duty or ensuring 'financeability'. In this section, we highlight the financeability approach taken by Ofwat and the key arguments from the parties, before undertaking our own assessment of the financeability of each of the Disputing Companies on the basis of the notional capital structure.

Ofwat's PR24 FD approach

8.261 Ofwat's approach to financeability was designed to assess whether revenues, relative to efficient costs, are sufficient for a notional company with the notional company capital structure to finance its investment on reasonable terms, while protecting the interests of customers now and in the long term. [277]

8.262 Ofwat set out that its financeability assessment considered whether, when all of the individual components of its PR24 FD are taken together (including totex, allowed return and retail margin, PAYG rates and RCV run-off), an efficient company with the notional capital structure would be able to generate cashflows sufficient to meet its financing needs. As part of this Ofwat carried out an assessment of financial ratios in setting its determinations.[278]

8.263 Ofwat's approach to financeability in its PR24 FD largely followed the approach used at previous determinations and consisted of the following main elements:

(a) each water company submitting a plan that is financeable, with board assurance that the plan is financeable on the basis of the notional capital structure with an opening level of gearing of 55%;[279]

[276] We note that following Ofwat's final determination on the 2024/25 blind year reconciliations in December 2025 (**Blind Year Reconciliation FD**), Southern's AMP8 expenditure allowances have increased by £392.4 million (approximately 73% of DM totex in Ofwat's PR24 FD) to reflect the removal of certain schemes from the delivery mechanism. See Ofwat (2025) Blind Year Reconciliation for 2024-25 (accessed 26 February 2026).
[277] Ofwat (2024) PR24 final determinations: Aligning risk and return, p34.
[278] Ofwat (2024) PR24 final determinations: Aligning risk and return, p34.
[279] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p39.

(b) a financeability assessment carried out at the Appointee level using the PR24 financial model by reference to an efficient company with the notional capital structure (the financeability assessment considered a range of financial metrics and other factors to help assess the financeability of water companies' business plans and Ofwat's determinations);[280]

(c) a notional capital structure, with opening proportion of ILD of 33% – maintained at a minimum of 33% over 2025-30 – with new ILD raised over the period being linked to CPIH;[281]

(d) financeability assessed before taking account of the revenue impact of any adjustments relating to the previous price review periods (for example, from reconciliation mechanisms);[282]

(e) targeting a credit rating at least two notches above minimum investment grade (BBB+/Baa1);[283]

(f) a dividend yield of 4%;[284] and

(g) use of equity to fund real RCV growth such that notional gearing does not increase materially from 55%;[285] where equity is requited to fund real RCV growth, an allowance of 2.5% of the equity raised is provided.[286]

8.264 As part of its financeability assessment, Ofwat targeted a credit rating two notches above the minimum investment grade (ie a target rating of BBB+/Baa1) for the notional company.[287] Ofwat updated its assessment to take account of the revised guidance published by Moody's but noted that neither Fitch nor S&P had updated their guidance between Ofwat's PR24 DD and its PR24 FD.[288]

8.265 Ofwat considered guidance at Baa1/BBB+ for Adjusted Interest Cover Ratio (**AICR**) of 1.6x and an FFO/net debt of around 10% (equivalent to 9% in its alternative approach).[289] Ofwat noted that where average financial ratios are below defined guidance, it considered whether the financial ratios overall and in the round were consistent with the target credit rating.[290] Table 8.19 below sets out Ofwat's PR24 FD AICR and FFO/net debt for the Disputing Companies.

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[280] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p39.
[281] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p39.
[282] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p39.
[283] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, pp39–40.
[284] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p69.
[285] Ofwat (2022) PR24 Final methodology - Appendix 10 - Aligning risk and return, p40.
[286] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p68.
[287] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p69.
[288] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p69.
[289] Ofwat response to Ofwat RFI07, Q3, p6. Ofwat's 'alternative' approach recognises the full interest charge for index linked debt (rather than the cash interest charge in the standard version).
[290] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p69.

Table 8.19: Ofwat PR24 FD average financial ratios and other metrics for 2025-30

2025-30 average	*AICR*	*FFO/net debt*	*Gearing*
Anglian	1.71x	9.45%	55.22%
Northumbrian	1.68x	9.01%	55.90%
South East	1.73x	8.90%	56.03%
Southern	1.70x	9.80%	55.55%
Wessex	1.73x	8.96%	55.65%

Source: AICR and FFO/Net debt from Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p70, Table 8.
Note 1: we include FFO/net debt based on Ofwat's 'alternative' approach which recognises the full interest charge for ILD (rather than the cash interest charge in the standard version). Gearing from Ofwat's Key Dataset 2 Costs, Past Delivery and Risk and Return data, 'Financial ratios' sheet, gearing 5-year average.
Note 2: Ofwat's analysis shows the financial ratios for Southern including all totex and revenues available under the delivery mechanism.

8.266 Ofwat also performed headroom tests in its financeability assessment. Ofwat reduced funds from operations in its PR24 FD, through an increase to costs or a reduction to revenue, to the point where the adjusted interest cover ratio is one.[291] Ofwat concluded that its determinations provided sufficient headroom for the Disputing Companies (on a notional basis) to withstand reasonable downside risk, which in severe cases could be mitigated by a reduction to dividends or the provision of further equity.[292]

Parties' submissions

Disputing Companies

8.267 We summarise the parties' submissions by key theme. As explained above, ensuring financeability is a broader assessment of efficient costs and the appropriate rate of return, with analysis of financial metrics forming just one part of it. Therefore, some of the parties' views on the overall financeability of Ofwat's PR24 FD are linked to their arguments on the individual building blocks, which are dealt with in other chapters. In this section, we focus on arguments relating to the financial analysis performed by Ofwat.

Financeability of Ofwat's PR24 FD and the CMA PR24 PD

8.268 Northumbrian said that it was unlikely that a notionally financed company would be able to attract the level of equity investment required to meet Ofwat's target credit rating under its financeability assessment. Northumbrian added that without the equity injections assumed, it calculated that the rating for the notionally financed company would fall to Baa2/BBB, and potentially further in future AMPs.[293]

[291] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p72.
[292] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p73.
[293] Northumbrian SoC, p154, paragraph 587.

8.269 South East submitted that Ofwat's PR24 FD did not allow a notional company operating in its region to achieve the target credit rating.[294]

8.270 Southern stated that Ofwat's PR24 FD was not financeable for the notional company, and therefore the Ofwat PR24 FD did not accord with Ofwat's financing duty in respect of debt.[295]

8.271 Following the CMA PR24 PD, Southern submitted that we had improved the financeability and investability of the package with some measures, but that this was not sufficient to render the CMA PR24 PD financeable or sustainably investable.[296] Southern discussed a range of overarching issues largely on investability and the balance of risk which it submitted influenced this picture.[297] Southern proposed measures to address its concerns, including adjusting run-off or PAYG rates, increasing allowed revenues, changing risk sharing mechanisms (particularly the ASM), and increasing the benchmark adjustment to the cost of new debt.[298]

8.272 Anglian submitted that it supported the CMA PR24 PD's 'more pragmatic' approach to debt financeability in particular our guidance for AICR, but submitted it was concerned about our guidance for FFO/Net debt and in sensitivity analysis (detailed below).[299]

8.273 South East submitted that the CMA PR24 PD contained a noticeable down-weighting of the financeability testing in comparison to the CMA's PR19 assessment, and asked that the work play a more central role in the formulation of the CMA PR24 FD. It submitted that it had two particular concerns about the specification of the CMA analysis (primarily on credit ratios and downside testing, as detailed below).[300]

Notional capital structure

8.274 Anglian, South East and Southernsubmitted that Ofwat's PR24 FD wrongly assumed that 90% of the opening ILD is linked to RPI.[301] They stated that given for AMP8 companies would not have any RCV linked to RPI, it was not internally consistent to assume that the notional company would run this level of basis risk for such a large proportion of their index-linked debt, with a material mismatch between assets (linked to CPIH) and debt (linked to RPI).

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[294] South East SoC, p88.
[295] Southern SoC, p96, paragraph 239.
[296] Southern (2025) Response to CMA PR24 PD, paragraph 2.2.
[297] Southern (2025) Response to CMA PR24 PD, paragraphs 2.8–2.38.
[298] Southern (2025) Response to CMA PR24 PD, paragraphs 2.3–2.7.
[299] Anglian (2025) Response to CMA PR24 PD, paragraphs 571–573.
[300] South East (2025) Response to CMA PR24 PD, paragraphs 7.19–7.43.
[301] Anglian SoC, p182, paragraph 687. South East SoC, Annex H – risk and financeability, paragraph 21. Southern SoC, p91, paragraphs 201–202.

8.275 Anglian also stated that Ofwat's PR24 FD wrongly concluded that investors would make a sizeable equity injection into Anglian, to maintain gearing below 57.5%, on a notional basis whilst receiving negative net dividends over AMP8.[302] South East[303] and Southern[304] similarly stated that Ofwat wrongly assumed new equity investment would be available without a supporting equity financeability analysis.

8.276 South East and Southern submitted that a revised notional financing structure should be adopted, which reflected 100% CPIH-linked debt and debt financing costs consistent with the Ofwat PR24 FD's methodology but increasing over time as embedded debt matures and new debt was issued.[305]

8.277 Following the CMA PR24 PD, Southern submitted that our assumptions on ILD[306] were inconsistent with financing options available to companies in practice, given that the market for CPIH-linked debt is very limited.[307] It asked that we adopt assumptions on ILD that are consistent with market evidence, ie that – in its view – nearly all new ILD issuance is likely to be linked to CPI, not CPIH.[308]

8.278 Southern, South East and their advisers, KPMG, set out a number of arguments relating to the level of notional gearing: see 'Notional gearing' in chapter 7 (Allowed return) above.

8.279 In response to our CMA PR24 PD, Southern submitted that we should stress test the financeability assessment on the basis of 60% notional gearing (as well as 55%), even if 55% was retained for the purposes of determining the allowed return.[309] Southern submitted that the use of a 55% gearing assumption 'weakens' the financeability assessment (mechanically improving financeability metrics), and referenced the CMA PR19 redetermination using an assumption of 60%.

Rating agency methodologies and targets

8.280 In their statements of case, Northumbrian, South East and Southern submitted that updated rating agency guidance implied that Moody's AICR of at least 1.60x and S&P's FFO/net debt of at least 11% were needed for a BBB+/Baa1 rating.[310] Anglian submitted that a minimum of 1.70x for Moody's AICR and 11% on S&P's FFO/net debt was needed for a BBB+/Baa1 rating.[311]

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[302] Anglian SoC, p180, paragraph 681.
[303] South East SoC, Annex H – risk and financeability, paragraph 20(a).
[304] Southern SoC, p92, paragraph 215.
[305] South East SoC, Annex H – risk and financeability, paragraph 29. Southern SoC, p91, paragraph 203.
[306] ie assuming that 10% of opening embedded debt is CPIH-linked, and all new ILD is CPIH-linked.
[307] Southern (2025) Response to CMA PR24 PD, paragraphs 2.133–2.134
[308] Southern (2025) Response to CMA PR24 PD, paragraphs 2.133–2.134
[309] Southern (2025) Response to CMA PR24 PD, paragraphs 2.135–2.139.
[310] Northumbrian SoC, Appendix 1: Supporting information, Figure 24, p62. South East SoC, p88, paragraph 7.23. Southern SoC, p90, Table 11.
[311] Anglian SoC, p181, paragraph 684.

8.281 In their statements of case, Anglian, Northumbrian and South East also submitted a range of views on the appropriate thresholds for Fitch's nominal and cash post-maintenance interest cover ratio (1.80x nominal Post-Maintenance Interest Coverage Ratio (**PMICR**) and 1.70x cash PMICR).[312]

8.282 Southern noted that the rating methodologies for Moody's and Fitch place significant weight on RCV gearing and coverage metrics such as AICR. These were largely independent constraints on ratings. Southern stated that 60% gearing typically implies a Moody's and Fitch rating of A3/A and that gearing was not a constraint for the notional company.[313]

8.283 In response to a CMA follow-up question, the Disputing Companies submitted that when inferring S&P's FFO/net debt thresholds for the sector, we should use the Standalone Credit Profile (**SACP**) because S&P's instrument ratings are affected by structural features not relevant to the notional company, ie the use of whole business securitisation structures.[314]

8.284 In response to the CMA PR24 PD, Anglian, South East and Southern made further submissions[315] about the target metrics used in our financeability assessment, with arguments largely reflecting an appended KPMG report.[316] These Disputing Companies submitted that the thresholds used in our CMA PR24 PD were only applicable to companies with whole business securitisation structures.

(a) Considering the **FFO/net debt** ratio (used by S&P) – in which we targeted 10% but noted that 8-9% was likely consistent with BBB+ – these Disputing Companies submitted that S&P's senior secured ratings are positioned one notch above the SACP, and that FFO/debt of 8-10% would support only a BBB senior unsecured rating. They submitted that a threshold of at least 11% should be targeted (11–13%, mid-point 12%).

(b) Considering the Fitch **cash PMICR**, these Disputing Companies submitted that the targets applied (although we did not specifically model cash PMICR in our CMA PR24 PD) would only be true for the senior secured debt of an issuer with a whole business securitisation structure, and proposed a target of around 1.7–2.0x.

8.285 In respect of whole business securitisation structures, these Disputing Companies submitted that the CMA PR24 PD in effect defines the notional company as a one

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[312] Anglian SoC, p181, paragraph 684. Northumbrian SoC, Appendix 1: Supporting information, Figure 24, p62. South East SoC, p88, paragraph 7.23.
[313] Southern SoC, p502, paragraph 578.
[314] Disputing Companies' response to Disputing Companies RFI04, p4, paragraph 11.
[315] Anglian (2025) Response to CMA PR24 PD, paragraphs 571–573. South East (2025) Response to CMA PR24 PD, paragraphs 7.19–7.43. Southern (2025) Response to CMA PR24 PD, paragraphs 2.39–2.49.
[316] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraphs 4.1.1–4.1.9.

using this structure, which was inconsistent with longstanding practice of Ofwat and other UK regulators. KPMG's report referenced past Ofwat commentary on covenanted structures, increased costs and constraints associated with these structures and transfer of risk from debt to equity.[317]

Stress testing and sensitivities

8.286 Anglian submitted that the sector's ODI performance in AMP7 suggests that the likelihood for downside risk outweighs the likelihood of outperformance. Anglian referenced analysis from KPMG which modelled ODI penalties of £290 million over the period to test the impact of 'plausible but severe downside events' on Anglian's financial resilience on a notional basis. Anglian stated that this downside scenario would result in credit metrics consistent with a rating below or at Baa3/BBB- at Moody's and S&P and below investment grade at Fitch, which would result in cash lock-up.[318]

8.287 Northumbrian stated that keeping revenue fixed as per Ofwat PR24 FD levels, but spending the capex, opex and interest costs in line with its statement of case, would result in the notional company dropping a credit rating. Northumbrian added that this suggested that it was critical for notional financeability for the correct levels of totex and interest to be assumed in the price controls.[319]

8.288 South East submitted that the notional company's financeability challenge then became more acute when considering expected (ie P50) performance. South East stated that if the notional company performs in line with P50 totex, ODIs, etc, it would face downgrading below investment grade with all credit rating agencies, calling into question its ability to satisfy Condition P of South East's licence, which requires it to maintain two investment grade credit ratings.[320]

8.289 Southern submitted that, for the notional company, the Ofwat PR24 FD debt financeability assessment assumed neutral operational and financing performance against its allowances, including that the actual cost of debt would be in line with that allowed. Southern stated that robust risk analysis indicated P50 performance equivalent to -3.75% RoRE for a notionally efficient company operating in its region, which should be considered when evaluating financeability.[321] Southern stated that metrics would fall to levels consistent with sub-investment grade when accounting for P50 performance.[322]

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[317] KPMG (2025) Analysis of and commentary on risk and financeabillity in the PR24 Provisional Determination (submitted as supporting document PDR-2-003 with Southern (2025) Response to CMA PR24 PD), paragraphs 4.1.1–4.1.9.
[318] Anglian SoC, p182, paragraph 688.
[319] Northumbrian SoC, Appendix 1: Supporting information, p73, paragraph 199.
[320] South East SoC, pp88–89, paragraph 7.25.
[321] Southern SoC, p91, paragraph 206.
[322] Southern SoC, p95, Figure 4.

8.290 In their joint reply to Ofwat's Response, the Disputing Companies submitted that RoRE underperformance of 2.4% in cash terms would jeopardise the ability of the notional company to maintain two Baa3/BBB- ratings. The Disputing Companies noted that RoRE underperformance of 2.4% is also below the 3% threshold at which the ASM would begin to mitigate ODI penalties.[323]

8.291 In the CMA PR24 PD we included 2 stress testing scenarios (1% RoRE downside in all years and 2% in years 2 and 3 with 1% in all other years). In response, Anglian, South East and Southern submitted as follows.

(a) Anglian and South East submitted that the resilience testing in the CMA PR24 PD did not reflect the plausible downside scenarios to which the notional company is exposed. Anglian referenced the stress tests that it is required to run to satisfy the UK Corporate Governance Code requirements as part of the Company's Long Term Viability Statement (**LTVS**).[324]

(b) Anglian and South East noted one scenario which considered a totex overspend of 10%, an ODI penalty of 1.5% of RoRE in each year plus a financial penalty of 1% of revenue in a single year. Anglian stated that this represents an overall RoRE impact of approximately 3%.[325]

(c) Southern also referenced the downside scenarios considered for the LTVS.[326] Southern included a table of the most severe LTVS stress operational scenarios assessed in a number of water company annual reports form 2024/25. These downside stress tests had a negative RoRE impact of 2.6% on average.[327]

8.292 Southern submitted that companies' operational RoRE performance in AMP7 show that outturn performance can be significantly more negative than the LTVS stress tests. Southern noted that median and average operational underperformance in AMP7 was -3.7% and -4.1% respectively, with 14 or 17 licensees underperforming by more than -2%.[328]

8.293 Southern also stated that we should consider downside scenarios informed by risk analysis.[329] Southern stated that its risk analysis, that it described as highly conservative, when applied to the CMA PR24 PD resulted in a P10 outcome for a notional company operating in its area of -3.73% RoRE.[330]

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[323] Disputing Companies (2025) Joint reply to Ofwat's Response, p10, paragraphs 44–45.
[324] Anglian (2025) Response to CMA PR24 PD, paragraph 573. South East (2025) Response to CMA PR24 PD, paragraph 7.36.
[325] Anglian (2025) Response to CMA PR24 PD, paragraph 573. South East (2025) Response to CMA PR24 PD, paragraph 7.36.
[326] Southern (2025) Response to CMA PR24 PD, paragraphs 2.50–2.53.
[327] Southern (2025) Response to CMA PR24 PD, Table 5, p33.
[328] Southern (2025) Response to CMA PR24 PD, paragraph 2.54.
[329] Southern (2025) Response to CMA PR24 PD, paragraph 2.58.
[330] Southern (2025) Response to CMA PR24 PD, paragraph 2.57.

Ofwat

Rating agency methodologies and thresholds

8.294 In Ofwat's Response to the Disputing Companies' statements of case, Ofwat reiterated the approach it took in its PR24 FD. Ofwat noted that it calculated AICR and FFO/net debt as the key credit metrics and also recognised that each credit rating agency applies its own methodology in assessing financial metrics, making adjustments that may be specific to each company. Ofwat stated that this requires careful interpretation when considering the levels of financial ratios that should be considered for the purposes of the financeability assessment.[331]

8.295 Ofwat stated that it took account of the changes to guidance published by the credit rating agencies in its PR24 FD to the extent the guidance was clear and relevant to the notional company.[332] Ofwat noted that Moody's had updated its assessment of the stability and predictability of the regulatory environment from Aa to A ahead of Ofwat's PR24 FD, and tightened its guidance for adjusted interest cover for the target credit rating of Baa1 to at or above 1.6x (previously 1.5x) and gearing to at or below 68% (previously 72%).[333]

8.296 Ofwat noted that S&P does not publish sector wide guidance for its assessment of financial metrics. Thresholds for companies can vary as a result of different assessments of business risk based on historical and expected levels of performance, and gearing levels relative to regulatory assumptions.[334] Ofwat stated that it considered an FFO to net debt financial ratio of around 10% – equating to around 9% under a measure closer to S&P's methodology – to be consistent with a BBB+ rating, noting that it considered this to be guidance rather than an absolute minimum.[335]

8.297 Following our CMA PR24 PD, Ofwat submitted that, while it agreed that the CMA PR24 PD was financeable and was supportive of many of our assumptions,[336] it disagreed with the levels set out as 'thresholds' for financial metrics. It submitted that our use of thresholds was well above those applied in previous determinations (including the CMA at PR19), and those proposed by companies themselves for assessing financial resilience.[337] It submitted that this could set an unhelpful reference point for future determinations.[338]

8.298 In respect of AICR and FFO/net debt more specifically, Ofwat submitted that the assessment of these was significantly higher than the minimum guidance provided

[331] Ofwat (2025) Response to common issues on risk and return, pp161–162, paragraph 9.46.
[332] Ofwat (2025) Response to common issues on risk and return, p163, paragraph 9.52.
[333] Ofwat (2025) Response to common issues on risk and return, pp162–163, paragraph 9.49.
[334] Ofwat (2025) Response to common issues on risk and return, p164, paragraph 9.58.
[335] Ofwat response to Ofwat RFI07, Q3, p5.
[336] This includes on the notional capital structure (eg on ILD) and on the consistent cost of debt assumption.
[337] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraphs 11.3–11.14.
[338] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraphs 11.3–11.14.

for by ratings agencies.[339] It considered it more appropriate – given the level of flexibility and judgement applied by agencies – to assess financial metrics against the lower boundaries of guidance.[340] It considered that the levels in assessment of financeability for its PR24 FD (1.6x for AICR and 9% for FFO/net debt) remained suitable guidance for the notional company.[341]

8.299 Ofwat submitted that ratings agencies take a range of company specific information into account when determining ratios and below target guidance may still be consistent with a BBB+/Baa1 rating where this is supported by an in-the-round assessment with stronger metrics elsewhere (eg gearing around 55%).[342] It submitted that this is consistent with its approach in its PR24 FD, the CMA's PR19 redeterminations and other regulators' price reviews.[343] It also gave examples of companies having maintained credit ratings despite a financial metric not being commensurate with the ratings agencies' guidance.[344]

8.300 Ofwat submitted that it supported our use of issuer credit ratings rather than the SACP to inform FFO/net debt guidance.[345] However, it submitted that if the SACP was used, this also results in similar guidance of 9% for the FFO/net debt ratio being appropriate when other factors are taken into account, such as how closely companies align to the notional capital structure.[346]

Stress testing and sensitivities

8.301 In Ofwat's Response, Ofwat submitted that, taking account of its interpretation of its duties, it did not consider that it was the role of the price determinations to protect companies under all scenarios. Ofwat added that investor returns should be at risk and as such, under severe downside scenarios, it may not expect a company to exhibit financial ratios consistent with the target credit rating in the short term. Ofwat stated that the target credit rating should not be considered a floor for stress testing as the target credit rating, itself, provides headroom to deal with cost shocks and other stressed scenarios.[347]

8.302 Ofwat also noted that it had carried out its financeability assessment before taking account of revenue adjustments for PR19 reconciliations which totalled around £1.5 billion for the sector over 2025-30 and that this would provide additional headroom to the financial ratios for most companies.[348]

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[339] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.10.
[340] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.10.
[341] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.10.
[342] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraphs 11.11–11.12.
[343] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.12.
[344] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.13.
[345] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.14.
[346] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.14.
[347] Ofwat (2025) Response to common issues on risk and return, p168, paragraphs 9.74–9.75.
[348] Ofwat (2025) Response to common issues on risk and return, p169, paragraph 9.76.

Our assessment and decision

Notional capital structure

8.303 The Disputing Companies made limited submissions on the calibration of Ofwat's notional capital structure, which can be categorised into the following areas:

(a) the level of notional gearing;

(b) the availability of new equity;

(c) which inflation measure ILD should be indexed to; and

(d) the profile of debt financing costs.

8.304 We set out our assessment of the notional gearing assumption in chapter 7 (Allowed return) above and the availability of new equity in the 'Investability' section below and therefore we do not repeat those points here.

8.305 In response to Southern's submission that financeability should be tested against 60% gearing, we consider it important to maintain a consistent gearing assumption across our analysis. While this may – as Southern submitted – improve modelled financeability metrics, we consider our methodology of using 55% notional gearing is consistent with our objective to test the financeability of notionally structured companies, incentivising resilient capital structures.

8.306 We continue to consider that Ofwat's assumption of 90% of opening ILD being linked to RPI broadly aligns with the actual financing structures observed in the sector, per Ofwat's PR24 FD cost of debt model.[349] In addition, we note that the impact on financeability of revenues and the RCV being linked to CPIH and 90% of ILD being linked to RPI is reduced in our final determination (compared to Ofwat's PR24 FD) as the wedge between RPI and CPIH has reduced from 90bps to 50bps.

8.307 We model new ILD, and the remaining 10% of opening ILD, as CPIH-linked. We consider this to be a reasonable forward-looking assumption which is consistent with our broader price control framework, and we note that transition to CPIH indexation of the RCV (informing likely future ILD issuance) has been well signalled for some time. We also note that this this is a new submission from Southern on an assumption which has been established since Ofwat's PR24 DD, and represents somewhat of a change in position since its statement of case

[349] Per Ofwat's embedded debt model, as of 31 March 2024 there was £21,423 million of RPI-linked debt and £2,354 million of CPI-linked debt equating to 90% RPI-linked ILD and 10% CPI-linked ILD. See Ofwat (2024) PR24-FD-RR02-Cost-of-debt.

(where it submitted that the notional company could be expected to have transitioned all ILD to a CPIH basis).[350]

8.308 On the profile of debt financing costs raised by Southern and South East, we note that the cost of debt used in the financial model is an average over the period, which reflects the average share of new and embedded debt over AMP8. Including an annual cost of debt which reflected the changing share of new debt, would alter the profile of interest costs in the financial model but not the average over AMP8. In addition, we note that it would be inconsistent to alter the cost of debt used for interest costs in the financial model but not the corresponding cost of debt used in the WACC to determine the allowed revenue. If both of these were updated there would not be an impact on financeability.

8.309 We therefore retain the notional capital structure assumptions used by Ofwat in its PR24 FD. The one exception being the estimate of long-term CPIH, which we set to 2.4%, as we discuss under 'Inflation and estimating the cost of capital in real terms' in chapter 7 (Allowed return) above.

Rating agencies methodologies and target guidance

8.310 Table 8.20 below shows the categorisation used by the key ratings agencies, with risk profile increasing from left to right. Consistent with Ofwat and submissions of Disputing Companies, we target a rating for the notional company two 'notches' above the threshold for 'investment grade' credit ratings.

Table 8.20: Credit ratings used to assess

	Investment grade										*Non-investment grade*					
S&P/ Fitch	AAA	AA+	AA	AA-	A+	A	A-	**BBB+**	BBB	BBB-	BB+	BB	BB-	B+	B	B-
Moody's	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	**Baa1**	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3

Source: CMA analysis.

8.311 We first note that ratings agencies assess the credit quality of issuers based on a range of inputs and analysis (eg on business/ operational risk), with guidance only forming part of an assessment, and target ratios themselves informed by operational performance of specific 'actual' companies.

8.312 Our assessment of the expected ratios of notionally structured companies is informed by this context. We also take account in our assessment of the notional company's broad expected business risk profile, and the notional gearing assumption. This is consistent with Ofwat's submission – in response to our CMA PR24 PD – that ratios below the target level may be consistent with a BBB+/Baa1 rating with stronger metrics elsewhere (eg gearing around the notional level).[351]

[350] Southern SoC, p91, paragraphs 201–202.
[351] Ofwat (2025) Response to CMA PR24 PD: Allowed Return, Risk and Return, paragraph 11.12.

8.313 We set out below our assessment of the rating agency guidance and our conclusions on the relevant Baa1/BBB+ ratios for AICR (interest cover ratios) and FFO/net debt.

Interest cover ratios

8.314 Moody's sets out ratio guidance for UK water utilities. Moody's updated its ratio thresholds in November 2024 to reflect its revised view of the stability and predictability of the regulatory environment ahead of the publication of Ofwat's PR24 FD. Moody's revised AICR guidance for a Baa1 rating is [✂]x, with [✂]x acting as a threshold for an A3 rating.[352]

8.315 In November 2025, Moody's published a sector-wide update which set out many of its concerns influencing its negative outlook on the sector.[353] Here, it maintained its view of the sector's heightened business risk (informing its assessment of the regulatory environment as A, compared to Aa in the previous year).

8.316 In response to CMA questions, Disputing Companies submitted that Fitch's thresholds for A- senior unsecured ratings, or A senior secured ratings, can be used to infer thresholds for a BBB+ issuer default rating.[354] This was on the basis that Fitch embeds a one-notch uplift to these senior secured and senior unsecured debt issued by regulated utilities, and senior secured ratings receive a one-notch uplift due to structural enhancements.

8.317 While we consider it important to take a prudent view of applicable targets – which informs our approach to ratios – we also consider that Fitch's treatment of issuers 'in creditor-friendly jurisdictions with a robust regulatory environment, such as the UK' is likely to be relevant to the notional company. We also consider that Ofwat's guidance to us – given that it oversees and enforces licence requirements – is relevant to informing applicable ratios.[355] Fitch's cash PMICR is broadly similar to the AICR we consider, and therefore we do not model this separately.

8.318 In our CMA PR24 PD, we broadly aimed for 1.7x AICR, to maintain headroom over published guidance. Consistent with [✂], and broadly consistent with submissions of Ofwat and the Disputing Companies following our CMA PR24 PD, in our final determinations, we target an AICR of at least 1.6x in our assessment, aiming to achieve around 1.6x – 1.7x coverage.

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[352] Moody's (2024) Regulated Water Utilities – UK, Sector in-depth, Exhibit 4, p4.
[353] Moody's (2025) Outlook remains negative amid regulatory overhaul and heightened social risk.
[354] Disputing Companies' response to DCs RFI04, Q1 eg at paragraph 7. See also report referred to by the Disputing Companies: Fitch (2025) UK Water in AMP8: Navigating Challenges, p3.
[355] Ofwat referred to the BBB+ senior unsecured ratings of Wessex and Northumbrian having cash PMICR over 1.5x, in the range 1.5x – 1.7x (1.7x acting as a threshold for A-). Ofwat submitted that cash PMICR is a similar metric to its adjusted interest cover, and therefore no adjustment was required to its financeability assessment. See Ofwat response to Ofwat RFI07, Q6 at p12.

FFO/net debt ratios

8.319 In respect of FFO/net debt ratios, we note that S&P does not publish a sector-wide methodology, and its threshold guidance is informed by an in-the-round assessment of each company.

8.320 We recognise the submission made by Disputing Companies that the SACP assessment may be uplifted by S&P for 'structurally enhanced debt transactions' reducing risk to senior creditors. However, we consider it reasonable to rely on the ratings agencies' published assessments of operational performance and issued credit ratings at the entity level.[356]

8.321 We nonetheless observe that – including at the SACP level – thresholds around 9%, particularly for 'low volatility' companies with strong operational performance, are consistent with BBB+, including in reports cited by Disputing Companies.[357] We consider this in the context of the notional company likely performing well on other parameters (eg having gearing around the notional level).

8.322 We therefore target 9.0% FFO/net debt in our base case assessment for a Baa1/ BBB+ rating.

Our assessment of financeability

8.323 Our starting point is that the allowed return is the primary factor in the redetermination ensuring that an efficient firm can finance its functions. If the allowed return is set at a level which properly reflects the cost of debt and cost of equity for the investors in the sector, both debt and equity investors will earn sufficient returns to cover the costs of financing, and therefore the companies will be financeable.

8.324 Analysis of financial ratios plays a supporting role to our broader assessment of efficient costs, the allowed return, and the overall balance of risk.

Our credit ratio assessment

8.325 Credit ratio analysis assesses whether the determination, specifically the amount of cash generated from regulated activities, is consistent with rating agency expectations. We note that the underlying definitions of ratios and the accounting conventions used to present inputs are important. In particular the interaction between regulatory concepts (such as totex, PAYG rates and RCV run-off) and accounting concepts (in relation to whether a particular cost is expensed in a single year or capitalised and subject to a periodic depreciation charge) affects the

[356] For example, S&P (2025) Tear Sheet: United Utilities Water Ltd.
[357] Disputing Companies' response to DCs RFI04, Q1 eg at pp4–5. See also report referred to by the Disputing Companies: S&P (2025) U.K. Water Regulatory Framework Support, Low Financial Flexibility In Coming Regulatory Period Drive Rating Actions, pp2–3.

values of credit ratios. Accordingly, the point value of a single credit ratio at a particular point in time is not likely to be determinative in itself of the conclusion on financeability.

8.326 Ratings agencies consider a range of quantitative and qualitative factors to rate corporate debt issuers and individual financial instruments. We note that the overall assessment of a credit rating requires judgement about a broad range of factors that contribute to credit quality (operational performance, business risk, and so on). Although financial ratios play an important role in the assessment of credit ratings, these are not applied mechanistically by rating agencies. We consider that caution is required in a financeability assessment to avoid placing undue emphasis on the value of a particular ratio.

8.327 In order to calculate ratios, we have used the financial models which calculated the ratios that reflect our decisions on totex allowances, allowed return and the assumptions on the notional capital structure as set out above.[358]

8.328 Table 8.21 sets out the average AMP8 AICR and FFO/net debt for the Disputing Companies based on our final determinations. Our analysis assumes that the Disputing Companies will spend in line with their totex allowances and have no out- or under-performance on ODIs or financing. We consider potential downside sensitivities and their impact on financeability in the section below.

Table 8.21: CMA AMP8 average financial ratios

2025-30 average	*AICR*	*FFO/net debt*	*Gearing*
Anglian	1.73x	9.73%	55.23%
Northumbrian	1.70x	9.31%	55.89%
South East	1.74x	9.15%	56.11%
Southern	1.73x	10.16%	55.37%
Wessex	1.74x	9.17%	55.78%

Source: CMA analysis.
Note 1: we include FFO/net debt based on Ofwat's 'alternative' approach which recognises the full interest charge for interest-linked debt (rather than the cash interest charge in the standard version).
Note 2: Southern ratios in the table above shown excluding delivery mechanism totex. If delivery mechanism totex is included, Southern's AICR would be 1.73x, the FFO/Net debt 10.13% and gearing 55.44%.

8.329 The results of our assessment give reasonable headroom on our 1.6x target for AICR. Each company also demonstrates headroom to our 9% target guidance for FFO/net debt. We also note that the gearing is at levels comfortably below that expected for the target rating. In the base case, we are therefore comfortable that our determinations allow each company to achieve a strong investment grade credit rating, in line with the target Baa1/BBB+.

8.330 We consider sensitivities to this in the following section.

[358] We have made changes and corrections to the CMA PR24 FD financial models in response to submissions from Disputing Companies. See Southern (2025) Response to CMA PR24 PD, paragraphs 2.140–2.144.

Stress testing and sensitivities

8.331 In understanding whether our determinations impose reasonable financial risks on the water companies, the financial exposure that the companies face to downside risks is relevant. We have considered the size of exposure of the Disputing Companies modelled financial ratios to reasonable downside scenarios.

8.332 In the CMA PR24 PD, we modelled the impact of:

(a) a 1% RoRE penalty incurred by the firm in each year of the price control; and

(b) a 2% RoRE penalty in 2 years of the price control, with a 1% RoRE penalty in the remaining years.

8.333 The Disputing Companies noted that more severe downside scenarios are included in water companies' annual LTVS testing, which is included in the companies' annual reports. We have reviewed the LTVS stress test scenarios considered by the water companies and consider it may be prudent to model a more severe downside scenario than we considered in our CMA PR24 PD analysis. We note that our downside testing goes beyond the approach adopted by Ofwat in its PR24 FD.[359]

8.334 We have considered the submissions from the Disputing Companies in response to our CMA PR24 PD and for our final decision, we have modelled the impact of a downside sensitivity for the exposure on totex and ODIs:

(a) a 1% RoRE penalty incurred by the firm in each year of the price control; and

(b) a 2% RoRE penalty incurred by the firm in each year of the price control.

8.335 We conclude that these stress tests are severe but plausible downsides for the notional company. Our downside stress tests are less severe than the P10 scenario of -3.46% submitted by the Disputing Companies (see paragraph 8.183). However, we do not consider it necessary to test this more extreme downside. As we set out in more detail below, in the event of sustained underperformance companies and their shareholders can be reasonably expected to take mitigating actions to maintain an investment grade credit rating (water companies have a licence requirement to maintain an investment grade credit rating).[360]

8.336 We implement our downside testing (both the 1% and 2% RoRE downsides) on a cash basis and assume the RoRE impact is net of mitigants such as cost sharing. These scenarios also assume consistent underperformance across all five years of the AMP. The 2% RoRE downside is within the range of the most severe

[359] In its PR24 FD, Ofwat performed headroom tests to measure the level of downside water companies could incur before the adjusted interest cover ratio fell to one. Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, pp72–73.
[360] Credit Ratings - Ofwat (as accessed on 26 February 2026).

downsides considered by companies in their LTVS testing. A 2% RoRE downside is also consistent with downsides considered by other regulators in price control decisions.[361]

8.337 We model the impact of the downside sensitivities as in-year revenue shocks. We note the following on this approach.

(a) In practice, ODI shocks would be incurred with a two-year lag but for simplicity we model downsides in-year.

(b) Modelling downsides as a revenue shock will reflect the cash-flow impacts of ODI penalties and operating cost overspends. A capital expenditure overspend would have less of an impact on key ratios as it would not impact the numerator (eg FFO), but only the denominator (eg interest costs and net debt).

8.338 Table 8.22 below sets out the average credit metrics over AMP8 under the base case and each of the downside stress tests.

Table 8.22: downside sensitivities impact on AMP8 average AICR, FFO/net debt and gearing

Key ratios	***Anglian***	***Northumbrian***	***South East***	***Southern***	***Wessex***
AICR					
Base case	1.73x	1.70x	1.74x	1.73x	1.74x
RoRE downside: 1% in all years	1.52x	1.49x	1.53x	1.53x	1.53x
RoRE downside: 2% in all years	1.32x	1.29x	1.34x	1.33x	1.33x
FFO/net debt					
Base case	9.73%	9.31%	9.15%	10.16%	9.17%
RoRE downside: 1% in all years	8.68%	8.29%	8.12%	9.12%	8.16%
RoRE downside: 2% in all years	7.68%	7.31%	7.13%	8.12%	7.19%
Gearing					
Base case	55.23%	55.89%	56.11%	55.37%	55.78%
RoRE downside: 1% in all years	56.41%	57.05%	57.33%	56.53%	56.88%
RoRE downside: 2% in all years	57.59%	58.21%	58.56%	57.68%	57.98%

Source: CMA analysis. Note, we include FFO/net debt based on Ofwat's 'alternative' approach which recognises the full interest charge for interest-linked debt (rather than the cash interest charge in the standard version). Southern ratios in the table above shown excluding delivery mechanism totex.

8.339 We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for the notional company are more in line with a credit rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (with 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade rating. Predicting the impact on the credit rating in these downsides is difficult, as it will depend on whether the shock is one-off or persistent and, as we noted earlier, rating agencies will take an overall assessment in the round. However, overall, we are broadly satisfied that an investment grade rating can be maintained in reasonable downside scenarios.

[361] For example, Ofgem considered a 2% RoRE downside in its financeability testing for RIIO-3. Ofgem (2025) RIIO-3 Draft Determinations - Finance Annex, paragraph 5.58.

8.340 We note that these results are consistent with the testing performed by water companies in their LTVS downside stress testing analysis. Water companies' LTVS also consider a number of mitigating measures to reduce the risk of a credit rating downgrade. These mitigating measures include:[362]

(a) new equity support;

(b) review and restriction of dividend payments;

(c) management of short-term working capital to improve cash flow;

(d) review of spend profile of the capital programme;

(e) cost reduction programme, with a focus on discretionary/non-essential items;

(f) consideration of alternative financing approaches including new sources of debt funding; and

(g) engagement with ratings agencies and banks to discuss the short-term nature of the impacts.

8.341 Cognisant of (i) our assessment of the package as a whole and (ii) the need to maintain incentives for companies to achieve cost efficiency and perform in line with targets, we consider that the outcomes of these tests are likely to demonstrate sufficient headroom for notionally structured companies.

8.342 We also note that these downsides do not factor in any mitigants, such as those set out above. For example, we do not assume any new equity is injected as can be seen by the increase in gearing in the downside scenarios. If a company is consistently underperforming, it would be reasonable for equity investors to provide support and/or other mitigants to be considered.

8.343 Finally, we note that we broadly agree with Ofwat that it is not the role of the price control settlement to provide protection against a credit rating downgrade in all downside scenarios.

Conclusions on financeability

8.344 Our view is that we have taken an approach to the wider determination which properly takes account of the risks of setting allowances too high and too low. We have re-assessed the allowed return and wholesale totex requirements. We have reduced some of the downside risks in the outcomes package relative to Ofwat's

[362] Water company annual reports. Anglian (2025) Annual Report, p120. Dŵr Cymru (2025) Annual Report, p58. Northumbrian (2025) Annual Report, pp92-96. Severn Trent (2025) Annual Report, pp81-83. Pennon (2025) Annual Report, p81. Southern (2025) Annual Report, pp134-135. Thames (2025) Annual Report, pp28-30. United Utilities (2025) Annual Report, p127. Yorkshire (2025) Annual Report, p130. Affinity (2025) Annual Report, p59. Portsmouth Water (2025) Annual Report, p99. South East (2025) Annual Report, pp127-128. South Staffs Water (2025) Annual Report, p162. SES Water (2025) Annual Report, p51.

PR24 FD, and have considered the arguments around the balance of risk, concluding that the price control overall is a balanced package.

8.345 In line with regulatory practice, we have also completed a financial ratio analysis and conclude that this supports the view that our determinations are financeable. Our base case ratio analysis produces ratios broadly consistent with a strong investment grade credit rating (BBB+/Baa1). We have also considered a range of downside sensitivities and conclude that each of the Disputing Companies, under the notional capital structure, can reasonably expect to maintain an investment grade credit rating.

Investability

8.346 We interpret 'investability' (which is also sometimes referred to as equity financeability) as consideration of whether the overall package is such that the notional company can attract and retain the equity investment required.

8.347 In its PR24 final methodology, Ofwat concluded that equity financeability was best addressed by setting an allowed return on equity based on market data and setting a balanced package of risk and reward. It included dividend yields in the suite of financial metrics to reflect its expectations of reasonable dividend policies but did not consider the need to include any additional metrics or analysis (in addition to what was already considered elsewhere) with regard to equity financeability.[363]

Ofwat's PR24 FD approach

8.348 In its PR24 FD, Ofwat responded to concerns raised by companies in their PR24 DD representations regarding the investability of Ofwat's determinations.[364]

8.349 Ofwat stated that it had addressed company concerns relating to investability by selecting an allowed return on equity towards the top of its range.[365] Ofwat also noted that it made further adjustments to the balance of risk and return and introduced the OAM alongside the ASMs for costs and outcomes.[366]

8.350 Ofwat noted that some investors valued a stable income stream, whereas others preferred growth of their investment. Ofwat stated that it had changed its approach to maintain the dividend yield at 4% irrespective of the level of RCV growth and that the equity required to fund investment growth was provided through new

[363] Ofwat (2022) PR24 final methodology: Aligning risk and return – appendix, p46.
[364] Ofwat (2024) PR24 Final Determinations Aligning Risk and Return, p10.
[365] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p75.
[366] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p75.

equity rather than an increase in retained earnings.[367] Ofwat noted that it provided an allowance of £0.3 billion for the costs of issuing £12.7 billion of new equity.[368]

8.351 Ofwat stated that it was for each company to decide when and to what extent it requires new equity over 2025-30 and beyond. Ofwat also said that it was for each company to decide how it obtained that equity, through retained earnings and/or through new equity issuance. Ofwat considered that its PR24 FD provided the basis for an efficient company to make those choices.[369]

Parties' submissions

8.352 We note that the submissions relating to investability at times overlap with financeability. The majority of the other arguments raised by the Disputing Companies, and their advisers, in relation to investability are concerned with:

(a) setting a sufficient allowed return, including drawing on cross-check evidence in addition to the CAPM; and

(b) ensuring an appropriate balance of risk and return.

8.353 We discuss the points raised by the parties in relation to the allowed return, including the use of cross-checks, and set out our view of the allowed return in chapter 7 (Allowed return). Similarly, we consider submissions relating to the overall balance of risk and return and the calibration of risk mechanisms such as the ASM and the OAM, earlier in this chapter. We therefore do not repeat submissions already covered earlier in this chapter and in the preceding chapters for the relevant building blocks.

Disputing Companies

General points on investability

8.354 Each Disputing Company submitted that there were increasing requirements for debt and equity investment in the water sector in AMP8 due to the large capital programme. The Disputing Companies noted that it was important to ensure that the allowed return was sufficient and there was an appropriate balance of risk and reward so that the sector was able to attract the required investment.[370]

8.355 Northumbrian and Southern also stated that attracting this finance means ensuring that investors, who can invest anywhere in the world in any sector, consider that

[367] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p75.
[368] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p76.
[369] Ofwat (2024) PR24 final determinations: Aligning risk and return – appendix, p76.
[370] Wessex SoC, p87. paragraphs 10.4–10.7. Northumbrian SoC, pp14–15, paragraph 43, South East SoC, p85, paragraphs 7.1–7.2. Southern SoC, p97, paragraph 241. Anglian SoC, p165, paragraph 629.

the returns on offer in UK water adequately compensate them for the risks that they are taking.[371]

8.356 Southern stated that a robust approach to assessing investability should include the following quantitative and qualitative tests:[372]

(a) the expected (P50) equity return for the notional company should be equal to the allowed cost of equity;

(b) the expected excess equity return over a risk-free benchmark for the notional company should be in line with, or above, market benchmarks for comparable investments;

(c) risk exposure for the notional company should be in line with what would typically be considered appropriate for a regulated utility;

(d) the regulatory framework should be one where there is a high degree of stability and predictability of regulatory decisions; and

(e) the notional company should not be exposed to significant, open-ended downside risk, including the prospect of being unable to achieve a positive dividend yield across the regulatory period.

8.357 Southern concluded that the notional company would fail all five investability tests under Ofwat's PR24 FD and be unable to attract the capital required in AMP8.[373]

8.358 Anglian submitted that to ensure the notional company's investability over AMP8 and beyond the CMA should:[374]

(a) revise the WACC, RCV run-off rates and retail margin so that it provides a sufficient return for an investor in the notional company, and confirm that the cost of equity is expected to increase over future AMPs to provide reasonable certainty to investors over the investment time horizon; and

(b) address or mitigate risks in Ofwat's PR24 FD at source where reasonably practicable to do so.

Oxera analysis

8.359 Anglian submitted a report from Oxera, on investability and financeability.[375]

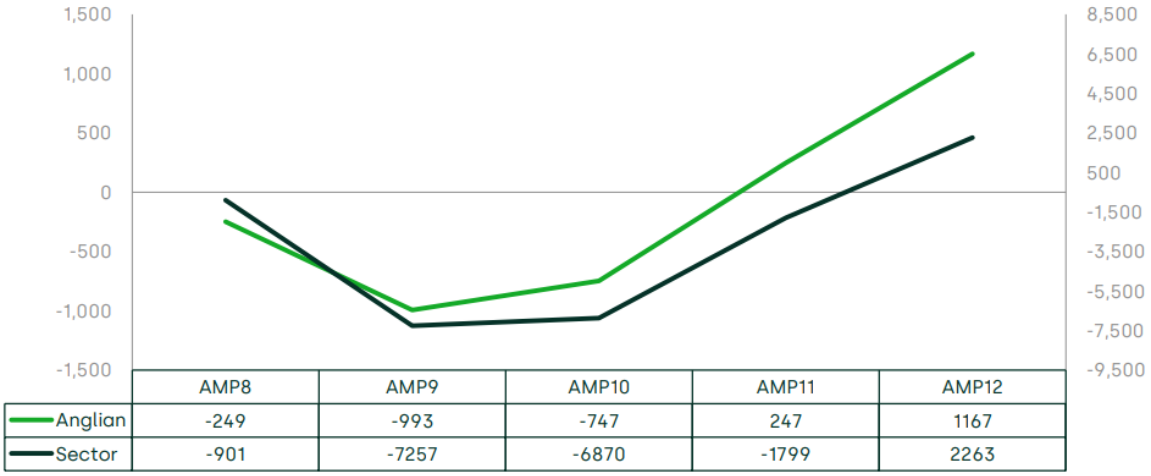
[371] Northumbrian SoC, p15, paragraph 44, Southern SoC, p97, paragraph 242.
[372] Southern SoC, p99, paragraphs 250 and 252.
[373] Southern SoC, p101, paragraph 264.
[374] Anglian SoC, p166, paragraph 635.
[375] Oxera (2025) Investability and Financeability in PR24.

8.360 Oxera submitted that the water sector faced a steep increase in investment requirements across the coming decades and that water companies were at the start of a multi-AMP period of significant RCV growth, which would be the fastest rate since privatisation.[376]

8.361 Oxera stated that its analysis showed that, at the sector level, even if all base returns were retained to fund investment (ie no dividends are paid), net new equity would still be required for the notional company in AMP8 and AMP9. Oxera noted that notwithstanding Ofwat's dividend payment assumptions for the notional company in Ofwat's PR24 FD, investors would face an 'implied net dividend' that was negative for at least ten years from the start of AMP8.[377]

8.362 Oxera submitted Figure 8.3 below to show its analysis of cumulative returns to investors in the water sector. Oxera noted that on average, based on Ofwat's notional company, investors would only receive net positive dividends partway through AMP11 – over 15 years after the initial AMP8 investment. Oxera stated that even upon achieving net positive cash flows, investors would not receive a reasonable dividend yield on their investments, even up to AMP12.[378]

Figure 8.3: Oxera analysis of cumulative net dividends, Anglian v Sector (WaSCs only), no de-gearing (£m real, 2022/23 prices)



	AMP8	AMP9	AMP10	AMP11	AMP12
Anglian	-249	-993	-747	247	1167
Sector	-901	-7257	-6870	-1799	2263

Source: Oxera (2025) Investability and Financeability in PR24, p9, Figure 1.5.

8.363 Referencing Oxera's analysis, Anglian submitted that its investors would not receive a reasonable dividend yield on their investments even by AMP12. Anglian added that no reasonable investor would accept this, no matter how long-term focused they are, especially considering what the current profile in the sector signals for future risks.[379]

[376] Oxera (2025) Investability and Financeability in PR24, p3, section 1.1.
[377] Oxera (2025) Investability and Financeability in PR24, p7, section 1.3.
[378] Oxera (2025) Investability and Financeability in PR24, p7, section 1.3.
[379] Anglian SoC, p182, paragraph 689.

8.364 In response to the CMA PR24 PD, Anglian submitted that it was not challenging the fact that in periods of high investment, it is reasonable for investors not to see a full return in cash on their investment over the short term. Anglian added that the CMA's mistake in the CMA PR24 PD was to avoid thinking about whether the returns on offer are sufficient to attract investors with the right profile, in particular whether the cash returns profile flowing from the cost of equity is sufficient to entice existing investors to commit further equity and to attract new investors.[380]

8.365 Anglian submitted that while a low-risk, low-return investor may reasonably accept low or negative net cash returns for a 5- or a 10-year period of heavy investment, it would be unthinkable for any investor to accept such a proposition for longer periods when there is inherent uncertainty on the ultimate level of return (which remains dependent on future regulatory settlements and the performance of the notional company over a much longer timeframe). Anglian submitted that this was the reason it proposed the CMA provide signalling vis-à-vis the expected future evolution of the cost of capital.[381]

Ofwat

General points on investability

8.366 Ofwat stated that it maintained that its PR24 FD would allow an efficient company with the notional capital structure to raise the required equity. Ofwat explained that the recalibration of expenditure allowances and performance targets – together with the changes to the overall risk and return package and its decision to set an allowed return on equity towards the top of its range – aimed to support companies to raise the necessary levels of equity finance in the 2025-30 period. Ofwat added that where equity was not forthcoming, a dividend restriction, even to zero, would provide material additional support across the sector for companies to meet their investment requirements.[382]

8.367 Ofwat stated that the levels of investment growth in 2025-30 and beyond provided significant opportunities for investors. Ofwat submitted that there were opportunities for investors to earn enhanced returns where companies delivered high levels of performance to customers and where companies outperformed, this would support equity financeability and support companies to raise necessary finance at efficient cost.[383]

[380] Anglian (2025) Response to CMA PR24 PD, paragraph 530.
[381] Anglian (2025) Response to CMA PR24 PD, paragraphs 530–531.
[382] Ofwat (2025) Response to common issues on risk and return, p153, paragraph 9.11.
[383] Ofwat (2025) Response to common issues on risk and return, pp153–154, paragraph 9.12.

8.368 In response to the CMA PR24 PD, Ofwat set out the following points, which it stated, showed that investor sentiment had improved since its PR24 FD:[384]

(a) the three listed water companies are trading at a MAR premium;

(b) the publication of the IWC Final Report in July 2025 reduced investor uncertainty;

(c) water companies have continued to raise equity since publication of Ofwat's PR24 final determinations, with £2.3 billion-£2.6 billion issued or committed;' and

(d) debt risk appeared to have reduced – since mid-2024, the cost of new debt for water companies has moved tighter to the cost of new debt benchmark index (the iBoxx A/BBB).

Oxera analysis

8.369 Ofwat noted that, given evidence of companies scaling equity injections in a manner that supported the ongoing payment of dividends, in its PR24 FD it had accepted that it was appropriate to amend the approach in its financeability assessment, to apply a 4% dividend yield and the greater use of equity injections. Ofwat referenced recent equity raises by National Grid and Severn Trent which scaled up their issuance requirements to maintain dividend yields. Ofwat stated that this appeared to contradict evidence provided to the CMA that the sector would have to wait until 2040 before seeing any cash dividend.[385]

Recent equity raises

8.370 In Ofwat's Response, Ofwat noted that a number of equity injections in the water sector, which went beyond statements made by companies as part of the Ofwat PR24 process, supported the view that the sector remains 'investable'.[386]

(a) South West Water did not consider equity financing to be necessary in either its business plan or its PR24 DD representation. However, its group had carried out a rights issue in January 2025, successfully raising £490 million of new equity.

(b) South East raised £75 million equity in December 2024. While this was to improve the company's liquidity position, this was additional to the £75 million to £125 million equity that its investors had already proposed as necessary to support investment in the 2025-30 period.

[384] Ofwat (2025) Response to common issues on risk and return, pp153–154, paragraph 4.54.
[385] Ofwat (2025) Response to common issues on risk and return, pp160–161, paragraph 9.41.
[386] Ofwat (2025) Response to common issues on risk and return, pp4– 5, paragraph 1.4.

(c) Affinity proposed no new equity in its PR24 DD representations. It had since confirmed that its investors had entered into a legally binding, unconditional agreement to inject into it £150 million equity before 31 March 2026.

(d) Southern announced that it would raise £900 million of committed equity to support its 2025-30 investment programme. Ofwat noted that this announcement, made in February 2025, after Ofwat's PR24 FD, is greater than the £650 million proposed in its PR24 DD representation.

Disputing Companies' reply to Ofwat

Recent equity raises

8.371 In their joint reply to Ofwat's Response, the Disputing Companies stated that the equity raises cited by Ofwat were not a holistic assessment of the investability of the sector. The Disputing Companies also noted that Pennon was targeting outperformance of approximately two percentage points of regulatory equity yet raised equity at a discount to RCV.[387]

8.372 The Disputing Companies stated that the equity raises referenced by Ofwat represented only £1.6 billion of the £12.6 billion notional equity investment Ofwat assumed in its PR24 FD, and that Ofwat's response ignored the conditions upon which the equity was raised. For example, the Disputing Companies noted that the stated equity raises for Southern and South East were to support lower gearing and credit ratings, rather than a vote of confidence for Ofwat's PR24 FD.[388]

8.373 The Disputing Companies noted that Ofwat did not report the value that Pennon shares traded at prior to the rights issue – which was a 3% discount to RCV (ie MAR below one) with zero market value attributed to the non-appointed businesses – nor that the rights issue was at a 35% discount.[389]

8.374 The Disputing Companies added that Pennon was targeting a 7% equity return, as confirmed in its investor presentation at the launch of the rights issue, which represented an implied return on equity significantly higher than that allowed by Ofwat's PR24 FD and that this cannot be argued to be supportive of the investability of the notional water company.[390]

8.375 South East stated that equity raises by South East, Anglian and Southern showed commitment of existing shareholders, but they did not constitute evidence that new investors are likely to commit capital based on an investment appraisal of the CMA PR24 PD. South East added that the delivery of the AMP8 programme require that

[387] Disputing Companies (2025) Joint reply to Ofwat's Response, p7.
[388] Disputing Companies (2025) Joint reply to Ofwat's Response, p7, paragraph 29.
[389] Disputing Companies (2025) Joint reply to Ofwat's Response, paragraph 30.
[390] Disputing Companies (2025) Joint reply to Ofwat's Response, paragraphs 30–31.

companies have continued access to financing from current, as well as new investors.[391]

8.376 Southern submitted that a significant quantum of equity coming to the sector was effectively 'rescue' equity to ensure companies remain going concerns and avoid a scenario like that at Thames Water, against the counterfactual of losing the entire equity investment. Southern added that the equity provided has either come from existing investors protecting their capital in existing investments, or from new investors securing ownership at a discount. Southern continued that from the perspective of existing shareholders, that discount represents a smaller loss compared with the counterfactual of a company not being able to meet its obligations and financial distress.[392]

8.377 Southern submitted that in the case of a regulated utility performing in line with its determination a 1x RCV multiple should be a price floor, provided the cost of capital is set correctly and the price control is a 'fair bet'. Southern added that if the multiple were less than 1x, the rights issue would effectively represent an unwarranted transfer of value from existing shareholders to new shareholders investing as part of the rights issue.[393]

Third parties

8.378 Pennon submitted that the cost of capital set by Ofwat in its PR24 FD was appropriate and consistent with the market conditions at that time. Pennon noted that following Ofwat's PR24 FD, it successfully raised £490 million in equity. Pennon added that this clearly signalled investor confidence in the regulatory package and Pennon's ability to deliver within it.[394]

8.379 Yorkshire Water submitted that ensuring the water sector is attractive to investors was crucial to delivering the service and environmental outcomes expected by its customers, and for the industry to comply with its legal obligations. Yorkshire Water added that it had significant concerns with the approach in Ofwat's PR24 FD on the WACC and balance of risk and return.[395]

Our assessment and decision

8.380 We do not repeat our assessment of the individual building blocks or the balance of risk and return here and instead focus our assessment on new issues raised in relation to investability, notably:

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[391] South East (2025) Response to CMA PR24 PD, paragraphs 7.40–7.41.
[392] Southern (2025) Response to CMA PR24 PD, paragraph 2.12.
[393] Southern (2025) Response to CMA PR24 PD, paragraph 2.17.
[394] Pennon (2025) Third Party Submission on the Water PR24 References, pp1–2.
[395] Yorkshire Water (2025) Third Party submission on the Water PR24 References, p2.

(a) Oxera's analysis on net dividend payments; and

(b) recent equity raises in the sector.

8.381 Southern set out a series of tests for assessing investability (see paragraphs 8.356(a) to (e)). As set out above, we have addressed the tests summarised at paragraph 8.356(a) to (d) through our assessment of the individual building blocks in our determination. We cover the test summarised at paragraph 8.356(e) in our discussion below of Oxera's analysis on net dividend payments.

8.382 Anglian argued that the required cost of equity was likely to increase in future AMPs, and certainty was needed for investors to invest over the long term. As set out in chapter 7 (Allowed return) there is significant uncertainty in estimating the cost of equity. This uncertainty increases as we look further ahead in time and it is not reasonable for us to estimate the market cost of equity for future AMPs. This is particularly the case given the potential changes in the regulatory framework (following the IWC Final Report) which may occur prior to PR29. It certainly would not be appropriate for us to speculate on whether the allowed return on equity would need to increase in future AMPs.

8.383 Regarding Anglian's proposition that investors are not prepared to commit capital without greater certainty over the future path of returns, first, we note that Anglian has not provided any convincing evidence to support this proposition. Second, we are of the view that any concerns around the long-term cost recovery of investment, including the opportunity to earn an appropriate rate of return, beyond the current price control, is a matter for future regulatory reform.

Oxera analysis

8.384 Oxera's analysis of 'net dividend' payments for the notional company set out that, at a sector level,[396] equity investors would not receive cash payments over and above total injected equity until AMP10. Oxera characterises this as an investment proposition which has shifted to a materially longer and uncertain payback period.[397] Oxera's suggested remedies for increasing net cash returns (or 'payback') to equity investors were: (i) increasing RCV run-off rates; and (ii) increasing the allowed return.[398]

8.385 In our view – particularly in the context of a sector going through a high capital investment phase and that sector being a regulated monopoly – it is not reasonable for equity investors to expect short (ie within 5 to 10 years) 'payback' periods, meaning that: (i) all new equity injected to fund investment is returned through cash dividends; and (ii) additional dividend payments are made over and

[396] Oxera's analysis defines the sector as the WaSCs only.
[397] Oxera (2025) Investability and Financeability in PR24, p11.
[398] Oxera (2025) Investability and Financeability in PR24, p2.

above this to form a ‘net dividend’, within a short timeframe. We consider that the current framework provides for sufficient returns to equity shareholders, which can materialise in a few ways. Examples are set out below.

(a) Companies can continue to maintain a stable dividend yield which provides cash dividend payments to shareholders. Equity injections can be scaled up to maintain this level of dividend yield. Depending on whether the new equity comes from new or existing shareholders, this may allow existing investors to maintain an income stream, without needing to provide additional capital (although the choice not to participate in supporting the growth of the capital base will come at a cost of longer-term dilution of their holdings).

(b) Companies can restrict dividends and reinvest more of their retained earnings to fund the growth in the capital base. The reinvested earnings still belong to shareholders, but investors can forego an immediate cash return, in exchange for reducing the need for new equity to fund the growth in the capital base (which can increase the value of their shares).

8.386 In our view, a reduction in net cash outflows to equity holders (or ‘net dividends’ as described by Anglian) is likely to be a feature of any period of high capital investment, including for companies in competitive markets. Put simply, when it is in a high capex environment a company cannot both: (i) maintain a steady dividend yield; and (ii) not expect shareholders to provide any capital to fund the capital programme. We find Oxera’s concept of a ‘net dividend’ not to be meaningful, in this context.

8.387 In the context of the regulated water sector, we consider that – given the high capex phase expected over the AMP8 period – the package is likely to provide sufficient returns to shareholders to allow for equity financeability when considering: (i) our relatively high point estimate within our range when setting the allowed cost of equity (see below); a (ii) 4% cash dividend yield provided for in our financial modelling, which increases allowed revenues by providing an allowance for equity issuance; and (iii) an RCV indexed with inflation.

8.388 We note Oxera’s arguments to increase run-off rates to increase net cashflows to equity investors. We set out above our approach to setting cost recovery rates, including run-off rates. Increasing run-off rates does not change the NPV of future cashflows to equity investors, it simply changes the timing of these cashflows, and therefore this is value-neutral for investors. Instead, cashflows increase in the short-term but reduce in future due to the accelerated RCV run-off. Given Oxera’s arguments that the high levels of capital investment are likely to be sustained over multiple price controls, we do not think that higher run-off rates to improve short-term cashflows is an appropriate remedy.

8.389 With respect to arguments around increasing the rate of return, we note that while different sets of investors might have different preferences around the timing of

cash flow returns, this does not affect the required rate of return on equity in the CAPM. Further, as noted above, water companies have flexibility to choose the right balance between maintaining dividends and equity injections, to cater to their investor preferences.

8.390 Further, in chapter 7 (Allowed return), we set out our allowed return on equity of 5.70%, which represents a point estimate 30bps above the mid-point of our CAPM range. When selecting our point estimate we considered the Disputing Companies' ability to raise the required debt and equity, and the welfare impacts of underinvestment.

8.391 In response to the CMA PR24 PD, Anglian submitted that the PR24 proposition requires investors with a fundamentally different risk appetite to the low-risk investors, such as pension and infrastructure funds, and that the CMA PR24 PD has not sufficiently considered whether the returns on offer would attract this other type of investor.[399] We have conducted a robust evidence-based assessment of the allowed rate of return and have considered the appropriate cost recovery profile for this AMP. In our view, this approach sufficiently considers the investability issues raised by Anglian. While a significant proportion of investment will only be recovered in future periods, from future customers, this is consistent with the current regulatory framework where the cost of that investment is spread over multiple generations and the allowed rate of return for the entire RCV is re-set every five years.

Recent equity raises

8.392 In addition to the equity raises cited by Ofwat in its response (see paragraph 8.370 above), there have been a number of additional equity raises in the sector.

(a) South East raised £200 million from existing shareholders in May 2025, to reduce gearing below 65% and reinforce its financial stability.[400]

(b) Anglian announced unconditional and legally binding commitments to inject £500 million into its group, pro-rata to their current shareholdings.[401]

(c) Southern announced in July 2025 an equity support package totalling up to £1.2 billion comprising an initial £655 million of binding equity commitments with up to a further £545 million intended to be committed by December 2025

[399] Anglian (2025) Response to CMA PR24 PD, paragraphs 530–531.
[400] Result of Equity Issue - 14:00:00 15 May 2025 - 53HO News article | London Stock Exchange (accessed 26 February 2026).
[401] Anglian Water announces £500m shareholder equity injection (accessed 26 February 2026).

– with a minimum of £245 million.[402] On 30 December 2025, Southern confirmed that the £245 million was now a binding equity commitment.[403]

8.393 We note that the reasoning for these recent equity raises from South East, Anglian and Southern are relating to debt restructuring or improving the financial resilience of the relevant company. We also recognise that these equity raises were from existing, rather than new, shareholders. However, we would not expect all new equity to come from new shareholders and these equity raises do provide some evidence that investors are willing to provide equity to put the companies on a more resilient and sustainable footing and in turn to deliver on their PR24 obligations.

8.394 With regard to Pennon's rights issue, the price discount does not necessarily imply that Ofwat's cost of equity is too low. Rights issues are typically done at a discount to incentivise participation. The rights price does not indicate the intrinsic value of the business.[404] We also do not agree with Southern's submission that the rights issue price can never be a discount to the RCV if the price control is a 'fair bet'. There are many factors influencing premia and discounts to RCV. In any case, Pennon's own view is the successful rights issue was an indicator that Ofwat's PR24 FD is investable.[405]

8.395 As set out in our MARs analysis (see 'Cross checks and selecting a cost of equity point estimate' section in chapter 7 (Allowed return) above), Pennon's MAR was above 1.0x as of November 2025 (see Figure 7.13) and the MARs for United Utilities and Severn Trent were 1.14x and 1.17x respectively. These observed metrics do not obviously raise concerns on the allowed return on equity. The CMA PR24 FD also adjusts the overall package to support investment from the Disputing Companies to better deliver for customers and the environment.

Conclusion

8.396 We recognise that the capital programme in AMP8 and beyond results in a significant increase in the required levels of equity and debt investment in the sector and it is crucial these determinations are set in a manner such that the Disputing Companies are able to raise finance to fund these activities.

8.397 Ofwat and the Disputing Companies made various arguments in response to the CMA PR24 PD regarding the overall investor sentiment in the sector. Ofwat stated a number of reasons why, in its view, investor sentiment had improved since

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[402] Capital Reorganisation - 08:41:41 01 Jul 2025 - BU33 News article | London Stock Exchange (accessed 26 February 2026).
[403] Further Equity Commitments - 17:42:28 30 Dec 2025 - BU33 News article | London Stock Exchange (accessed 26 February 2026).
[404] Allen, F, Brealey, RA, Edmans, A and Myers, SC (2022) *Principles of Corporate Finance: Fourteenth edition*, pp419–420.
[405] Pennon (2025) Third party submission on the PR24 Water References, p2.

Ofwat's PR24 FD. This included reference to increased regulatory certainty due to the publication of the IWC Final Report. On the other hand, the Disputing Companies set out arguments as to why investability had not improved or even worsened. This included reference to rating agency downgrades of the sector. Both Ofwat and the Disputing Companies drew on evidence of MAR analysis and recent equity raises. It is not easy to conclude whether the overall investor sentiment in the sector has improved or not since Ofwat's PR24 FD. This is highlighted by Ofwat and the Disputing Companies drawing on the same evidence to support competing conclusions on this matter.

8.398 There is no mechanism for guaranteeing that water companies will be able to raise the necessary debt and equity capital in AMP8, and a number of factors relating to actual company performance and financial resilience may influence outcomes. However, we consider that overall our final decision is investable for the following reasons.

(a) We have assessed the allowed return afresh, reflecting the latest market data and evidence. We have also selected a point estimate for the allowed return on equity above the mid-point of our CAPM range, primarily to reduce the risk of the sector under-delivering on its large-scale capital programme needed to improve services and resilience, given the potential welfare implications of underinvestment.

(b) We have updated the cost allowances and made some targeted adjustments to the outcomes package, to ensure efficient costs are funded and that performance targets are stretching but achievable.

(c) We have considered the arguments around the balance of risk and return and have satisfied ourselves that the package is broadly balanced.

(d) We have tested the financeability of a notional company, including against reasonable downside scenarios, and have concluded that the notional company can maintain an investment grade credit rating.

(e) We have retained an assumption of a cash dividend yield of 4%, regardless of RCV growth. We have also funded equity issuance costs of 2.5% for notional company structures, which increases allowed revenues.

8.399 We are of the view that our final determinations provide an investable settlement for the Disputing Companies on a notional basis.

Tax

8.400 Ofwat's calculation of allowed revenues included an allowance for corporation tax. However, the large investment programme in AMP8 along with the ability to deduct the full capital expenditure from taxable revenue means that the tax

allowance in Ofwat's PR24 FD had a zero contribution to allowed revenues and customer bills for all of the Disputing Companies for the 2025-30 period.[406] None of the Disputing Companies challenged Ofwat's approach to tax allowances.

8.401 We have retained Ofwat's tax allowance methodology in our calculation of allowed revenues and customer bills for these determinations. This results in a zero tax allowance for all of the Disputing Companies.

[406] Ofwat (2024) PR24 Final Determinations Aligning Risk and Return, p37.

9. Other Issues

9.1 In this chapter we cover our decisions in relation to:

(a) the implementation through our redeterminations of Ofwat's December 2025 blind year reconciliation final determinations for the Disputing Companies;

(b) the Revenue Forecasting Incentive;

(c) the bill impact of our final determinations (revenue profiling); and

(d) the recovery of costs incurred in connection with the References.

Blind year reconciliation

Introduction

9.2 When Ofwat sets allowances for a price control period, it uses a mixture of actual and forecast data because its final determinations are published before the outturn data for the final year of the previous price control period is available.

9.3 Ofwat then adjusts companies' price controls through its 'blind year reconciliation' process, performed following the end of each AMP, to account for the difference between companies' actual performance and the forecast performance included in Ofwat's final determinations once the outturn data for the final year of the previous AMP is available (in this case AMP7).[407] As part of this process Ofwat may also correct unambiguous errors identified in Ofwat's PR24 FD after it was issued. This process may result in Ofwat making adjustments to both the revenue allowances companies can recover from customers and the RCV balance for each company.

9.4 Water companies published their outturn 2024/25 data in July 2025. Ofwat published its final determination on the 2024/25 blind year reconciliations In December 2025 (**Blind Year Reconciliation FD**), following consideration of stakeholder responses to its October 2025 draft determination and the CMA PR24 PD.[408]

9.5 Ofwat also published in December 2025 an updated log of unambiguous errors identified in its PR24 FD which had been corrected within its Blind Year Reconciliation FD.[409]

9.6 The blind year reconciliation can relate to a range of parameters. Figure 9.1 below lists those covered by Ofwat's PR19 blind year reconciliation process (for AMP7).

[407] For example, see Ofwat (2025) Blind Year Reconciliation for 2024-25 (accessed 26 February 2026).
[408] Ofwat (2025) Blind Year Reconciliation for 2024-25 (accessed 26 February 2026).
[409] Ofwat (2025) Blind Year Reconciliation for 2024-25 (accessed 26 February 2026).

Figure 9.1: Parameters which are subject to blind year reconciliation and the timing of the implementation of those adjustments

Table 1: PR19 reconciliation models and application of differences

Model	In-period determination of 2025-30 price controls	Adjustment to 2026-30 revenue through RFI	Adjustment at PR29
ODI performance	✓		✓
C-MeX	✓		
D-MeX	✓		
Revenue Forecasting Incentive (RFI)		✓	
Cost of new debt		✓	✓
Tax		✓	✓
Totex		✓	✓
Developer services		✓	
Green recovery cost adjustment		✓	✓
Green recovery time value of money			✓
Accelerated / transition programme			✓
RPI-CPIH wedge		✓	✓
Water trading		✓	
Strategic Regional Water Resources		✓	✓
Bioresources			✓
Residential retail			✓
Business retail			✓
Land sales			✓

Source: Ofwat (2025) Information notice, IN 25/01 Expectations for the PR19 blind year reconciliation, p2 (Table 1).

Blind year reconciliation and the CMA redetermination process

9.7 Our final determinations incorporate three types of adjustment, with two resulting from Ofwat's Blind Year Reconciliation FD:

(a) Ofwat's final determination on the 2024/25 blind year reconciliation process for ODI blind year payments;[410]

(b) corrections for unambiguous errors for the Disputing Companies (using Ofwat's published aggregator models as a starting point) to reflect our final determinations;[411] and

(c) an adjustment due to an overstatement in Southern's capitalised income relating to developer services.[412]

[410] Ofwat (2025), Final determination adjusting for company actual ODI payments in 2024-25: Sector Overview, Table 2. NB figures included in Ofwat's Table 2 in the document are in 2017/18 prices; we show adjustments in 2022/23 prices.
[411] Ofwat (2025) Final Determination: Blind Year Reconciliation for 2024-25 (accessed 26 February 2026): Base costs aggregator model, Enhancement costs aggregator model and opex-capex split model.
[412] Ofwat response to Southern and Ofwat RFI01, Q1; Southern response to Southern and Ofwat RFI01, Q1; Ofwat correspondence to the CMA dated 19 December 2025 flagged the over stated allowances for capitalised income.

Blind year reconciliation process for ODI blind year payments

9.8 The blind year reconciliation adjustments that we have included in our redetermination process are those shown in column 'In-period determination of 2025-30 price controls' in Figure 9.1 above, which impact companies' allowed revenues in year 2 of the current price control. Remaining blind year reconciliation items (shown in the other two columns on the right hand side of Figure 9.1 above) are implemented by Ofwat either through the Revenue Forecasting Incentive discussed below or at the next price review (PR29). Table 9.1 below shows changes to revenue allowances as a result of Ofwat's blind year revenue adjustments to 2026/27 bills, which our final determinations incorporate.[413]

Table 9.1: Summary of blind year adjustments as published by Ofwat and incorporated in the CMA Final Determinations, 2022/23 prices

Adjustment made to year 2 of PR24 price control	*Anglian*	*Northumbrian*	*South East*	*Southern*	*Wessex*
	£m	**£m**	**£m**	**£m**	**£m**
Blind year adjustments to revenue	21.360	-9.945	0.402	-17.515	-10.466

Sources: Ofwat response to Ofwat RFI30, Q5.
Note: Anglian, South East and Southern blind year adjustments agree to Ofwat (2025) Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Anglian Water, Table 3; Ofwat (2025) Final determination adjusting for actual company performance in 2024-25: Blind year adjustment South East Water, Table 3; Ofwat (2025) Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Southern Water, Table 3; Ofwat (2025) Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Northumbrian Water, Table 3 adjusted for a bespoke adjustment of £-0.222 million shown in Ofwat (2025) Final determination adjusting for company actual ODI payments in 2024-25: Northumbrian Water Table 2, expressed in 2017-18 CPIH prices. Ofwat (2025) Wessex Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Wessex Water, Table 3 adjusted for a deferral of £-9.707 million shown in Ofwat (2025) Final determination adjusting for company actual ODI payments in 2024-25: Northumbrian Water Table 2, expressed in 2017/18 CPIH prices.

Unambiguous errors

9.9 We also make adjustments to reflect Ofwat's PR24 unambiguous errors. For the Disputing Companies, Ofwat updated its aggregator models[414] to reflect the changes in totex allowances due to the unambiguous errors. We used these models in our final determinations, and the unambiguous errors are included in the CMA PR24 FD through changes in totex allowances, as set out in Table 9.2 below. For Southern, the unambiguous errors include the transfer of around £392.4 million of allowances from delivery mechanism into PR24 allowances.[415]

[413] We incorporate these by adjusting revenues for the relevant wholesale and retail controls in the financial model.
[414] Base aggregator model, enhancement aggregator model and the opex-capex split model. Ofwat (2025) Final Determination: Blind Year Reconciliation for 2024-25 (accessed 26 February 2026). Base costs aggregator model, Enhancement costs aggregator model and opex-capex split model.
[415] Ofwat (2025), Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Southern Water, p5.

Table 9.2: Summary of changes to totex allowances due to Ofwat's PR24 unambiguous errors and incorporated in the CMA Final Determinations, 2022/23 prices

AMP8 total	*Anglian* £m	*Northumbrian* £m	*South East* £m	*Southern* £m	*Wessex* £m
Unambiguous errors totex adjustment	-43.294	20.641	-4.753	411.953	42.311

Source: CMA analysis of Ofwat blind year opex-capex split model (available at Ofwat (2025) Final Determination: Blind Year Reconciliation for 2024-25; accessed 26 February 2026) and Ofwat PR24 FD opex-capex split model (available at Ofwat (2025) PR24 Final determinations; accessed 26 February 2026).
Note: Southern includes the transfer of around £392.4 million of allowances from delivery mechanism into PR24 allowances.

Southern capitalised income

9.10 In response to Ofwat's Blind Year Reconciliation FD, Southern noted overstatement of capitalised income relating to developer services of £42 million.[416] This correction is implemented in our final determination by reducing Southern's capitalised income in our financial modelling.

Impact of these adjustments

9.11 The impact of the Blind Year Reconciliation FD[417] on Disputing Companies' allowed revenues and average bills in the current price control is small, with no more than ±£1 per annum to the average bill (see Table 9.3 below).

9.12 However, at Ofwat's Blind Year Reconciliation FD, Ofwat and Southern agreed to transfer around £392.4 million of allowances from the delivery mechanism into PR24 allowances resulting in an increase in average bills of around £5 before the impact of our redeterminations are reflected (see Table 9.3 below).[418]

[416] Ofwat response to Southern and Ofwat RFI01, Q1; Southern response to Southern and Ofwat RFI01, Q1; Ofwat correspondence to the CMA dated 19 December 2025 flagged the overstated allowances for capitalised income.
[417] Ofwat's Blind Year Reconciliation FD includes impact of unambiguous error corrections and the adjustment to Southern's capitalised income.
[418] Ofwat for its PR24 FD published two financial models for Southern (and Thames Water), one with the delivery mechanism and one without. In its Blind Year Reconciliation FD Ofwat included an upward adjustment to the expenditure allowance of £392.4 million previously recognised as part of the delivery mechanism scheme. Ofwat's reclassification of this expenditure has resulted in an increase in Southern's totex allowance as part of the price control of £392.4 million and an equivalent reduction in allowed revenue for Southern including the delivery mechanism. Ofwat (2025) Final determination adjusting for actual company performance in 2024/25: Blind year adjustment Southern Water, p5.

Table 9.3: Impact on average bills between Ofwat PR24 FD and Ofwat PR24 FD including blind year reconciliation and correction of unambiguous errors, 2022/23 prices

Company	*Ofwat PR24 FD*	*Ofwat PR24 FD including BYR and unambiguous errors*	*Variance*
	£	£	£
Anglian	591	592	+1
Northumbrian	488	488	-1
South East	274	274	0
Southern excluding delivery mechanism	620	626	+6
Southern including delivery mechanism	627	626	-1
Wessex	594	594	-0

Source: CMA analysis.
Note: Ofwat PR24 FD including blind year reconciliation, and unambiguous errors (which includes the adjustment to Southern's capitalised income) average bills have been calculated by CMA using Ofwat's financial models.

Revenue Forecasting Incentive

Introduction

9.13 The Revenue Forecasting Incentive mechanism incentivises WoCs and WaSCs to accurately collect revenues and allows them to adjust their charges to customers to account for any under- or over-recovery of revenue in a previous year.[419]

9.14 It is a symmetric revenue adjustment applied in-period which applies a financial penalty where differences between actual and allowed revenues exceed 2%.[420]

Revenue Forecasting Incentive and the CMA redetermination process

9.15 As set out under 'Blind year reconciliation' above, our final determinations reflect Ofwat's Blind Year Reconciliation FD adjustments for the Disputing Companies.[421]

9.16 Our final determinations will be implemented from year 3 of the current price control (2027/28), with real revenues in years 1 and 2 (2025/26 and 2026/27) aligning to Ofwat's PR24 FD and Ofwat's Blind Year Reconciliation FD respectively. Nominal revenues and the resulting K factors[422] will depend on the short-term inflation assumptions used in financial modelling.

9.17 As part of the financial modelling of the CMA's final determinations, we decided to maintain Ofwat's short-term inflation assumptions used in Ofwat's PR24 FD financial models.[423] As part of Ofwat's blind year reconciliation process, Ofwat has

[419] Ofwat (2024) PR24 draft determinations - Revenue forecasting incentive, p1.
[420] Ofwat (2025) PR24 Reconciliation Rulebook: Guidance Document, p77.
[421] To model our final decision we used Ofwat's revised feeder models, published with its Blind Year Reconciliation FD, to reflect the correction of unambiguous errors. Ofwat (2025) Blind year reconciliation for 2024-25 final determination.
[422] The K factor is used by Ofwat to express whether revenues are increasing or decreasing in real terms from the previous year. The K factor is used to adjust wholesale price limits and control the level of revenues water companies can recover during a price control. The K factors apply to the three wholesale controls: water resources; water network and wastewater resources.
[423] We note that the overall revenues companies can recover are determined in real terms. Short-term inflation is a modelling assumption – any changes to K factors as a result of changing the modelling assumptions (such as short-term inflation) do not represent genuine changes in allowances.

updated some of its short-term inflation forecasts using actuals and more recent forecasts. To ensure the year 1 (2025/26) K factors align with Ofwat PR24 FD we have not made a similar adjustment to the short-term inflation. This has resulted in a small discrepancy between Ofwat's Blind Year Reconciliation FD and the CMA PR24 FD year 2 (2026/27) wholesale K factors and nominal residential retail revenues (see Table 9.3 above and Table 9.4 below).

9.18 For AMP8, the Revenue Forecasting Incentive mechanism can be used to resolve the discrepancies to ensure the Disputing Companies can recover allowed revenues and are not penalised as a result of a small discrepancy. South East noted the discrepancies between year 2 (2026/27) wholesale K factors were not material enough to justify a manual adjustment, but could be addressed by Ofwat by updating the Revenue Forecasting Incentive formulae.[424]

Table 9.4: Ofwat's Blind Year Reconciliation FD and CMA PR24 FD year 2 (2026/27) wholesale K factor variances to be resolved through the Revenue Forecasting Incentive mechanism

	Anglian	***Northumbrian***	***South East***	***Southern***	***Wessex***
CMA FD Water Resources – K	24.02%	5.83%	-18.63%	50.38%	13.81%
Ofwat BYR Water Resources – K	24.02%	5.84%	-18.61%	50.32%	13.81%
Variance	-	-0.01%	-0.02%	0.06%	-
CMA Water network – K	2.07%	7.07%	8.19%	11.64%	-6.32%
Ofwat BYR Water network – K	2.08%	7.05%	8.20%	11.65%	-6.31%
Variance	-0.01%	0.02%	-0.01%	-0.01%	0.01%
CMA Wastewater network – K	5.89%	2.92%	-	-10.30%	8.06%
Ofwat Wastewater network - K	5.94%	2.88%	-	-10.34%	7.99%
Variance	-0.05%	0.04%	-	0.04%	0.07%

Source: CMA analysis.

9.19 In relation to the discrepancies between Ofwat's PR24 FD blind year reconciliation and CMA PR24 FD year 2 nominal residential retail variances (set out in Table 9.5 below), we have not addressed the variances. We would expect the Disputing Companies to refer to Ofwat's Blind Year Reconciliation FD for nominal revenue allowances and to our final determinations in respect of allowed revenues for years 3 to 5 of the price control. Table 9.5 below presents total residential retail revenue per customer in nominal terms.

[424] South East response to Main Parties RFI03, Q1.

Table 9.5: Ofwat's Blind Year Reconciliation FD and CMA PR24 FD year 2 (2026/27) nominal residential retail (allowance per customer)

	Anglian £	*Northumbrian* £	*South East* £	*Southern* £	*Wessex* £
CMA FD residential retail allowance	46.92	47.41	29.57	45.21	45.44
Ofwat BYR residential retail allowance	46.86	47.55	29.55	45.16	45.63
Variance	0.06	-0.14	0.02	0.05	-0.19

Source: CMA analysis.
Note: The reason for the variance in the calculation of the residential retail revenue allowance relates to the financial model applying a margin to residential retail revenue allowance which is not included in the in-period adjustments model. This results in the residential retail revenue allowance in the financial model being greater in nominal terms than the allowance calculated within the in-period adjustments model. A margin of 1.5% is applied to residential retail allowance in the company-specific financial models which is not applied in Ofwat's in-period model. South East response to Main Parties RFI03, Q1. Ofwat response to RFI41A Q2.

Bill impact of CMA final determinations

Introduction

9.20 The price control sets revenue allowances for each water company. Each company is responsible for determining its charges and ensuring it does not exceed its revenue allowances.[425]

9.21 We set out below how we have approached calculating an indicative bill impact of our final determinations.

Revenue profiling

9.22 For our PR24 redeterminations, once we determine the revenue allowances over the whole AMP, an additional step is required to 'profile' the allowed revenues: that is to decide how the total amount of allowed revenue over AMP8 is to be spread over the five years in the price control period. This spread or 'profile' will determine how companies will set their charges for each remaining year of AMP8. As part of a price control determination, the profiling decision is taken by Ofwat with input from water companies and will depend on a range of factors: projected changes in customers numbers; types of customers in the area (eg metered versus non-metered); customer preferences etc. As part of our redeterminations, we must also take a view on how to profile allowed revenues for the Disputing Companies over AMP8.

9.23 For the CMA PR24 PD, we assumed that that any additional revenue allowed was profiled over years 2 to 5 in AMP8 such that customers' bills would remain constant in real terms (ie before impacts of inflation). This was an illustrative assumption and did not reflect any particular position regarding bill profiling. We sought views on the appropriate profile to apply.

[425] Individual bills will vary depending on the charging scheme adopted by the company: Ofwat's Charging information (accessed 26 February 2026).

9.24 In response to the CMA PR24 PD, we received a range of views on how Disputing Companies' bills should be profiled over the price control.

(a) Northumbrian submitted that customer bills should be profiled to reflect a gradual increase over the remainder of AMP8.[426] It submitted that this approach to bill profiling would be more consistent with the preferences of its customers and reflects the profile previously suggested by CCW.[427]

(b) Southern said that our bill profiling approach should follow Ofwat's approach to allow bills to be smoothed through the AMP, to ensure that customers' bills do not oscillate across the 5-year period.[428] This would allow Southern to continue to distribute revenue collection in the interests of customers.[429]

(c) Wessex said it preferred to keep bill rises in line with inflation for as many years as possible, to minimise perceived volatility and improve affordability.[430] This approach would align with customer expectations for stability and predictability, while allowing for gradual cost recovery in a way that would feel fair and manageable. It submitted that it would be in customers' interests to set bills to be flat in real terms for the remainder of the price review period.[431]

(d) Additionally, Wessex reiterated its aim, at the outset of the price control process, of keeping bill increases below 30% in real terms between 2024/25 and 2029/30 and that Wessex considered that it would be possible to broadly align with this aim in the context of the CMA PR24 PD.[432]

(e) Ofwat submitted that for Ofwat's PR24 FD, where possible the bill profiling mirrored companies' proposed profiles, with bills rising in real terms over the period.[433] Ofwat noted that it had engaged with CCW on bill profiling and concluded that a phased approach to bill increases across the period would be the preferred approach to better support consumer affordability.[434]

(f) CCW submitted that the CMA must use revenue profiling to smooth bill trajectories and avoid sharp year-to-year increases, noting that research shows customers generally prefer smooth bill increase profiles.[435]

9.25 For the CMA's final determinations we use a 'smooth' bill profile approach, with bills gradually increasing in real terms year on year starting from year 3 of the

[426] Northumbrian (2025) Response to CMA PR24 PD, p6, paragraph 9.
[427] Northumbrian (2025) Response to CMA PR24 PD, p6, paragraph 9.
[428] Southern (2025) Response to CMA PR24 PD, p160, paragraph 8.22.
[429] Southern (2025) Response to CMA PR24 PD, p160, paragraph 8.22.
[430] Wessex (2025) Response to CMA PR24 PD, p13, paragraph 9.10.
[431] Wessex (2025) Response to CMA PR24 PD, p14, paragraph 9.11.
[432] Wessex (2025) Response to CMA PR24 PD, p11, paragraph 9.1.
[433] Ofwat (2025) Response to CMA PR24 PD: Overview, p7, paragraph 1.26.
[434] Ofwat (2025) Response to CMA PR24 PD: Overview, p7, paragraph 1.26.
[435] CCW (2025) Response to CMA PR24 PD, p10, paragraph 3.26.

price control. Bills in years 1 and 2 are modelled to align with Ofwat's PR24 FD and Ofwat's Blind Year Reconciliation FD (as discussed in more detail above in paragraph 9.16). This profiling method aligns with customers' general preference for a smooth bill increase over the price control which minimises any step-change in bills aiding the predictability to the bill pattern over the AMP.

9.26 Wessex's proposal to apply a flat bill profile in real terms would not achieve Wessex's overarching priority of minimising bill volatility. Applying a consistent, gradual increase in bills is the most effective approach to minimising bill volatility across the price control.[436] We also do not consider it necessary to strictly limit Wessex's total bill increase to 30% for the reasons discussed in chapter 8 (Risk and return), paragraphs 8.245 to 8.247.

9.27 Disputing Companies' indicative annual bills under our final determinations are shown in Table 9.6 below.

Table 9.6: Disputing Companies' indicative annual bills (£, 2022/23 CPIH real prices)

	2024/25	***2025/26***	***2026/27***	***2027/28***	***2028/29***	***2029/30***
Anglian	£491	£547	£569	£599	£631	£664
Year-on-year change (%)	-	*11.4%*	*4.1%*	*5.3%*	*5.3%*	*5.3%*
2024/25 to 2029/30 change (%)						*35.3%*
Northumbrian	£422	£463	£480	£489	£499	£509
Year-on-year change (%)	-	*9.6%*	*3.5%*	*2.0%*	*2.0%*	*2.0%*
2024/25 to 2029/30 change (%)						*20.4%*
South East	£232	£260	£268	£282	£297	£313
Year-on-year change (%)	-	*12.2%*	*2.9%*	*5.4%*	*5.4%*	*5.4%*
2024/25 to 2029/30 change (%)						*35.0%*
Southern	£420	£611	£611	£636	£661	£687
Year-on-year change (%)	-	*45.4%*	*-0.0%*	*4.0%*	*4.0%*	*4.0%*
2024/25 to 2029/30 change (%)						*63.5%*
Wessex	£508	£575	£579	£607	£637	£669
Year-on-year change (%)	-	*13.1%*	*0.7%*	*4.9%*	*4.9%*	*4.9%*
2024/25 to 2029/30 change (%)						*31.6%*

Source: CMA analysis.
Note: Southern bills shown excluding remaining delivery mechanism totex.

Costs incurred in connection with the References

Background

9.28 As part of the redeterminations under section 12(3A) of the Act, the CMA has discretion to decide to what extent it is reasonable to take into account in its redeterminations costs incurred or borne by a Disputing Company in connection with the reference.[437] In deciding what costs may be taken into account, the group shall have regard to the extent to which the determination is likely to support the

[436] Wessex (2025) Response to CMA PR24 PD, p12, paragraph 9.3.
[437] The Act, section 12(3A); Rules (CMA204), Rule 13.1.

Disputing Company's rather than Ofwat's claims.[438] The CMA's Rules and Guide include further details of factors the CMA may consider in its costs determination.[439]

9.29 The Disputing Companies provided details of the costs they incurred during the redeterminations, on which Ofwat provided representations. Each Disputing Company used external legal, economic and other specialist advisers during the process.

9.30 The group, having considered costs submissions from the Disputing Companies and Ofwat, formed a provisional view on the proportion of costs incurred by each Disputing Company in connection with the References that would be appropriate to be recovered through the price control. The CMA issued a provisional determination on costs (**PDC**) to all main parties in January 2026, then received and considered responses to the PDC in February 2026.

Disputing Company costs

9.31 We decide that only external costs should be considered when allowing the Disputing Companies to recover costs through the price control. In principle, references are an integral part of the regulatory framework and can be considered part of expected activities for the Disputing Companies' staff. We did not consider any internal cost claims as submitted by the Disputing Companies to be sufficiently justified. Specifically, we did not consider that the Disputing Companies that made such claims had set out clearly why internal costs were not already funded by customers through base expenditure. We therefore considered that allowing recovery of internal costs would risk double-funding by customers.

9.32 The Disputing Companies respectively incurred external costs for the redetermination totalling around £9.0 million (Anglian), £3.7 million (Northumbrian), £9.0 million (South East), £7.6 million (Southern) and £3.1 million (Wessex).

9.33 We decide that Disputing Companies should not be allowed to recover 100% of their external costs through the price control from customers, despite some Disputing Company submissions that redeterminations were requested in consideration of customers' interests. We consider it appropriate for each Disputing Company's external redetermination costs to be shared between that company and its customers, taking relevant factors into account to determine the appropriate proportions payable by each. We also note that cost decisions in previous CMA redeterminations have consistently only allowed a proportion, rather than all, of a Disputing Company's costs to be recovered through the price control.

[438] The Act, section 12(3A); Rules (CMA204), Rule 13.2; Guide (CMA205), paragraphs 7.1–7.2.
[439] Rules (CMA204), Rules 13.3; Guide (CMA205), paragraphs 7.1–7.8.

9.34 We set a starting point recovery rate of 22% for all Disputing Companies. This is informed in particular by the extent to which the Disputing Companies overall succeeded in being awarded additional revenue claimed in their statements of case.[440] We also took into account that the CMA had been persuaded to change other aspects of Ofwat's PR24 FD that did not directly result in any additional revenue, including requests to amend aspects of the Outcomes framework.[441]

9.35 We then considered any reasons to allow a higher or lower rate of recovery for any individual Disputing Company. For example, we note that some external costs incurred by the Disputing Companies appeared high, raising concerns that at least some Disputing Companies may have over-engaged external advisers. Taking a proportionate approach, we set the following two recovery rates, reflecting significantly different levels of cost incurred by Disputing Companies and the behaviour we wish to encourage (ie in terms of controlling costs, taking a focused approach to claims, and being reasonable in the costs claimed):

(a) 42% for Northumbrian and Wessex; and

(b) 22% for Anglian, South East and Southern.

9.36 Ofwat estimated its internal and external costs for the process to be approximately £1.9 million and £1.3 million respectively. Ofwat cannot claim any costs directly against the Disputing Companies.

CMA costs

9.37 The Disputing Companies are required to pay in full to the Secretary of State under the conditions of their licences a CMA fee for the redetermination process. Ofwat determines the CMA Fee, following consultation with the CMA, by estimating costs incurred by the CMA in carrying out the redeterminations and determining the appropriate allocation between Disputing Companies.

9.38 Ofwat has estimated that the total CMA costs will amount to £5.2 million across all five Disputing Companies' determinations. As a result of the period of time for which the CMA was required to work on the redeterminations, the CMA costs will be recovered as two separate CMA Fees.

9.39 While some CMA costs can be attributed as specific costs for a given Disputing Company, most CMA costs are 'common' costs, as they relate to addressing issues relevant to more than one Disputing Company. After allocating company-specific costs to Disputing Companies, the remaining 'common' costs incurred by

[440] See the 'Change from Ofwat's PR24 FD AMP8 allowed revenue' and 'Change from Ofwat's AMP8 allowed revenue' values for each Disputing Company in Summary, at 'Table 1: Impact of our redeterminations on total revenue'.
[441] In addition, we note that a significant proportion of increases in revenue that we allowed under our final determinations was due to changes in financial markets rather than the strength of the Disputing Companies' arguments.

the CMA are allocated between the Disputing Companies as considered appropriate.[442]

9.40 Some causes of common costs relate to wastewater,[443] which are therefore not relevant to South East (a WoC). This is particularly notable for the period following the CMA PR24 PD. After consultation with the CMA, Ofwat will set the CMA Fees by charging, in addition to the respective specific costs for each company:

(a) each Disputing Company an equal share of 20% of CMA common costs incurred up to the end of September 2025;

(b) each of Anglian, Northumbrian, Southern and Wessex (as WaSCs) an equal share of 21% of CMA common costs incurred since 1 October 2025; and

(c) South East (as a WoC) a slightly lower share of 16% of CMA common costs incurred since 1 October 2025.

9.41 These fees are part of the costs incurred by the Disputing Companies in relation to the redeterminations, and so we have included these in our determinations in the same proportions as other company costs: 42% for each of Northumbrian and Wessex; and 22% for each of Anglian, South East and Southern.

Decision on recovery of costs incurred in connection with the References

9.42 We decide that the Disputing Companies can recover from their customers, through the PR24 price control, a proportion of the costs they have incurred in connection with the References.

9.43 For the reasons given above, we therefore decide to include the following costs in the determinations:

(a) Anglian £2.2 million;

(b) Northumbrian £2.0 million;

(c) South East £2.2 million;

(d) Southern £1.9 million; and

(e) Wessex £1.7 million.

[442] Guide (CMA205), paragraphs 7.11–7.12.
[443] For example, some aspects of base cost modelling – which generated a relatively greater share of the CMA's common costs in the period since the CMA PR24 PD when the Working Paper was published for consultation.

10. The final determination for Anglian

10.1 This section summarises our final determination for Anglian. In this, we set out our final determination, but we do not restate the explanation or rationale for our decisions; we cross-reference to the relevant earlier sections of our report to identify where we have explained these rationales.

10.2 We have reached our final determination for Anglian in accordance with the statutory principles that apply to Ofwat, including various statutory duties.

10.3 We consider that the final determination for Anglian is best calculated to further the Consumer Objective and Resilience Objective and to secure the Functions Duty, the Financing Duty and the Licence Duty set out in section 2(2A) of the Act (the primary duties). Subject to the primary duties, in reaching this determination for Anglian, we have reached a final determination for Anglian which we consider best calculated to promote, secure, ensure and contribute to the secondary duties (as appropriate) set out in section 2(3) of the Act.

10.4 We have had regard to the principles of best regulatory practice per section 2(4) of the Act. We have acted in accordance with the SPS in reaching this determination, per the requirement in section 2A(2) of the Act. We consider that our decision is consistent with the Growth Duty.

10.5 We have exercised our own regulatory discretion in appropriately complying with these statutory duties. We have considered the final package for Anglian in the round and are satisfied that it is consistent with the relevant statutory principles.

Approach to the determination

10.6 We have used the same regulatory building blocks as used in Ofwat's PR24 FD.[444]

10.7 The rest of this section sets out the final decisions we have applied to Anglian, grouped into the following areas:

(a) expenditure (base and enhancement) allowances;

(b) PCDs, ODIs, ASMs and OAM;

(c) allowed return;

(d) financeability; and

(e) calculations of allowed revenue, with implications for K factors and customer bills in AMP8.

[444] CMA PR24 Approach document, paragraph 32.

Totex allowances

Base cost allowances

10.8 Our final determination on the base cost allowances for Anglian is set out in Table 10.1 below.

Table 10.1: Base cost allowances

		£m
Ofwat PR24 FD (before frontier shift and real price effects)	*A*	6,121
Blind year adjustments	*B*	-10
Ofwat PR24 FD including blind year adjustments (before frontier shift and real price effects)	***C = A + B***	**6,110**
Total base CMA determination changes	***G***	14
Total base CMA determination (before frontier shift and real price effects)	***H = C + G***	**6,124**
Frontier shift and real price effects	*I*	-132
Total base CMA determination (after frontier shift and real price effects)	***J = H + I***	**5,992**
Ofwat PR24 FD including blind year adjustments (after frontier shift and real price effects)	*K*	5,985
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift and real price effects)	*L = ((J – K) / K) x 100*	0.1%

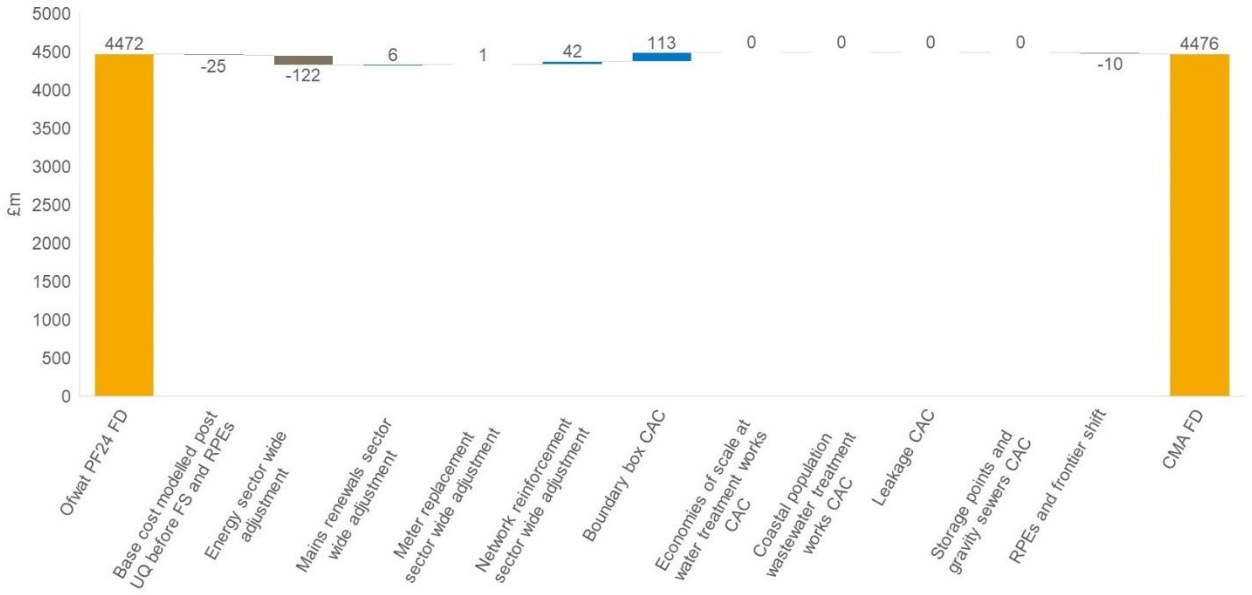
Source: CMA analysis. Disputing Companies' total base expenditure allowance (£m), rounded to zero decimal places.
Note 1: Totals include base expenditure allowances for: wholesale water, wastewater network plus, bioresources, and retail AMP8 total.
Note 2: % change is rounded to one decimal place.

10.9 The combination of modelling changes and cost adjustment claims results in an overall increase of £7 million after frontier shift and real price effects for Anglian compared with Ofwat's PR24 FD including blind year adjustments.

10.10 True-ups will be applied for labour and energy costs relating to base cost allowances – see chapter 4 (Base costs).

10.11 In Figure 10.1 below we set out the impact of our decisions on base costs on Anglian's total water, wastewater and bioresources allowances.

Figure 10.1: Impact of our decisions on base costs on Anglian's total water, wastewater and bioresources allowances



Source: CMA analysis.
Notes: For the CMA PR24 FD energy and labour cost for water and wastewater are included in the base case modelling so energy sector wide uplift and RPEs for water and wastewater are removed; Ofwat PR24 FD figure takes account of Ofwat's December 2025 Blind Year Reconciliation FD; totals exclude retail and unmodelled costs.

Enhancement cost allowances

10.12 In Table 10.2 and Figure 10.2 below, we show the changes to Anglian's enhancement allowances between Ofwat's PR24 FD and our final determination. The changes reflect:

(a) Ofwat's blind year adjustments (£34 million reduction);

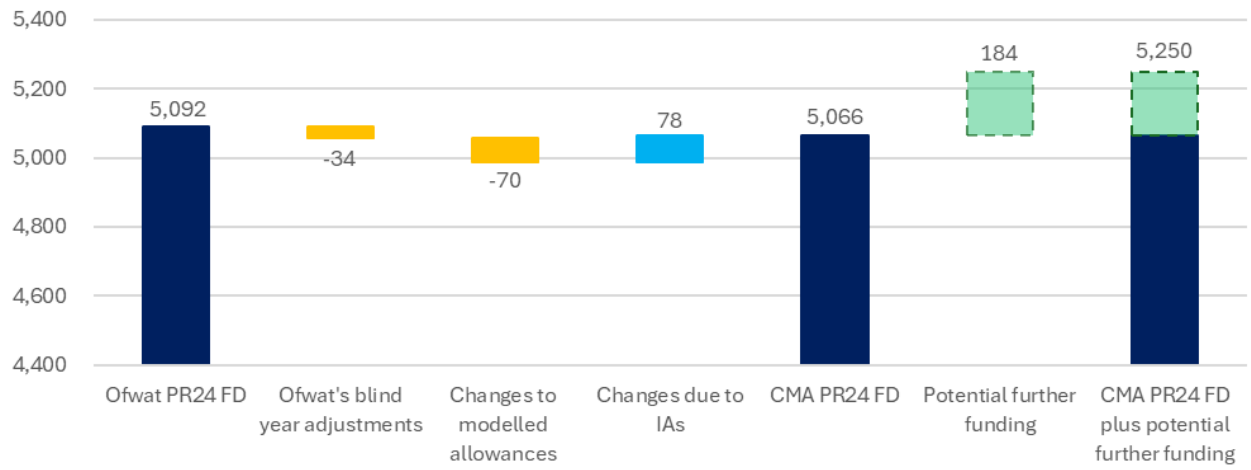
(b) changes to modelled allowances (an £85 million increase in the supply interconnectors allowance and a £155 million reduction in the phosphorus removal allowance); and

(c) additional funding for two individual assessments that relate to leakage and the reversal of an under-delivery adjustment in Ofwat's PR24 FD (combined £78 million increase).

10.13 We also illustrate (to the right of the chart) the potential additional funding that Anglian estimates that it will require for its Cambridge Water Recycling Centre scheme (£184 million[445]). We have decided to add this scheme to the large scheme gated process and Anglian will be able to make submissions to Ofwat to access additional funding for this scheme in AMP8 through the normal operation of the large scheme gated process.

[445] £184 million = £200 million (Anglian's maximum estimate of scheme costs) less £16 million development allowance.

Figure 10.2: Changes to Anglian's enhancement allowances between Ofwat's PR24 FD and our final determination and an estimate of potential additional funding for the Cambridge Water Recycling Centre scheme that we have added to the large scheme gated process (before frontier shift, £m)



Source: CMA analysis.
Note: The potential further funding relates to Anglian's estimate of the maximum additional funding required for its Cambridge Water Recycling Centre scheme that we have added to the large scheme gated process.

10.14 In Table 10.2 below, we summarise Anglian's enhancement allowances before and after frontier shift.

Table 10.2: Enhancement cost allowances

		£m
Ofwat PR24 FD	*A*	5,092
Blind year adjustments	*B*	-34
Ofwat PR24 FD including blind year adjustments	***C = A + B***	**5,058**
CMA determinations		
Benchmark modelling	*D*	-70
Individual assessments	*E*	80
Schemes moved to large scheme gated process	*F*	-2
Total CMA determination changes	***G = D + E + F***	**8**
Total enhancement CMA determination (before frontier shift, excluding potential further funding)	***H = C + G***	**5,066**
Potential further funding (note 1)	***I***	184
Total enhancement CMA determination (before frontier shift, including potential further funding)	***J = H + I***	**5,250**
Frontier shift	*K*	-55
Total enhancement CMA determination (after frontier shift)	***L = J + K***	**5,195**
Ofwat PR24 FD including blind year adjustments (after frontier shift)	*M*	4,942
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift, including potential further funding)	*N = ((L – M) / M) x 100*	5.1%

Source: CMA analysis.

Overall totex allowances

10.15 Our final determination of Anglian's wholesale totex allowance is shown in Table 10.3.

Table 10.3: Totex allowances compared with Ofwat's PR24 FD including blind year adjustments (after frontier shift and real price effects, £m)

	Ofwat PR24 FD (including blind year adjustments) £m	CMA final determination £m	Change from Ofwat's PR24 FD (including blind year adjustments) £m	%
Total base costs	5,985	5,992	7	0.1
Total enhancement costs	4,942	5,195	253	5.1
Total	**10,927**	**11,187**	**260**	**2.4**

Source: CMA analysis

10.16 We retain Ofwat's PR24 FD approach to cost sharing.

PCDs, ODIs, ASMs and OAM

PCDs and ODIs

10.17 For the purposes of this redetermination, we do not list every PCD or performance commitment to which Anglian is subject. Instead, we provide a list of the PCDs (or features of PCDs) and performance commitments (or other features of ODIs) in relation to which: (a) Anglian requested that changes be made; or (b) we have assessed and made changes that apply to Anglian following a request for a change from another Disputing Company. In each case we identify changes we make to Ofwat's PR24 FD, within Table 10.4.

Table 10.4: CMA final determinations on relevant PCDs and ODIs compared to Ofwat's PR24 FD

Category	*Performance commitment*	*CMA decision compared to Ofwat's PR24 FD*
PCDs applied to enhancement costs	Metering	No change
PCDs applied to base costs	Mains renewal	No change
Time incentive PCDs		No change
Adjustments to PCDs during AMP		No change, with the benefit of Ofwat's Updated November 2025 PCDs Guidance
PCDs and administrative and regulatory burdens		No change
ODI PCLs	External sewer flooding	Anglian company-specific PCL baseline set closer to the industry median and using the latest outturn data, converging to Ofwat's forecast median level of performance for companies for 2032/33
	Total pollution incidents	No change except to apply the latest outturn data for all Disputing Companies
	Water supply interruptions	Baseline level for common PCL set according to industry median (ie higher) and using latest outturn data, with glidepath to 5 minutes in year 5; apply enhanced ODI rate thresholds as per Ofwat's PR24 FD
	Leakage	2024/25 baseline reset to align with closing position at the end of AMP7 (ie apply the latest outturn data); glidepath to the 2029/30 PCL as per Ofwat's PR24 FD; apply enhanced ODI rate thresholds for Anglian as per Table 6.17 in chapter 6 (Outcomes)
ODI rates	Storm overflows	No change except to apply the latest outturn data
	Total pollution incidents	Calculation of performance range changed and apply latest outturn data, resulting in lower ODI rates for all Disputing Companies than in Ofwat's PR24 FD
	Water supply interruptions	No change except to apply the latest outturn data
	Experience measures (C-MeX, and D-MeX)	No change except to apply the latest outturn data

Source: CMA analysis.

10.18 Our decisions on consequential updates to PCDs are included in chapter 6 (Outcomes), along with associated content in Appendix E. We have detailed new PCDs we are applying in Appendix G – for Anglian this covers a new allowance we have given for boundary boxes.

ASMs and OAM

10.19 We make no changes to the ASMs and the OAM.

10.20 Our determinations on the ASMs are:

(a) to maintain the existing design of the totex ASM by not separating the mechanism between water and wastewater; and

(b) to maintain the existing thresholds of the totex and outcomes ASMs.

10.21 We retain the OAM with the ±50bps deadband.

Allowed return

10.22 We set an Appointee real CPIH-based WACC of 4.20%. We also set the wholesale WACC equal to the Appointee WACC, based on our view that there is no double counting of returns between the wholesale and the retail controls. We set out our detailed assessment of the allowed return in chapter 7 (Allowed return).

Financeability

10.23 For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. We completed an assessment of Anglian's notional financeability, including a financial ratio analysis, in line with standard regulatory practice. The outputs of this financial ratio analysis for Anglian are shown in Table 10.5 below.

10.24 The financial ratio analysis is one part of a broader assessment of financeability. We set out our detailed assessment of financeability in chapter 8 (Risk and return).

Table 10.5: Notional credit ratio analysis for Anglian

Key ratios	*AICR*	*FFO/net debt*	*Gearing*
Base case	1.73x	9.73%	55.23%
RoRE downside: 1% in all years	1.52x	8.68%	56.41%
RoRE downside: 2% in all years	1.32x	7.68%	57.59%

Source: CMA analysis. Note: AMP8 average financial ratios.

10.25 We conclude that, on a notional basis, Anglian's ratios are consistent with a Baa1/BBB+ rating in the base case. We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for Anglian are more in line with a credit rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (an annual 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade credit rating.

10.26 We consider that companies facing a financeability constraint, such as to address a downside scenario, can be reasonably expected to adopt a range of mitigating actions to address the impact, such as absorbing headroom in credit ratios, or increasing the contribution of equity either by forgoing dividends or injecting fresh capital. We conclude that this supports the view that our determination for Anglian is financeable.

Implied calculations of revenue and implications for K and bills

10.27 All revenue and customer bill figures in this section are presented in 2022/23 CPIH deflated prices.

Revenue adjustments

10.28 The majority of a water company's wholesale revenue is derived from the totex and WACC figures discussed above.

10.29 We have also included in chapter 9 (Other issues) adjustments relating to Ofwat's 'blind year' final determination, in which Ofwat conducts a reconciliation for company performance in the final year of the last AMP – this uses data which was not available at the time of Ofwat's PR24 FD – and corrects for unambiguous errors in Ofwat's PR24 FD. We include these adjustments in our final determination, which results in a £13 million increase in Anglian's revenue for the period.[446]

10.30 We also allow Anglian to recover a proportion of its costs for the CMA redetermination process, which includes an allocation of our own costs. This represents around £2.2 million (which is excluded from totex cost-sharing).

Implied Anglian revenue in AMP7 and calculations of K

10.31 In order to calculate Anglian's revenue figures, we need to include PAYG rates to split totex into in-period recovery and RCV additions. Our starting point for this is to use the 'natural rate' approach included in Ofwat's PR24 FD. [447]

10.32 We also set RCV run-off rates to determine the rate at which totex added to the RCV is recovered through revenues. We retain the run-off rates used by Ofwat in its PR24 FD. Table 10.6 sets out a calculation of the allowed revenue for Anglian's wholesale controls.

[446] £13 million increase relates to Anglian's total revenue, which includes wholesale and retail revenue.
[447] PAYG natural rate calculated as a proportion of net opex to net totex. See chapter 8 (Risk and return), section titled 'Cost recovery'.

Table 10.6: Calculation of Anglian's wholesale allowed revenue (£m)

CPIH-real	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*	*Total*
PAYG	352	1,542	1,548	339	3,781
RCV run-off	137	867	1,407	135	2,546
Return on capital	128	939	1,320	94	2,482
Revenue adjustments for PR19 reconciliations	19	165	29	4	216
Quality and ambition assessment (QAA) reward / penalty	-	-	-	-	-
Tax	-	-	-	-	-
Developer services, diversions and other contributions (price control)	-	97	94	-	191
Other income (non-price control)	-20	-62	-27	-7	-115
Innovation & Water efficiency fund	-	28	23	-	51
Revenue re-profiling	1	6	2	1	9
Total	**616**	**3,582**	**4,396**	**567**	**9,161**

Source: CMA analysis.
Note: £m over the whole 2025-2030 price control in 2022/23 CPIH deflated prices.

10.33 This calculation results in Anglian's wholesale revenue over the AMP being around £145 million higher than Ofwat's PR24 FD.[448]

10.34 Following our prioritisation decisions, we have not redetermined the retail price control, so our decision makes no changes compared to Ofwat's PR24 FD with the following exceptions. First, we update the retail frontier shift to align to the 0.7% applied to wholesale costs. Second, we update the long-term inflation assumption to 2.4%. Third, we maintain Ofwat's methodology of calculating retail allowances based on wholesale, which results in a small incremental allowance of £5 million for Anglian. The total incremental increase in retail allowance is £7 million (£636 million in our determination compared to £629 million in Ofwat's PR24 FD).[449]

10.35 The estimated effect of these changes on average annual customer bills is shown in Table 10.7, compared to Anglian's historical bills and Ofwat's PR24 FD.

[448] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the wholesale revenue by a further £10 million, approximately.
[449] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the retail revenue by a further £2 million, approximately, in addition to the £5 million resulting from our decision.

Table 10.7: Indicative impact of our determination on Anglian's annual household customer bills

	Average historical bill	*Ofwat PR24 FD AMP8 average bill*	*Anglian SoC AMP8 average bill*	*CMA PR24 FD AMP8 average bill*
Average bill	£491	£591	£649	£602

Source: Ofwat's PR24 FD financial models for 'Ofwat PR24 FD' bills (for 'Average historical bill' and 'Ofwat PR24 FD average bill'); CMA analysis (for 'CMA PR24 FD AMP8 average bill'); Anglian response to Disputing Companies RFI07 (for 'Anglian SoC AMP8 average bill'). NB Disputing Companies RFI07 requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case. Note: these are forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance.

10.36 The AMP8 average bill in our determination is higher than Ofwat's PR24 FD by around £10, or 1.7%, per year.[450]

10.37 Having determined the revenue allowances over the whole AMP, we profile it between individual years in order to provide customers with a better view of the potential impact, and to allow for an annual calculation of K. In doing so, we choose to implement a consistent annual increase in real bills over the course of the remaining years in the AMP.

10.38 The results of this profiling, as well as the impact on K and bills, is shown in Table 10.8 and Table 10.9.

Table 10.8: Anglian's K factors by charging year

	2025/26	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Water resources	60.79%	24.02%	-5.19%	6.57%	6.38%
Water network plus	18.01%	2.07%	9.12%	6.20%	6.03%
Wastewater network plus	3.12%	5.89%	6.80%	6.60%	6.42%

Source: CMA analysis.

Table 10.9: Anglian's indicative annual bills

	2024/25	*2025/26*	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Customer bills	£491	£547	£569	£599	£631	£664

Source: CMA analysis.

10.39 In addition, we update Anglian's bioresources control such that its tonnes per dry solid revenue average is set to £712.24 in years 3 to 5 of the AMP.

10.40 We also updated Anglian's retail cost to serve to reflect our decision on Frontier Shift, resulting in a 5-year average retail cost to serve of £32.63.

[450] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the bill by an additional £1 per annum. If Ofwat allows the potential further funding of £184 million (shown in Figure 10.2 above) through the large scheme gated process this would increase the average AMP8 customer bill by approximately £2 per year. We note that there is uncertainty in this bill impact given the level and timing of funding allowed by Ofwat through the large scheme gated process may vary.

11. The final determination for Northumbrian

11.1 This section summarises our final determination for Northumbrian. In this, we set out our final determination, but we do not restate the explanation or rationale for our decisions; we cross-reference to the relevant earlier sections of our report to identify where we have explained these rationales.

11.2 We have reached our final determination for Northumbrian in accordance with the statutory principles that apply to Ofwat, including various statutory duties.

11.3 We consider that the final determination for Northumbrian is best calculated to further the Consumer Objective and Resilience Objective and to secure the Functions Duty, the Financing Duty and the Licence Duty set out in section 2(2A) of the Act (the primary duties). Subject to the primary duties, in reaching this determination for Northumbrian, we have reached a final determination for Northumbrian which we consider best calculated to promote, secure, ensure and contribute to the secondary duties (as appropriate) set out in section 2(3) of the Act.

11.4 We have had regard to the principles of best regulatory practice per section 2(4) of the Act. We have acted in accordance with the SPS in reaching this determination, per the requirement in section 2A(2) of the Act. We consider that our decision is consistent with the Growth Duty.

11.5 We have exercised our own regulatory discretion in appropriately complying with these statutory duties. We have considered the final package for Northumbrian in the round and are satisfied that it is consistent with the relevant statutory principles.

Approach to the determination

11.6 We have used the same regulatory building blocks as used in Ofwat's PR24 FD.[451]

11.7 The rest of this section sets out the final decisions we have applied to Northumbrian, grouped into the following areas:

(a) expenditure (base and enhancement) allowances;

(b) PCDs, ODIs, ASMs and OAM;

(c) allowed return;

(d) financeability; and

[451] CMA PR24 Approach document, paragraph 32.

(e) calculations of allowed revenue, with implications for K factors and customer bills in AMP8.

Totex allowances

Base cost allowances

11.8 Our final determination on the base cost allowances for Northumbrian is set out in Table 11.1 below.

Table 11.1: Base cost allowances

		£m
Ofwat PR24 FD (before frontier shift and real price effects)	*A*	3,614
Blind year adjustments	*B*	-9
Ofwat PR24 FD including blind year adjustments (before frontier shift and real price effects)	***C = A + B***	**3,605**
Total base CMA determination changes	***G***	-88
Total base CMA determination (before frontier shift and real price effects)	***H = C + G***	**3,517**
Frontier shift and real price effects	*I*	-74
Total base CMA determination (after frontier shift and real price effects)	***J = H + I***	**3,443**
Ofwat PR24 FD including blind year adjustments (after frontier shift and real price effects)	*K*	3,533
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift and real price effects)	*L = ((J – K) / K) x 100*	-2.5%

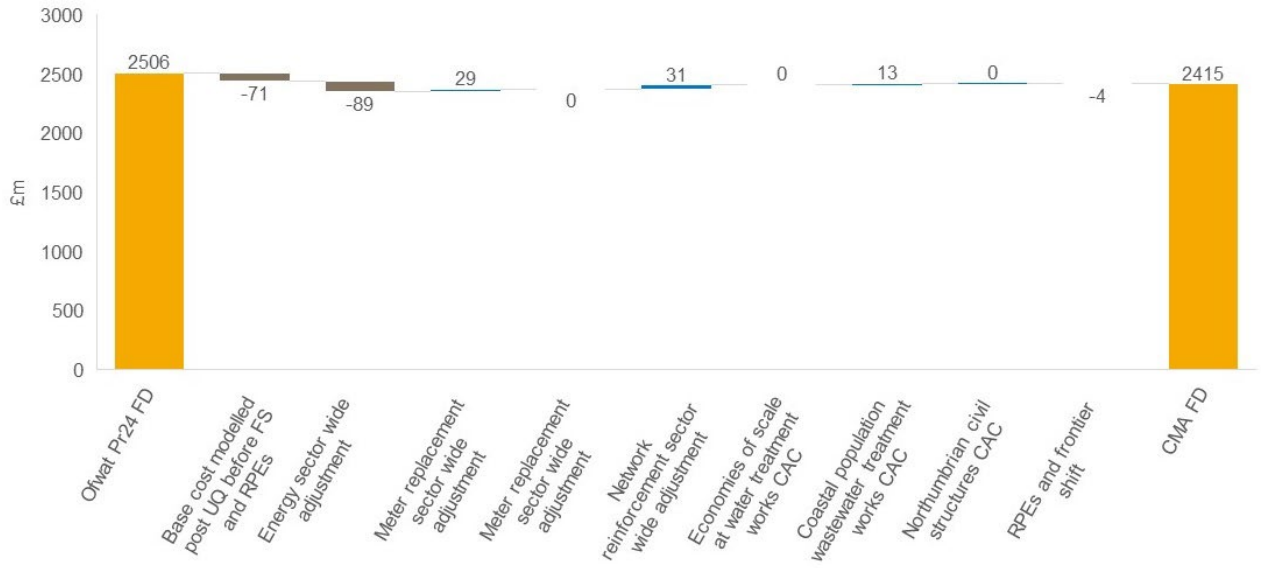
Source: CMA analysis. Disputing Companies' total base expenditure allowance (£m), rounded to zero decimal places.
Note 1: Totals include base expenditure allowances for: wholesale water, wastewater network plus, bioresources, and retail AMP8 total.
Note 2: % change is rounded to one decimal place.

11.9 The combination of modelling changes and cost adjustment claims results in an overall decrease of £89 million after frontier shift and real price effects for Northumbrian compared with Ofwat's PR24 FD including blind year adjustments.

11.10 True ups will be applied for labour and energy costs relating to base cost allowances – see chapter 4 (Base costs).

11.11 In Figure 11.1 below we set out the impact of our decisions on base costs on Northumbrian's total water, wastewater and bioresources allowances.

Figure 11.1: Impact of our decisions on base costs on Northumbrian's total water, wastewater and bioresources allowances



Source: CMA analysis.
Notes: For the CMA PR24 FD energy and labour cost for water and wastewater are included in the base case modelling so energy sector wide uplift and RPEs for water and wastewater are removed; Ofwat PR24 FD figure takes account of Ofwat's December 2025 Blind Year Reconciliation FD; totals exclude retail and unmodelled costs.

Enhancement cost allowances

11.12 In Table 11.2 and Figure 11.2 below, we show the changes to Northumbrian's enhancement allowances between Ofwat's PR24 FD and our final determination. The changes reflect:

(a) Ofwat's blind year adjustments (£31 million increase);

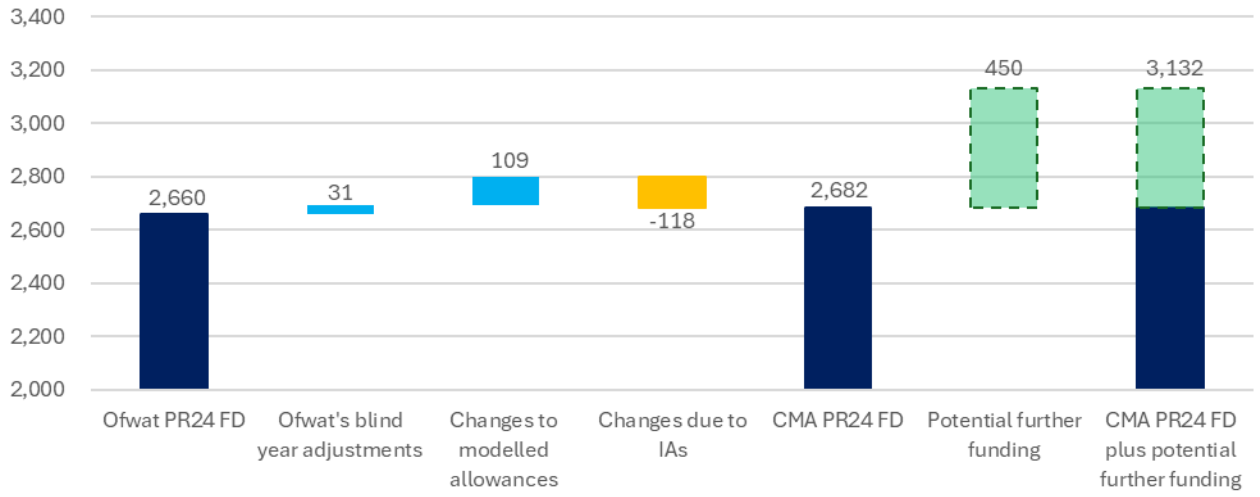
(b) changes to modelled allowances (a £21 million increase in the supply interconnectors allowance, an £82 million increase in the phosphorus removal allowances and an increase of £6 million to correct unambiguous errors); and

(c) changes that relate to our individual assessments (a £129 million reduction for the Suffolk strategic network scheme that we have added to the large scheme gated process which is partially offset by a net £11 million increase arising from three other claims).

11.13 We also illustrate (to the right of the chart) the potential additional funding that Northumbrian estimates that it will require for its Suffolk strategic network scheme (£129 million), its Howdon WWTW growth scheme (£317 million) and its Bacton desalination plant scheme (£4 million). We have decided to add these schemes to the RAPID and large scheme gated processes and Northumbrian will be able to make submissions to Ofwat to access additional funding in AMP8 for these

schemes through the normal operation of the RAPID and large scheme gated processes.

Figure 11.2: Changes to Northumbrian's enhancement allowances between Ofwat's PR24 FD and our final determination and an estimate of potential additional funding for the Suffolk strategic network, Howdon WWTW growth and Bacton desalination schemes that we have added to the RAPID and large scheme gated processes (before frontier shift, £m)



Source: CMA analysis.
Note: The potential further funding relates to Northumbrian's estimate of the additional funding required for its Suffolk strategic network, Howdon WWTW growth and Bacton desalination schemes that we have added to the RAPID and large scheme gated processes.

11.14 In Table 11.2 below, we summarise Northumbrian's enhancement allowances before and after frontier shift.

Table 11.2: Enhancement cost allowances

		£m
Ofwat PR24 FD	*A*	2,660
Blind year adjustments	*B*	31
Ofwat PR24 FD including blind year adjustments	***C = A + B***	**2,691**
CMA determinations		
Benchmark modelling	*D*	109
Individual assessments	*E*	11
Schemes moved to RAPID and/or large schemes gated processes	*F*	-129
Total CMA determination changes	***G = D + E + F***	**-9**
Total enhancement CMA determination (before frontier shift, excluding potential further funding)	***H = C + G***	**2,682**
Potential further funding (note 1)	***I***	450
Total enhancement CMA determination (before frontier shift, including potential further funding)	***J = H + I***	**3,132**
Frontier shift	*K*	-22
Total enhancement CMA determination (after frontier shift)	***L = J + K***	**3,110**
Ofwat PR24 FD including blind year adjustments (after frontier shift)	*M*	2,642
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift)	*N = ((L – M) / M) x 100*	17.7%

Source: CMA analysis

Note 1: Note: The potential further funding relates to Northumbrian's estimate of the additional funding required for its Suffolk strategic network, Howdon WWTW growth and Bacton desalination schemes that we have added to the RAPID and large scheme gated processes.

Overall totex allowances

11.15 Our final determination of Northumbrian's wholesale totex allowance is shown in Table 11.3.

Table 11.3: Totex allowances compared with Ofwat's PR24 FD including blind year adjustments (after frontier shift and real price effects, £m)

	Ofwat PR24 FD (including blind year adjustments)	**CMA final determination**	**Change from Ofwat's PR24 FD (including blind year adjustments)**	
	£m	**£m**	**£m**	**%**
Total base costs	3,533	3,443	-90	-2.5
Total enhancement costs	2,642	3,110	468	17.7
Total	**6,175**	**6,553**	**378**	**6.1**

Source: CMA analysis.

11.16 We retain Ofwat's PR24 FD approach to cost sharing.

PCDs, ODIs, ASMs and OAM

PCDs and ODIs

11.17 For the purposes of this redetermination, we do not list every PCD or performance commitment to which Northumbrian is subject. Instead, we provide a list of the PCDs (or features of PCDs) and performance commitments (or other features of ODIs) in relation to which: (a) Northumbrian requested that changes be made; or (b) we have assessed and made changes that apply to Northumbrian following a request for a change from another Disputing Company. In each case we identify changes we make to Ofwat's PR24 FD, within Table 11.4.

Table 11.4: CMA final determinations on relevant PCDs and ODIs compared to Ofwat PR24 FD

Category	*Performance commitment*	*CMA decision compared to Ofwat PR24 FD*
PCDs applied to enhancement costs	Lead	No change
PCDs applied to base costs	Mains renewal	No change
ODI PCLs	Total pollution incidents	No change except to apply the latest outturn data for all Disputing Companies
	Water supply interruptions	Baseline level for common PCL set according to industry median (ie higher) and using latest outturn data, with glidepath to 5 minutes in year 5; apply enhanced ODI rate thresholds as per Ofwat's PR24 FD
ODI rates	Storm overflows	No change except to apply the latest outturn data
	Total pollution incidents	Calculation of performance range changed and apply latest outturn data, resulting in lower ODI rates for all Disputing Companies than in Ofwat's PR24 FD
	Water supply interruptions	No change except to apply the latest outturn data
	Experience measures (C-MeX, and D-MeX)	No change except to apply the latest outturn data

Source: CMA analysis.

11.18 Our decisions on consequential updates to PCDs are included in chapter 6 (Outcomes), along with associated content in Appendix E. We have detailed any new PCDs we are applying in Appendix G – this does not include any matters relevant to Northumbrian.

ASMs and OAM

11.19 We make no changes to the ASMs and the OAM.

11.20 Our determinations on the ASMs are:

(a) to maintain the existing design of the totex ASM by not separating the mechanism between water and wastewater; and

(b) to maintain the existing thresholds of the totex and outcomes ASMs.

11.21 We retain the OAM with the ±50bps deadband.

Allowed return

11.22 We set an Appointee real CPIH-based WACC of 4.20%. We also set the wholesale WACC equal to the Appointee WACC, based on our view that there is no double counting of returns between the wholesale and the retail controls. We set out our detailed assessment of the allowed return in chapter 7 (Allowed return).

Financeability

11.23 For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. We completed an assessment of Northumbrian's notional financeability, including a financial ratio analysis, in line with standard regulatory practice. The outputs of this financial ratio analysis for Northumbrian are shown in Table 11.5 below.

11.24 The financial ratio analysis is one part of a broader assessment of financeability. We set out our detailed assessment of financeability in chapter 8 (Risk and return).

Table 11.5: Notional credit ratio analysis for Northumbrian

Key ratios	*AICR*	*FFO/net debt*	*Gearing*
Base case	1.70x	9.31%	55.89%
RoRE downside: 1% in all years	1.49x	8.29%	57.05%
RoRE downside: 2% in all years	1.29x	7.31%	58.21%

Source: CMA analysis.
Note: AMP8 average financial ratios.

11.25 We conclude that, on a notional basis, Northumbrian's ratios are consistent with a Baa1/BBB+ rating in the base case. We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for Northumbrian are more in line with a credit rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (an annual 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade credit rating.

11.26 We consider that companies facing a financeability constraint, such as to address a downside scenario, can be reasonably expected to adopt a range of mitigating actions to address the impact, such as absorbing headroom in credit ratios, or increasing the contribution of equity either by forgoing dividends or injecting fresh capital. We conclude that this supports the view that our determination for Northumbrian is financeable.

Implied calculations of revenue and implications for K and bills

11.27 All revenue and customer bill figures in this section are presented in 2022/23 CPIH deflated prices.

Revenue adjustments

11.28 The majority of a water company's wholesale revenue is derived from the totex and WACC figures discussed above.

11.29 We have also included in chapter 9 (Other issues), adjustments relating to Ofwat's 'blind year' final determination, in which Ofwat conducts a reconciliation for company performance in the final year of the last AMP – this uses data which was not available at the time of Ofwat's PR24 FD – and corrects for unambiguous errors in its PR24 FD. We include these adjustments in our final determination, which results in a £5 million decrease in Northumbrian's revenue for the period.[452]

11.30 We also allow Northumbrian to recover a proportion of its costs for the CMA redetermination process, which includes an allocation of our own costs. This represents around £2.0 million (which is excluded from totex cost-sharing).

Implied Northumbrian revenue in AMP7 and calculations of K

11.31 In order to calculate Northumbrian's revenue figures, we need to include PAYG rates to split totex into in-period recovery and RCV additions. Our starting point for this is to use the 'natural rate' approach included in Ofwat's PR24 FD.[453]

11.32 We also set RCV run-off rates to determine the rate at which totex added to the RCV is recovered through revenues. We retain the run-off rates used by Ofwat in its PR24 FD. Table 11.6 below sets out a calculation of the allowed revenue for Northumbrian's wholesale controls.

[452] £5 million decrease relates to Northumbrian's total revenue, which includes wholesale and retail revenue.
[453] PAYG natural rate calculated as a proportion of net opex to net totex. See chapter 8 (Risk and return), section titled 'Cost recovery'.

Table 11.6: Calculation of Northumbrian's wholesale allowed revenue (£m)

CPIH-real	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*	*Total*
PAYG	395	1,007	605	81	2,088
RCV run-off	80	562	595	66	1,303
Return on capital	76	535	657	43	1,312
Revenue adjustments for PR19 reconciliations	32	44	-3	-7	67
Quality and ambition assessment (QAA) reward / penalty	-	3	4	-	7
Tax	-	-	-	-	-
Developer services, diversions and other contributions (price control)	-	18	7	-	25
Other income (non-price control)	-13	-30	-		-44
Innovation & Water efficiency fund	-	19	10	-	28
Revenue re-profiling	-1	0	0	0	-1
Total	**570**	**2,158**	**1,874**	**184**	**4,785**

Source: CMA analysis.
Note: £m over the whole 2025-2030 price control in 2022/23 CPIH deflated prices.

11.33 This calculation results in Northumbrian's wholesale revenue over the AMP being around £11 million lower than Ofwat's PR24 FD.[454]

11.34 Following our prioritisation decisions, we have not redetermined the retail price control, so our decision makes no changes compared to Ofwat's PR24 FD with the following exceptions. First, we update the retail frontier shift to align to the 0.7% applied to wholesale costs. Second, we update the long-term inflation assumption to 2.4%. Third, we maintain Ofwat's methodology of calculating retail allowances based on wholesale; this results in a small incremental allowance of £2 million for Northumbrian. The total incremental increase in retail allowance is £5 million (£405 million in our determination compared to £400 million in Ofwat's PR24 FD).[455]

11.35 The estimated effect of these changes on average annual customer bills is shown in Table 11.7, compared to Northumbrian's historical bills and Ofwat's PR24 FD.

Table 11.7: Indicative impact of our determination on Northumbrian's annual household customer bills

	Average historical bill	*Ofwat PR24 FD AMP8 average bill*	*Northumbrian SoC AMP8 average bill*	*CMA PR24 FD AMP8 average bill*
Average bill	£422	£488	£515	£488

Source: Ofwat's PR24 FD financial models for 'Ofwat PR24 FD' bills (for 'Average historical bill' and 'Ofwat PR24 FD average bill'); CMA analysis (for 'CMA PR24 FD AMP8 average bill'); Northumbrian response to Disputing Companies RFI07 (for 'Northumbrian SoC AMP8 average bill'). NB Disputing Companies RFI07 requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case.
Note: these are forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance.

[454] Inclusion of Ofwat's Blind Year Reconciliation FD would decrease the wholesale revenue by a further £9 million, approximately.
[455] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the retail revenue by a further £3 million, in addition to the £2 million resulting from our deci7sion.

11.36 The AMP8 average bill in our determination is higher than Ofwat's PR24 FD by less than £1.[456]

11.37 Having determined the revenue allowances over the whole AMP, we profile it between individual years in order to provide customers with a better view of the potential impact, and to allow for an annual calculation of K. In doing so, we choose to implement a consistent annual increase in real bills over the course of the remaining years in the AMP.

11.38 The results of this profiling, as well as the impact on K and bills, is shown in Table 11.8 and Table 11.9.

Table 11.8: Northumbrian's K factors by charging year

	2025/26	***2026/27***	***2027/28***	***2028/29***	***2029/30***
Water resources	-11.51%	5.83%	-6.90%	3.19%	2.97%
Water network plus	13.50%	7.07%	2.86%	2.91%	2.70%
Wastewater network plus	21.18%	2.92%	7.12%	3.11%	2.88%

Source: CMA analysis.

Table 11.9: Northumbrian's indicative annual bills

	2024/25	***2025/26***	***2026/27***	***2027/28***	***2028/29***	***2029/30***
Customer bills	£422	£463	£480	£489	£499	£509

Source: CMA analysis.

11.39 In addition, we update Northumbrian's bioresources control such that its tonnes per dry solid revenue average is set to £520.71 in years 3 to 5 of the AMP.

11.40 We also updated Northumbrian's retail cost to serve to reflect our decision on frontier shift, resulting in a 5-year average retail cost to serve of £32.45.

[456] Inclusion of Ofwat's Blind Year Reconciliation FD would decrease the bill by less than £1 per annum. If Ofwat allows the potential further funding of £450 million (shown in Figure 11.2 above) through the large scheme gated process, £330 million of this would be incurred in AMP8 and would increase the average AMP8 customer bill by approximately £9 per year. We note that there is uncertainty in this bill impact given the level and timing of funding allowed by Ofwat through the large scheme gated process may vary.

12. The final determination for South East

12.1 This section summarises our final determination for South East. In this, we set out our final determination, but we do not restate the explanation or rationale for our decisions; we cross-reference to the relevant earlier sections of our report to identify where we have explained these rationales.

12.2 We have reached our final determination for South East in accordance with the statutory principles that apply to Ofwat, including various statutory duties.

12.3 We consider that the final determination for South East is best calculated to further the Consumer Objective and Resilience Objective and to secure the Functions Duty, the Financing Duty and the Licence Duty set out in section 2(2A) of the Act (the primary duties). Subject to the primary duties, in reaching this determination for South East, we have reached a final determination for South East which we consider best calculated to promote, secure, ensure and contribute to the secondary duties (as appropriate) set out in section 2(3) of the Act.

12.4 We have had regard to the principles of best regulatory practice per section 2(4) of the Act. We have acted in accordance with the SPS in reaching this determination, per the requirement in section 2A(2) of the Act. We consider that our decision is consistent with the Growth Duty.

12.5 We have exercised our own regulatory discretion in appropriately complying with these statutory duties. We have considered the final package for South East in the round and are satisfied that it is consistent with the relevant statutory principles.

Approach to the determination

12.6 We have used the same regulatory building blocks as used in Ofwat's PR24 FD.[457]

12.7 The rest of this section sets out the final decisions we have applied to South East, grouped into the following areas:

(a) expenditure (base and enhancement) allowances;

(b) PCDs, ODIs, ASMs and OAM;

(c) allowed return;

(d) financeability; and

(e) calculations of allowed revenue, with implications for K factors and customer bills in AMP8.

[457] CMA PR24 Approach document, paragraph 32.

Totex allowances

Base cost allowances

12.8 Our final determination on the base cost allowances for South East is set out in Table 12.1 below.

Table 12.1: Base cost allowances

		£m
Ofwat PR24 FD (before frontier shift and real price effects)	*A*	1,282
Blind year adjustments	*B*	-5
Ofwat PR24 FD including blind year adjustments (before frontier shift and real price effects)	***C = A + B***	**1,277**
Total base CMA determination changes	***G***	18
Total base CMA determination (before frontier shift and real price effects)	***H = C + G***	**1,294**
Frontier shift and real price effects	*I*	-29
Total base CMA determination (after frontier shift and real price effects)	***J = H + I***	**1,265**
Ofwat PR24 FD including blind year adjustments (after frontier shift and real price effects)	*K*	1,250
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift and real price effects)	*L = ((J – K) / K) x 100*	1.2%

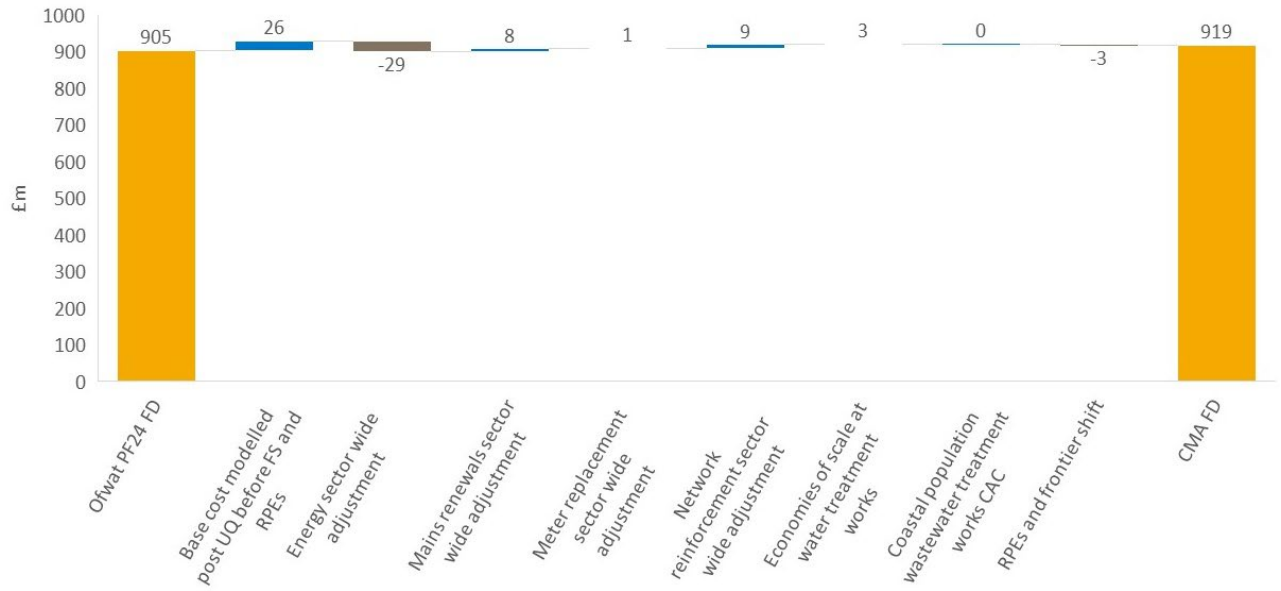
Source: CMA analysis. Disputing Companies' total base expenditure allowance (£m), rounded to zero decimal places.
Note 1: Totals include base expenditure allowances for: wholesale water, wastewater network plus, bioresources, and retail AMP8 total.
Note 2: % change is rounded to one decimal place.

12.9 The combination of modelling changes and cost adjustment claims results in an overall increase of £15 million after frontier shift and real price effects for South East compared with Ofwat's PR24 FD including blind year adjustments.

12.10 True ups will be applied for labour and energy costs relating to base cost allowances – see chapter 4 (Base costs).

12.11 In Figure 12.1 below we set out the impact of our decisions on base costs on South East's total water, wastewater and bioresources allowances.

Figure 12.1: Impact of our decisions on base costs on South East's total water, wastewater and bioresources allowances



Source: CMA analysis.
Notes: For the CMA PR24 FD energy and labour cost for water and wastewater are included in the base case modelling so energy sector wide uplift and RPEs for water and wastewater are removed; Ofwat PR24 FD figure takes account of Ofwat's December 2025 Blind Year Reconciliation FD; totals exclude retail and unmodelled costs.

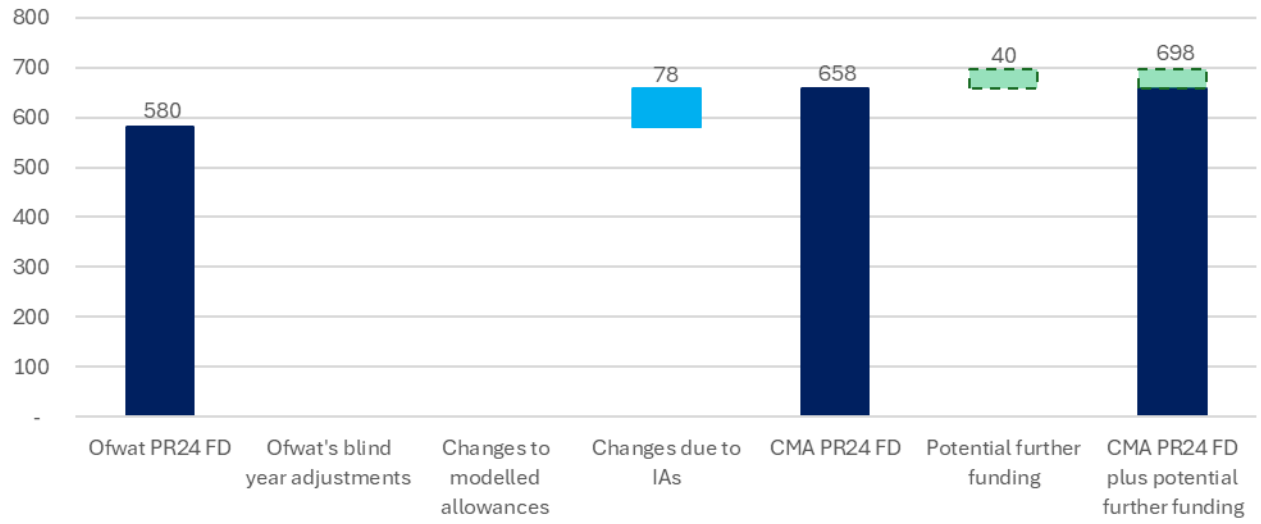
Enhancement cost allowances

12.12 In Table 12.2 and Figure 12.2 below, we show the changes to South East's enhancement allowances between Ofwat's PR24 FD and our final determination.

12.13 The increase in South East's enhancement allowance is due to the cumulative impact of changes in nine different areas, including investment to increase capacity at Bewl WTW and interventions to reduce leakage and reduce water supply interruptions.

12.14 We also illustrate (to the right of the chart) an estimate of the potential additional funding that South East may require for its contribution to the updates to [Southern site 3] WTW (£40 million). Southern manages this site, but South East is required to contribute 25% of the costs and is permitted to take 25% of the water supply. We have decided to add this scheme to the large scheme gated process. Southern and South East will be able to make submissions to Ofwat to access additional funding for this scheme in AMP8 through the normal operation of the large scheme gated process.

Figure 12.2: Changes to South East's enhancement allowances between Ofwat's PR24 FD and our final determination and an estimate of potential additional funding for South East's contribution to the updates to [Southern site 3] WTW that we have added to the large scheme gated process (before frontier shift, £m)



Source: CMA analysis.
Note: The potential further funding relates to 25% of Southern's estimate of the maximum additional funding required for a water resilience scheme at [Southern site 3] WTW, which we have added to the large scheme gated process. South East is required to contribute 25% of the scheme costs at this site.

12.15 In Table 12.2 below, we summarise South East's enhancement allowances before and after frontier shift.

Table 12.2: Enhancement cost allowances

		£m
Ofwat PR24 FD	*A*	580
Blind year adjustments	*B*	0
Ofwat PR24 FD including blind year adjustments	***C = A + B***	**580**
CMA determinations		
Benchmark modelling	*D*	0
Individual assessments	*E*	85
Schemes moved to RAPID and/or large schemes gated processes	*F*	-7
Total CMA determination changes	***G = D + E + F***	**78**
Total enhancement CMA determination (before frontier shift, excluding potential further funding)	***H = C + G***	**658**
Potential further funding (note 1)	***I***	40
Total enhancement CMA determination (before frontier shift, including potential further funding)	***J = H + I***	**698**
Frontier shift	*K*	-8
Total enhancement CMA determination (after frontier shift)	***L = J + K***	**690**
Ofwat PR24 FD including blind year adjustments (after frontier shift)	*M*	566
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift)	*N = ((L – M) / M) x 100*	21.9%

Source: CMA analysis.

Note 1: The potential further funding relates to South East's estimate of the maximum additional funding required for its contribution to the upgrades to the [Southern site 3] WTW that we have added to the large scheme gated processes.

Overall totex allowances

12.16 Our final determination of South East's wholesale totex allowance is shown in Table 12.3.

Table 12.3: Totex allowances compared with Ofwat's PR24 FD including blind year adjustments (after frontier shift and real price effects)

	Ofwat PR24 FD (including blind year adjustments)	**CMA final determination**	**Change from Ofwat's PR24 FD (including blind year adjustments)**	
	£m	**£m**	**£m**	**%**
Total base costs	1,250	1,265	15	1.2
Total enhancement costs	566	690	124	21.9
Total	**1,816**	**1,955**	**139**	**7.7**

Source: CMA analysis.

12.17 We retain Ofwat's PR24 FD approach to cost sharing.

PCDs, ODIs, ASMs and OAM

PCDs and ODIs

12.18 For the purposes of this redetermination, we do not list every PCD or performance commitment to which South East is subject. Instead, we provide a list of the PCDs (or features of PCDs) and performance commitments (or other features of ODIs) in relation to which: (a) South East requested that changes be made; or (b) we have assessed and made changes that apply to South East following a request for a change from another Disputing Company. In each case we identify changes we make to Ofwat's PR24 FD, within Table 12.4 below.

Table 12.4: CMA final determinations on relevant PCDs and ODIs compared to Ofwat PR24 FD

Category	*Performance commitment*	*CMA decision compared to Ofwat PR24 FD*
PCDs applied to base costs	Mains renewal	No change
ODI PCLs	Water supply interruptions	Baseline level for common PCL set according to industry median (ie higher) and using latest outturn data, with glidepath to 5 minutes in year 5; apply enhanced ODI rate thresholds as per Ofwat's PR24 FD For South East: higher company-specific PCL based on South East's Ofwat PR24 DD response, with a glidepath to the common PCL in year 5; a common penalty collar of 1% RoRE; and a deadband for performance between the company-specific and common PCL
	Leakage	For South East: 2024/25 baseline reset to align with closing position at the end of AMP7 (ie apply the latest outturn data); glidepath to the 2029/30 PCL as per Ofwat's PR24 FD; apply enhanced ODI rate thresholds for South East as per Table 6.17 in chapter 6 (Outcomes)
	C-MeX	No change
	Non-household voids (PR19 penalty)	No change
ODI rates	Water supply interruptions	No change except to apply the latest outturn data
	Experience measures (C-MeX, and D-MeX)	No change except to apply the latest outturn data

Source: CMA analysis.

12.19 Our decisions on consequential updates to PCDs are included in chapter 6 (Outcomes). We have detailed new PCDs we are applying in Appendix G – for South East, this covers new allowances we have given for Bewl and lead.

ASMs and OAM

12.20 We make no changes to the ASMs and the OAM.

12.21 Our determinations on the ASMs are:

(a) to maintain the existing design of the totex ASM by not separating the mechanism between water and wastewater; and

(b) to maintain the existing thresholds of the totex and outcomes ASMs.

12.22 We retain the OAM with the ±50bps deadband.

Allowed return

12.23 We set an Appointee real CPIH-based WACC of 4.20%. We also set the wholesale WACC equal to the Appointee WACC, based on our view that there is no double counting of returns between the wholesale and the retail controls. We set out our detailed assessment of the allowed return in chapter 7 (Allowed return).

Financeability

12.24 For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. We completed an assessment of South East's notional financeability, including a financial ratio analysis, in line with standard regulatory practice. The outputs of this financial ratio analysis for South East are shown in Table 12.5 below.

12.25 The financial ratio analysis is one part of a broader assessment of financeability. We set out our detailed assessment of financeability in chapter 8 (Risk and return).

Table 12.5: Notional credit ratio analysis for South East

Key ratios	*AICR*	*FFO/net debt*	*Gearing*
Base case	1.74x	9.15%	56.11%
RoRE downside: 1% in all years	1.53x	8.12%	57.33%
RoRE downside: 2% in all years	1.34x	7.13%	58.56%

Source: CMA analysis.
Note: AMP8 average financial ratios.

12.26 We conclude that, on a notional basis, South East's ratios are consistent with a Baa1/BBB+ rating in the base case. We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for South East are more in line with a credit rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (an annual 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade credit rating.

12.27 We consider that companies facing a financeability constraint, such as to address a downside scenario, can be reasonably expected to adopt a range of mitigating actions to address the impact, such as absorbing headroom in credit ratios, or increasing the contribution of equity either by forgoing dividends or injecting fresh capital. We conclude that this supports the view that our determination for South East is financeable.

Implied calculations of revenue and implications for K and bills

12.28 All revenue and customer bill figures in this section are presented in 2022/23 CPIH deflated prices.

Revenue adjustments

12.29 The majority of a water company's wholesale revenue is derived from the totex and WACC figures discussed above.

12.30 We have also included in chapter 9 (Other issues), adjustments relating to Ofwat's 'blind year' final determination, in which Ofwat conducts a reconciliation for company performance in the final year of the last AMP – this uses data which was not available at the time of Ofwat's PR24 FD – and corrects for unambiguous errors in its PR24 FD. We include these adjustments in our final determination, which results in a £0.2 million increase in South East's revenue for the period.[458]

12.31 We also allow South East to recover a proportion of its costs for the CMA redetermination process, which includes an allocation of our own costs. This represents around £2.2 million (which is excluded from totex cost-sharing).

Implied South East revenue in AMP7 and calculations of K

12.32 In order to calculate South East's revenue figures, we need to include PAYG rates to split totex into in-period recovery and RCV additions. Our starting point for this is to use the 'natural rate' approach included in Ofwat's PR24 FD. [459]

12.33 We also set RCV run-off rates to determine the rate at which totex added to the RCV is recovered through revenues. We retain the run-off rates used by Ofwat in its PR24 FD. Table 12.6 below sets out a calculation of the allowed revenue for South East's wholesale controls.

[458] £0.2 million increase relates to South East's total revenue, which includes wholesale and retail revenue.
[459] PAYG natural rate calculated as a proportion of net opex to net totex. See chapter 8 (Risk and return), section titled 'Cost recovery'.

Table 12.6: Calculation of South East's wholesale allowed revenue (£m)

CPIH-real	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*	*Total*
PAYG	145	597	-	-	743
RCV run-off	25	348	-	-	373
Return on capital	25	369	-	-	394
Revenue adjustments for PR19 reconciliations	2	34	-	-	37
Quality and ambition assessment (QAA) reward / penalty	-	-	-	-	-
Tax	-	-	-	-	-
Developer services, diversions and other contributions (price control)	-	63	-	-	63
Other income (non-price control)	-	-4	-	-	-4
Innovation & Water efficiency fund	-	9	-	-	9
Revenue re-profiling	1	3	-	-	3
Total	**198**	**1,419**	**-**	**-**	**1,617**

Source: CMA analysis.
Note: £m over the whole 2025-2030 price control in 2022/23 CPIH deflated prices.

12.34 This calculation results in South East's wholesale revenue over the AMP being around £60 million higher than Ofwat's PR24 FD.[460]

12.35 Following our prioritisation decisions, we have not redetermined the retail price control, so our decision makes no changes compared to Ofwat's PR24 FD with the following exceptions. First, we update the retail frontier shift to align to the 0.7% applied to wholesale costs. Second, we update the long-term inflation assumption to 2.4%. Third, we maintain Ofwat's methodology of calculating retail allowances based on wholesale, which results in a small incremental allowance of £1 million for South East. The total incremental increase in retail allowance is £1 million (£123 million in our determination compared to £122 million in Ofwat's PR24 FD).[461]

12.36 The estimated effect of these changes on average annual customer bills is shown in Table 12.7, compared to South East's historical bills and Ofwat's PR24 FD.

[460] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the wholesale revenue by a further £1 million, approximately.
[461] Ofwat's Blind Year Reconciliation FD did not impact the retail revenue allowance.

Table 12.7: Indicative impact of our determination on South East's annual household customer bills*

	Average historical bill	*Ofwat's PR24 FD AMP8 average bill*	*South East SoC AMP8 average bill*	*CMA PR24 FD AMP8 average bill*
Average bill	£232	£274	£322	£284

Source: Ofwat's PR24 FD financial models for 'Ofwat PR24 FD' bills (for 'Average historical bill' and 'Ofwat PR24 FD average bill'); CMA analysis (for 'CMA PR24 FD AMP8 average bill'); South East response to Disputing Companies RFI07 (for 'South East SoC AMP8 average bill'). NB Disputing Companies RFI07 requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case.
Note: these are forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance.
**Bills for South East do not include the cost of wastewater services as it is a WoC; each of the other Disputing Companies is a WaSC.*

12.37 The AMP8 average bill in our determination is higher than Ofwat's PR24 FD by around £10, or 3.7%, per year.[462]

12.38 Having determined the revenue allowances over the whole AMP, we profile it between individual years in order to provide customers with a better view of the potential impact, and to allow for an annual calculation of K. In doing so, we choose to implement a consistent annual increase in real bills over the course of the remaining years in the AMP.

12.39 The results of this profiling, as well as the impact on K and bills, is shown in Table 12.8 and Table 12.9.

Table 12.8: South East's K factors by charging year

	2025/26	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Water resources	92.59%	-18.63%	-6.87%	7.47%	7.23%
Water network plus	7.36%	8.19%	9.35%	6.91%	6.70%
Wastewater network plus	-	-	-	-	-

Source: CMA analysis.

Table 12.9: South East's indicative annual bills

	2024/25	*2025/26*	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Customer bills	£232	£260	£268	£282	£297	£313

Source: CMA analysis.

12.40 We also updated South East's retail cost to serve to reflect our decision on frontier shift, resulting in a 5-year average retail cost to serve of £22.62.

[462] Inclusion of Ofwat's Blind Year Reconciliation FD would not impact the annual bill. If Ofwat allows the potential further funding of £40 million (shown in Figure 12.2 above) through the large scheme gated process this would increase the average AMP8 customer bill by approximately £3 per year. We note that there is uncertainty in this bill impact given the level and timing of funding allowed by Ofwat through the large scheme gated process may vary.

13. The final determination for Southern

13.1 This section summarises our final determination for Southern. In this, we set out our final determination, but we do not restate the explanation or rationale for our decisions; we cross-reference to the relevant earlier sections of our report to identify where we have explained these rationales.

13.2 We have reached our final determination for Southern in accordance with the statutory principles that apply to Ofwat, including various statutory duties.

13.3 We consider that the final determination for Southern is best calculated to further the Consumer Objective and Resilience Objective and to secure the Functions Duty, the Financing Duty and the Licence Duty set out in section 2(2A) of the Act (the primary duties). Subject to the primary duties, in reaching this determination for Southern, we have reached a final determination for Southern which we consider best calculated to promote, secure, ensure and contribute to the secondary duties (as appropriate) set out in section 2(3) of the Act.

13.4 We have had regard to the principles of best regulatory practice per section 2(4) of the Act. We have acted in accordance with the SPS in reaching this determination, per the requirement in section 2A(2) of the Act. We consider that our decision is consistent with the Growth Duty.

13.5 We have exercised our own regulatory discretion in appropriately complying with these statutory duties. We have considered the final package for Southern in the round and are satisfied that it is consistent with the relevant statutory principles.

Approach to the determination

13.6 We have used the same regulatory building blocks as used in Ofwat's PR24 FD.[463]

13.7 The rest of this section sets out the final decisions we have applied to Southern, grouped into the following areas:

(a) expenditure (base and enhancement) allowances;

(b) PCDs, ODIs, ASMs and OAM;

(c) allowed return;

(d) financeability; and

(e) calculations of allowed revenue, with implications for K factors and customer bills in AMP8.

[463] CMA PR24 Approach document, paragraph 32.

Totex allowances

Base cost allowances

13.8 Our final determination on the base cost allowances for Southern is set out in Table 13.1 below.

Table 13.1: Base cost allowances

		£m
Ofwat PR24 FD (before frontier shift and real price effects)	*A*	4,080
Blind year adjustments	*B*	-5
Ofwat PR24 FD including blind year adjustments (before frontier shift and real price effects)	***C = A + B***	**4,074**
Total base CMA determination changes	***G***	90
Total base CMA determination (before frontier shift and real price effects)	***H = C + G***	**4,164**
Frontier shift and real price effects	*I*	-96
Total base CMA determination (after frontier shift and real price effects)	***J = H + I***	**4,068**
Ofwat PR24 FD including blind year adjustments (after frontier shift and real price effects)	*K*	3,986
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift and real price effects)	*L = ((J – K) / K) x 100*	2.1%

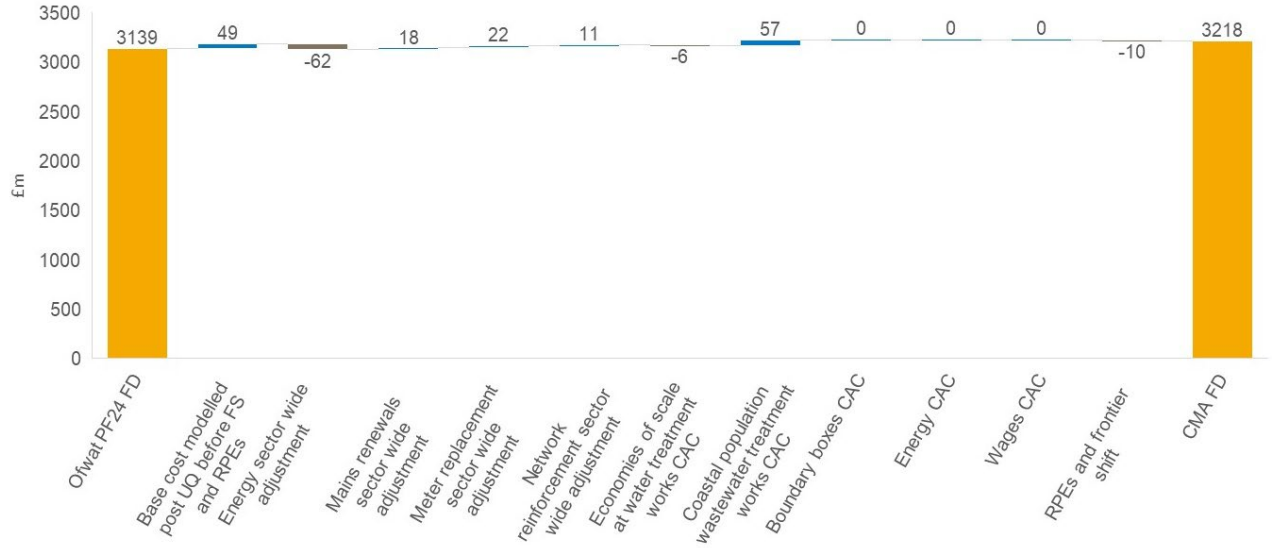
Source: CMA analysis. Disputing Companies' total base expenditure allowance (£m), rounded to zero decimal places.
Note 1: Totals include base expenditure allowances for: wholesale water, wastewater network plus, bioresources, and retail AMP8 total
Note 2: % change is rounded to one decimal place.

13.9 The combination of modelling changes and cost adjustment claims results in an overall increase of £82 million after frontier shift and real price effects for Southern compared with Ofwat's PR24 FD including blind year adjustments.

13.10 True ups will be applied for labour and energy costs relating to base cost allowances – see chapter 4 (Base costs).

13.11 In Figure 13.1 below we set out the impact of our decisions on base costs on Southern's total water, wastewater and bioresources allowances.

Figure 13.1: Impact of our decisions on base costs on Southern's total water, wastewater and bioresources allowances



Source: CMA analysis.
Notes: For the CMA PR24 FD energy and labour cost for water and wastewater are included in the base case modelling so energy sector wide uplift and RPEs for water and wastewater are removed; Ofwat PR24 FD figure takes account of Ofwat's December 2025 Blind Year Reconciliation FD; totals exclude retail and unmodelled costs.

Enhancement cost allowances

13.12 In Table 13.2 and Figure 13.2 below, we show the changes to Southern's enhancement allowances between Ofwat's PR24 FD and our final determination. The changes reflect:

(a) Ofwat's blind year adjustments (£36 million increase);

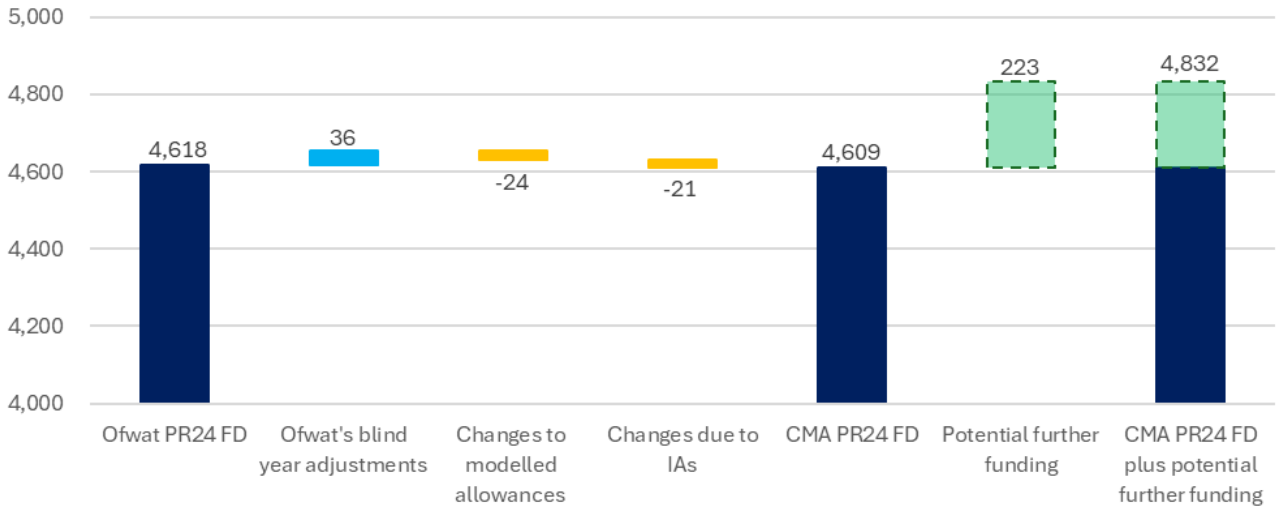
(b) changes to modelled allowances (£24 million reduction);

(c) the outcome of five individual assessments (£43 million increase); and

(d) the removal of the allowances relating to three water resilience schemes that the CMA has added to the large scheme gated processes (£64 million reduction).

13.13 We also illustrate (to the right of the chart) the potential additional funding that Southern estimates that it will require for its water resilience schemes at three sites. We have decided to add Southern's three water resilience schemes to the large scheme gated process and Southern will be able to make submissions to Ofwat to access additional funding in AMP8 for these schemes through the normal operation of the large scheme gated process.

Figure 13.2: Changes to Southern's enhancement allowances between Ofwat's PR24 FD and our final determination and an estimate of potential additional funding for the water resilience schemes that we have added to the large scheme gated process (before frontier shift, £m)



Note 1: The potential further funding relates to Southern's estimate of the maximum additional funding required for its three water resilience schemes that we have added to the large scheme gated process.
Note 2: The Ofwat PR24 FD allowance and the CMA PR24 FD allowance include allowances arising from delivery mechanisms. This is consistent with Table 50 in Ofwat's PR24 FD (PR24-FD-Expenditure-allowances-summary-tables.xlsx accessed 2 March 2026).
Source: CMA analysis.

13.14 In Table 13.2 below, we summarise Southern's enhancement allowances before and after frontier shift.

Table 13.2: Enhancement cost allowances

		£m
Ofwat PR24 FD	*A*	4,618
Blind year adjustments	*B*	36
Ofwat PR24 FD including blind year adjustments	***C = A + B***	**4,654**
CMA determinations		
Benchmark modelling	*D*	-24
Individual assessments	*E*	43
Schemes moved to RAPID and/or large schemes gated processes	*F*	-64
Total CMA determination changes	***G = D + E + F***	**-45**
Total enhancement CMA determination (before frontier shift, excluding potential further funding)	***H = C + G***	**4,609**
Potential further funding (note 1)	***I***	223
Total enhancement CMA determination (before frontier shift, including potential further funding)	***J = H + I***	**4,832**
Frontier shift	*K*	-36
Total enhancement CMA determination (after frontier shift)	***L = J + K***	**4,796**
Ofwat PR24 FD including blind year adjustments (after frontier shift)	*M*	4,574
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift)	*N = ((L – M) / M) x 100*	4.9%

Source: CMA analysis.

Note 1: The potential further funding relates to Southern's estimate of the maximum additional funding required for its three water resilience schemes that we have added to the large scheme gated process.

Overall totex allowances

13.15 Our final determination of Southern's wholesale totex allowance is shown in Table 13.3.

Table 13.3: Totex allowances compared with Ofwat's PR24 FD including blind year adjustments (after frontier shift and real price effects, £m)

	Ofwat PR24 FD (including blind year adjustments)	***CMA final determination***	***Change from Ofwat's PR24 FD (including blind year adjustments)***	
	£m	**£m**	**£m**	**%**
Total base costs	3,986	4,068	82	2.1
Total enhancement costs	4,574	4,796	222	4.9
Total	**8,560**	**8,864**	**304**	**3.6**

Source: CMA analysis.

13.16 We retain Ofwat's PR24 FD approach to cost sharing.

PCDs, ODIs, ASMs and OAM

PCDs and ODIs

13.17 For the purposes of this redetermination, we do not list every PCD or performance commitment to which Southern is subject. Instead, we provide a list of the PCDs (or features of PCDs) and performance commitments (or other features of ODIs) in relation to which: (a) Southern requested that changes be made; or (b) we have assessed and made changes that apply to Southern following a request for a change from another Disputing Company. In each case we identify changes we make to Ofwat's PR24 FD, within Table 13.4.

Table 13.4: CMA final determinations on relevant PCDs and ODIs compared to Ofwat PR24 FD

Category	*Performance commitment*	*CMA decision compared to Ofwat PR24 FD*
PCDs applied to base costs	Mains renewal	No change
	Network reinforcement	No change
Non-delivery PCD clawback arrangements		No change, with the benefit of Ofwat's Updated November 2025 PCDs Guidance
Time incentive PCDs		No change
Adjustments to PCDs during AMP		No change, with the benefit of Ofwat's Updated November 2025 PCDs Guidance
PCDs and overlapping penalties		No change
PCDs and administrative and regulatory burdens		No change
ODI PCLs	Storm overflow PCL	No change
	Total pollution incidents	No change except to apply the latest outturn data for all Disputing Companies
	Water supply interruptions	Baseline level for common PCL set according to industry median (ie higher) and using latest outturn data, with glidepath to 5 minutes in year 5; apply the enhanced ODI rate thresholds as per Ofwat's PR24 FD
	C-MeX	No change
ODI rates	Storm overflows	No change except to apply the latest outturn data
	Total pollution incidents	Calculation of performance range changed and apply latest outturn data, resulting in lower ODI rates for all Disputing Companies than in Ofwat's PR24 FD
	Water supply interruptions	No change except to apply the latest outturn data
	Experience measures (C-MeX, D-MeX and BR-MeX)	No change except to apply the latest outturn data
Individual risk protections	Caps, collars and deadbands	No change

Source: CMA analysis.

13.18 Our decisions on consequential updates to PCDs are included in chapter 6 (Outcomes), along with associated content in Appendix E. We have detailed new PCDs we are applying in Appendix G – this does not cover any matters relevant to Southern.

ASMs and OAM

13.19 We make no changes to the ASMs and the OAM.

13.20 Our determinations on the ASMs are:

(a) to maintain the existing design of the totex ASM by not separating the mechanism between water and wastewater; and

(b) to maintain the existing thresholds of the totex and outcomes ASMs.

13.21 We retain the OAM with the ±50bps deadband.

Allowed return

13.22 We set an Appointee real CPIH-based WACC of 4.20%. We also set the wholesale WACC equal to the Appointee WACC, based on our view that there is no double counting of returns between the wholesale and the retail controls. We set out our detailed assessment of the allowed return in chapter 7 (Allowed return).

Financeability

13.23 For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. We completed an assessment of Southern's notional financeability, including a financial ratio analysis, in line with standard regulatory practice. The outputs of this financial ratio analysis for Southern are shown in Table 13.5 below.

13.24 The financial ratio analysis is one part of a broader assessment of financeability. We set out our detailed assessment of financeability in chapter 8 (Risk and return).

Table 13.5: Notional credit ratio analysis for Southern (excluding delivery mechanism)

Key ratios	*AICR*	*FFO/net debt*	*Gearing*
Base case	1.73x	10.16%	55.37%
RoRE downside: 1% in all years	1.53x	9.12%	56.53%
RoRE downside: 2% in all years	1.33x	8.12%	57.68%

Source: CMA analysis.
Note: AMP8 average financial ratios.

13.25 We conclude that, on a notional basis, Southern's ratios are consistent with a Baa1/BBB+ rating in the base case. We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for Southern are more in line with a credit

rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (an annual 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade credit rating. We also performed the financial ratio analysis for Southern including the remaining delivery mechanism totex, and the results are similar.[464]

13.26 We consider that companies facing a financeability constraint, such as to address a downside scenario, can be reasonably expected to adopt a range of mitigating actions to address the impact, such as absorbing headroom in credit ratios, or increasing the contribution of equity either by forgoing dividends or injecting fresh capital. We conclude that this supports the view that our determination for Southern is financeable.

Implied calculations of revenue and implications for K and bills

13.27 All revenue and customer bill figures in this section are presented in 2022/23 CPIH deflated prices.

Revenue adjustments

13.28 The majority of a water company's wholesale revenue is derived from the totex and WACC figures discussed above.

13.29 We have also included in chapter 9 (Other issues), adjustments relating to Ofwat's 'blind year' final determination, in which Ofwat conducts a reconciliation for company performance in the final year of the last AMP – this uses data which was not available at the time of Ofwat's PR24 FD – and corrects for unambiguous errors in its PR24 FD. For Southern this includes an increase in totex allowances of approximately £390 million, which was released from the delivery mechanism. We include these adjustments in our final determination, which results in approximately a £25 million increase in Southern's revenue for the period.[465]

13.30 We also allow Southern to recover a proportion of its costs for the CMA redetermination process, which includes an allocation of our own costs. This represents around £1.9 million (which is excluded from totex cost-sharing).

[464] Ofwat moved approximately £390 million from Southern's delivery mechanism into totex in its blind year final determination: Ofwat (2025) Final determination adjusting for actual company performance in 2024-25: Blind year adjustment Southern Water. There is approximately £155 million remaining of the delivery mechanism totex.
[465] £25 million increase relates to Southern's total revenue, which includes wholesale and retail revenue.

Implied Southern revenue in AMP7 and calculations of K

13.31 In order to calculate Southern's revenue figures, we need to include PAYG rates to split totex into in-period recovery and RCV additions. Our starting point for this is to use the 'natural rate' approach included in Ofwat's PR24 FD.[466]

13.32 We also set RCV run-off rates to determine the rate at which totex added to the RCV is recovered through revenues. We retain the run-off rates used by Ofwat in its PR24 FD. Table 13.6 sets out a calculation of the allowed revenue for Southern's wholesale controls.

Table 13.6: Calculation of Southern's wholesale allowed revenue, excluding delivery mechanism (£m)

CPIH-real	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*	*Total*
PAYG	202	839	1,228	169	2,439
RCV run-off	57	457	1,248	112	1,874
Return on capital	53	434	1,170	72	1,729
Revenue adjustments for PR19 reconciliations	-17	-20	140	4	106
Quality and ambition assessment (QAA) reward / penalty	-	-	-	-	-
Tax	-	-	-	-	-
Developer services, diversions and other contributions (price control)	-	32	74	-	106
Other income (non-price control)	-16	-30	-28	-	-74
Innovation & Water efficiency fund	-	18	18	-	36
Revenue re-profiling	0	1	6	1	7
Total	279	1,731	3,855	358	6,224

Source: CMA analysis.
Note: £m over the whole 2025-2030 price control in 2022/23 CPIH deflated prices.

13.33 This calculation results in Southern's wholesale revenue over the AMP being around £151 million higher than Ofwat's PR24 FD.[467] If Southern's remaining (approximately £155 million) delivery mechanism totex is included, AMP8 wholesale revenues would increase by a further £14 million.

13.34 Following our prioritisation decisions, we have not redetermined the retail price control, so our decision makes no changes compared to Ofwat's PR24 FD with the following exceptions. First, we update the retail frontier shift to align to the 0.7% applied to wholesale costs. Second, we update the long-term inflation assumption to 2.4%. Third, we maintain Ofwat's methodology of calculating retail allowances based on wholesale, which results in a small incremental allowance of £4 million for Southern. The total incremental increase in retail allowance is less than £1

[466] PAYG natural rate calculated as a proportion of net opex to net. See chapter 8 (Risk and return), section titled 'Cost recovery'.
[467] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the wholesale revenue by a further £28 million, approximately.

million (£422 million to the nearest million in both our determination and Ofwat's PR24 FD).[468]

13.35 The estimated effect of these changes on average annual customer bills is shown in Table 13.7, compared to Southern's historical bills and Ofwat's PR24 FD.

Table 13.7: Indicative impact of our determination on Southern's annual household customer bills

	Average historical bill	*Ofwat PR24 FD AMP8 average bill*	*Southern SoC AMP8 average bill*	*CMA PR24 FD AMP8 average bill (excluding delivery mechanism)*	*CMA PR24 FD AMP8 average bill (including delivery mechanism)*
Average bill	£420	£620	£710	£641	£643

Source: Ofwat's PR24 FD financial models for 'Ofwat PR24 FD' bills (for 'Average historical bill' and 'Ofwat PR24 FD average bill'); CMA analysis (for 'CMA PR24 FD AMP8 average bill (excluding DM)' and 'CMA PR24 FD AMP8 average bill (including DM)'); Southern response to Disputing Companies RFI07 (for 'Southern SoC AMP8 average bill'). NB Disputing Companies RFI07 requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case.
Note: these are forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance.

13.36 The AMP8 average bill in our determination (excluding the Delivery Mechanism) is higher than Ofwat's PR24 FD by around £15, or 2.5%, per year.[469] Including Southern's delivery mechanism totex would increase AMP8 average bills by a further £2 per year.[470]

13.37 Having determined the revenue allowances over the whole AMP, we profile it between individual years in order to provide customers with a better view of the potential impact, and to allow for an annual calculation of K. In doing so, we choose to implement a consistent annual increase in real bills over the course of the remaining years in the AMP.

13.38 The results of this profiling, as well as the impact on K and bills, is shown in Table 13.8 and Table 13.9.

Table 13.8: Southern's K factors by charging year (excluding delivery mechanism)

	2025/26	*2026/27*	*2025/26*	*2026/27*	*2025/26*
Water resources	41.26%	50.38%	-17.28%	5.54%	5.32%
Water network plus	54.07%	11.64%	7.30%	5.38%	5.17%
Wastewater network plus	60.13%	-10.30%	6.46%	4.92%	5.19%

Source: CMA analysis.

[468] Inclusion of Ofwat's Blind Year Reconciliation FD would decrease the retail revenue by approximately £4 million before additional £4 million increase resulting from our decision is taken into account.
[469] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the bill by an additional £6 per annum.
[470] If Ofwat allows the potential further funding of £223 million (shown in Figure 13.2 above) through the large scheme gated process this would increase the average AMP8 customer bill by approximately £11 per year. We note that there is uncertainty in this bill impact given the level and timing of funding allowed by Ofwat through the large scheme gated process may vary.

Table 13.9: Southern's indicative annual bills (excluding delivery mechanism)

	2024/25	*2025/26*	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Customer bills	£420	£611	£611	£636	£661	£687

Source: CMA analysis.

13.39 In addition, we update Southern's bioresources control such that its tonnes per dry solid revenue average is set to £615.24 in years 3 to 5 of the AMP.

13.40 We also updated Southern's retail cost to serve to reflect our decision on frontier shift, resulting in a 5-year average retail cost to serve of £34.57.

14. The final determination for Wessex

14.1 This section summarises our final determination for Wessex. In this, we set out our final determination, but we do not restate the explanation or rationale for our decisions; we cross-reference to the relevant earlier sections of our report to identify where we have explained these rationales.

14.2 We have reached our final determination for Wessex in accordance with the statutory principles that apply to Ofwat, including various statutory duties.

14.3 We consider that the final determination for Wessex is best calculated to further the Consumer Objective and Resilience Objective and to secure the Functions Duty, the Financing Duty and the Licence Duty set out in section 2(2A) of the Act (the primary duties). Subject to the primary duties, in reaching this determination for Wessex, we have reached a final determination for Wessex which we consider best calculated to promote, secure, ensure and contribute to the secondary duties (as appropriate) set out in section 2(3) of the Act.

14.4 We have had regard to the principles of best regulatory practice per section 2(4) of the Act. We have acted in accordance with the SPS in reaching this determination, per the requirement in section 2A(2) of the Act. We consider that our decision is consistent with the Growth Duty.

14.5 We have exercised our own regulatory discretion in appropriately complying with these statutory duties. We have considered the final package for Wessex in the round and are satisfied that it is consistent with the relevant statutory principles.

Approach to the determination

14.6 We have used the same regulatory building blocks as used in Ofwat's PR24 FD.[471]

14.7 The rest of this section sets out the final decisions we have applied to Wessex, grouped into the following areas:

(a) expenditure (base and enhancement) allowances;

(b) PCDs, ODIs, ASMs and OAM;

(c) allowed return;

(d) financeability; and

(e) calculations of allowed revenue, with implications for K factors and customer bills in AMP8.

[471] CMA PR24 Approach document, paragraph 32.

Totex allowances

Base cost allowances

14.8 Our final determination on the base cost allowances for Wessex is set out in Table 14.1 below.

Table 14.1: Base cost allowances

		£m
Ofwat PR24 FD (before frontier shift and real price effects)	*A*	2,232
Blind year adjustments	*B*	-3
Ofwat PR24 FD including blind year adjustments (before frontier shift and real price effects)	***C = A + B***	**2,229**
Total base CMA determination changes	***G***	-4
Total base CMA determination (before frontier shift and real price effects)	***H = C + G***	**2,225**
Frontier shift and real price effects	*I*	-51
Total base CMA determination (after frontier shift and real price effects)	***J = H + I***	**2,175**
Ofwat PR24 FD including blind year adjustments (after frontier shift and real price effects)	*K*	2,181
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift and real price effects)	*L = ((J – K) / K) x 100*	-0.3%

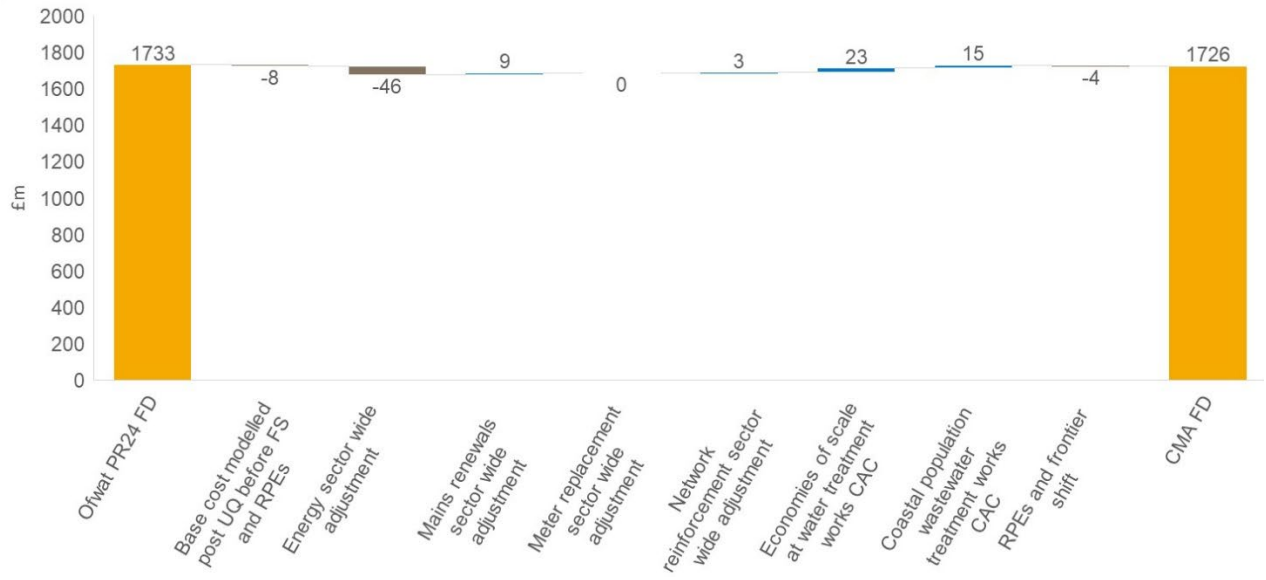
Source: CMA analysis. Disputing Companies' total base expenditure allowance (£m), rounded to zero decimal places.
Note 1: Totals include base expenditure allowances for: wholesale water, wastewater network plus, bioresources, and retail AMP8 total.
Note 2: % change is rounded to one decimal place.

14.9 The combination of modelling changes and cost adjustment claims results in an overall decrease of £6 million after frontier shift and real price effects for Wessex compared with Ofwat's PR24 FD including blind year adjustments.

14.10 True ups will be applied for labour and energy costs relating to base cost allowances – see chapter 4 (Base costs).

14.11 In Figure 14.1 below we set out the impact of our decisions on base costs on Wessex's total water, wastewater and bioresources allowances.

Figure 14.1: Impact of our decisions on base costs on Wessex's total water, wastewater and bioresources allowances



Source: CMA analysis.
Notes: For the CMA PR24 FD energy and labour cost for water and wastewater are included in the base case modelling so energy sector wide uplift and RPEs for water and wastewater are removed; Ofwat PR24 FD figure takes account of Ofwat's December 2025 Blind Year Reconciliation FD; totals exclude retail and unmodelled costs.

Enhancement cost allowances

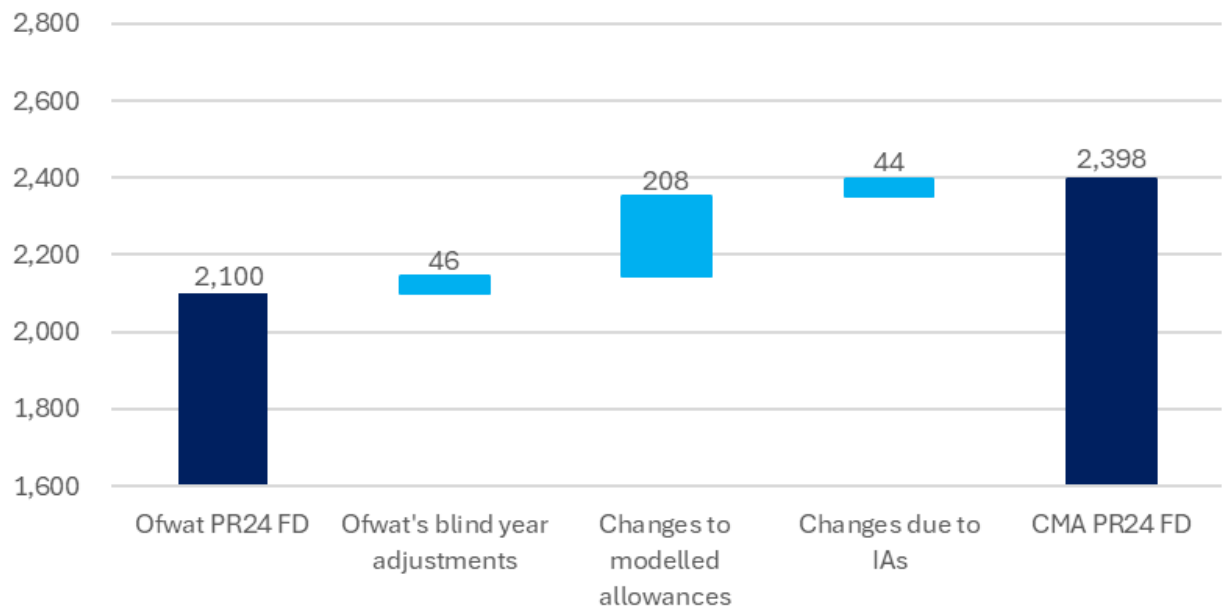
14.12 In Table 14.2 and Figure 14.2, we show the changes to Wessex's enhancement allowances between Ofwat's PR24 FD and our final determination. The changes reflect:

(a) Ofwat's blind year adjustments (£46 million increase);

(b) a higher modelled allowance for phosphorus removal (£208 million increase); and

(c) additional funding for two individual assessments for water disinfection and the reversal of an under-delivery adjustment in Ofwat's PR24 FD (£44 million increase).

Figure 14.2: Changes to Wessex's enhancement allowances between Ofwat's PR24 FD and our final determination (before frontier shift, £m)



Source: CMA analysis.
Note: We have not added any Wessex schemes to the RAPID or large scheme gated processes. Hence, we have not included any potential further funding.

14.13 In Table 14.2 below, we summarise Wessex's enhancement allowances before and after frontier shift.

Table 14.2: Enhancement cost allowances

		£m
Ofwat PR24 FD	*A*	2,100
Blind year adjustments	*B*	46
Ofwat PR24 FD including blind year adjustments	***C = A + B***	**2,146**
CMA determinations		
Benchmark modelling	*D*	208
Individual assessments	*E*	44
Schemes moved to RAPID and/or large schemes gated processes	*F*	0
Total CMA determination changes	***G = D + E + F***	**252**
Total enhancement CMA determination (before frontier shift)	***H = C + G***	**2,398**
Frontier shift	*I*	-28
Total enhancement CMA determination (after frontier shift)	***J = H + I***	**2,370**
Ofwat PR24 FD including blind year adjustments (after frontier shift)	*K*	2,093
% change CMA determination vs Ofwat PR24 including blind year adjustments (after frontier shift)	*L = ((J – K) / K) x 100*	13.2%

Source: CMA analysis.

Overall totex allowances

14.14 Our final determination of Wessex's wholesale totex allowance is shown in Table 14.3.

Table 14.3: Totex allowances compared with Ofwat's PR24 FD including blind year adjustments (after frontier shift and real price effects, £m)

	Ofwat PR24 FD (including blind year adjustments)	*CMA final determination*	*Change from Ofwat's PR24 FD (including blind year adjustments)*	
	£m	**£m**	**£m**	**%**
Total base costs	2,181	2,175	-6	-0.3
Total enhancement costs	2,093	2,370	277	13.2
Total	**4,274**	**4,545**	**271**	**6.3**

Source: CMA analysis.

14.15 We retain Ofwat's PR24 FD approach to cost sharing.

PCDs, ODIs, ASMs and OAM

PCDs and ODIs

14.16 For the purposes of this redetermination, we do not list every PCD or performance commitment to which Wessex is subject. Instead, we provide a list of the PCDs (or features of PCDs) and performance commitments (or other features of ODIs) in relation to which: (a) Wessex requested that changes be made; or (b) we have assessed and made changes that apply to Wessex following a request for a change from another Disputing Company. In each case we identify changes we make to Ofwat's PR24 FD, within Table 14.4.

Table 14.4 CMA final determinations on relevant PCDs and ODIs compared to Ofwat PR24 FD

Category	*Performance commitment*	*CMA decision compared to Ofwat PR24 FD*
PCDs applied to base costs	Mains renewal	No change
	Network reinforcement	No change
ODI PCLs	Total pollution incidents	No change except to apply the latest outturn data for all Disputing Companies
	Water supply interruptions	Baseline level for common PCL set according to industry median (ie higher) and using latest outturn data, with glidepath to 5 minutes in year 5; apply enhanced ODI rate thresholds as per Ofwat's PR24 FD
ODI rates	Storm overflows	No change except to apply the latest outturn data
	Total pollution incidents	Calculation of performance range changed and apply latest outturn data, resulting in lower ODI rates for all Disputing Companies than in Ofwat's PR24 FD
	Water supply interruptions	No change except to apply the latest outturn data
	Experience measures (C-MeX, and D-MeX)	No change except to apply the latest outturn data

Source: CMA analysis.

14.17 Our decisions on consequential updates to PCDs are included in chapter 6 (Outcomes), along with associated content in Appendix E. We have detailed new PCDs we are applying in Appendix G – for Wessex this covers a new allowance we have given for disinfection improvements.

ASMs and OAM

14.18 We make no changes to the ASMs and the OAM.

14.19 Our determinations on the ASMs are:

(a) to maintain the existing design of the totex ASM by not separating the mechanism between water and wastewater; and

(b) to maintain the existing thresholds of the totex and outcomes ASMs.

14.20 We retain the OAM with the ±50bps deadband.

Allowed return

14.21 We set an Appointee real CPIH-based WACC of 4.20%. We also set the wholesale WACC equal to the Appointee WACC, based on our view that there is no double counting of returns between the wholesale and the retail controls. We set out our detailed assessment of the allowed return in chapter 7 (Allowed return).

Financeability

14.22 For each Disputing Company, we considered whether our decisions will enable them to finance the proper carrying out of their functions. We completed an assessment of Wessex's notional financeability, including a financial ratio analysis, in line with standard regulatory practice. The outputs of this ratio analysis for Wessex are shown in Table 14.5 below.

14.23 The financial ratio analysis is one part of a broader assessment of financeability. We set out our detailed assessment of financeability in chapter 8 (Risk and return).

Table 14.5: Notional credit ratio analysis for Wessex

Key ratios	*AICR*	*FFO/net debt*	*Gearing*
Base case	1.74x	9.17%	55.78%
RoRE downside: 1% in all years	1.53x	8.16%	56.88%
RoRE downside: 2% in all years	1.33x	7.19%	57.98%

Source: CMA analysis.
Note: AMP8 average financial ratios.

14.24 We conclude that, on a notional basis, Wessex's ratios are consistent with a Baa1/BBB+ rating in the base case. We observe that in the first downside scenario (an annual 1% RoRE penalty) the ratios for Wessex are more in line with a credit rating of BBB/Baa2 than BBB+/Baa1. In the more severe scenario (an annual 2% RoRE downside), the metrics, as expected, worsen but remain broadly consistent with an investment grade credit rating.

14.25 We consider that companies facing a financeability constraint, such as to address a downside scenario, can be reasonably expected to adopt a range of mitigating

actions to address the impact, such as absorbing headroom in credit ratios, or increasing the contribution of equity either by forgoing dividends or injecting fresh capital. We conclude that this supports the view that our determination for Wessex is financeable.

Implied calculations of revenue and implications for K and bills

14.26 All revenue and customer bill figures in this section are presented in 2022/23 CPIH deflated prices.

Revenue adjustments

14.27 The majority of a water company's wholesale revenue is derived from the totex and WACC figures discussed above.

14.28 We have also included in chapter 9 (Other issues), adjustments relating to Ofwat's 'blind year' final determination, in which Ofwat conducts a reconciliation for company performance in the final year of the last AMP – this uses data which was not available at the time of Ofwat's PR24 FD – and corrects for unambiguous errors in its PR24 FD. We include these adjustments in our final determination, which results in a £3 million decrease in Wessex's revenue for the period.[472]

14.29 We also allow Wessex to recover a proportion of its costs for the CMA redetermination process, which includes an allocation of our own costs. This represents around £1.7 million (which is excluded from totex cost-sharing).

Implied Wessex revenue in AMP7 and calculations of K

14.30 In order to calculate Wessex's revenue figures, we need to include PAYG rates to split totex into in-period recovery and RCV additions. Our starting point for this is to use the approach included in Ofwat's PR24 FD.[473]

14.31 We also set RCV run-off rates to determine the rate at which totex added to the RCV is recovered through revenues. We retain the run-off rates used by Ofwat in its PR24 FD. Table 14.6 below sets out a calculation of the allowed revenue for Wessex's wholesale controls.

[472] £4 million decrease relates to Wessex's total revenue, which includes wholesale and retail revenue.
[473] For Wessex the PAYG rate is calculated as a proportion of net opex plus capitalised infrastructure renewals expenditure to net totex. See chapter 8 (Risk and return), section titled 'Cost recovery'.

Table 14.6: Calculation of Wessex's wholesale allowed revenue (£m)

CPIH-real	*Water resources*	*Water network plus*	*Wastewater network plus*	*Bioresources*	*Total*
PAYG	75	484	819	130	1,508
RCV run-off	27	235	610	71	943
Return on capital	24	258	671	35	988
Revenue adjustments for PR19 reconciliations	-1	31	-10	2	22
Quality and ambition assessment (QAA) reward / penalty	-	-	-	-	-
Tax	-	-	-	-	-
Developer services, diversions and other contributions (price control)	-	14	27	-	40
Other income (non-price control)	-1	-24	-21	-1	-47
Innovation & Water efficiency fund	-	10	12	-	22
Revenue re-profiling	-	4	3	0	7
Total	**124**	**1,012**	**2,109**	**237**	**3,482**

Source: CMA analysis.
Note: £m over the whole 2025-2030 price control in 2022/23 CPIH deflated prices.

14.32 This calculation results in Wessex's wholesale revenue over the AMP being around £104 million higher than Ofwat's PR24 FD.[474]

14.33 Following our prioritisation decisions, we have not redetermined the retail price control, so our decision makes no changes compared to Ofwat's PR24 FD with the following exceptions. First, we update the retail frontier shift to align to the 0.7% applied to wholesale costs. Second, we update the long-term inflation assumption to 2.4%. Third, we maintain Ofwat's methodology of calculating retail allowances based on wholesale, which results in a small incremental allowance of £2 million for Wessex. Total incremental increase in retail allowance is £5 million (£252 million in our determination compared to £247 million in Ofwat's PR24 FD).[475]

14.34 The estimated effect of these changes on average annual customer bills is shown in Table 14.7, compared to Wessex's historical bills and Ofwat's PR24 FD.

Table 14.7: Indicative impact of our determination on Wessex's annual household customer bills

	Average historical bill	*Ofwat PR24 FD AMP8 average bill*	*Wessex SoC AMP8 average bill*	*CMA PR24 FD AMP8 average bill*
Average bill	£508	£594	£642	£614

Source: Ofwat's PR24 FD financial models for 'Ofwat PR24 FD' bills (for 'Average historical bill' and 'Ofwat PR24 FD average bill'); CMA analysis (for 'CMA PR24 FD AMP8 average bill'); Wessex response to Disputing Companies RFI07 (for 'Wessex SoC AMP8 average bill'). NB Disputing Companies RFI07 requested £ figures in 2022/23 CPIH real prices as per Disputing Companies' statements of case. Note: these are forecasts of average bills. Actual bills will vary according to, for example, average customer water consumption and company performance.

[474] Inclusion of Ofwat's Blind Year Reconciliation FD would decrease the wholesale revenue by £6 million.
[475] Inclusion of Ofwat's Blind Year Reconciliation FD would increase the retail revenue by a further £3 million, in addition to the £2 million resulting from our decision.

14.35 The AMP8 average bill in our determination is higher than Ofwat's PR24 FD by around £19, or 3.3%, per year.[476]

14.36 Having determined the revenue allowances over the whole AMP, we profile it between individual years in order to provide customers with a better view of the potential impact, and to allow for an annual calculation of K. In doing so, we choose to implement a consistent annual increase in real bills over the course of the remaining years in the AMP.

14.37 The results of this profiling, as well as the impact on K and bills, is shown in Table 14.8 and Table 14.9. Wessex proposed a cap of 30% on its bill increases from 2024/25 to 2029/30 and asked us to broadly align with this in the CMA PR24 FD. We consider the 31.6% increase in the CMA PR24 FD to broadly align with Wessex's commitment; our rationale is set out in more detail in chapter 8 (Risk and return), in the section titled 'PAYG rates'.

Table 14.8: Wessex's K factors by charging year

	2025/26	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Water resources	3.66%	13.81%	-7.10%	6.34%	6.45%
Water network plus	13.36%	-6.32%	3.67%	6.55%	6.62%
Wastewater network plus	22.36%	8.06%	7.23%	5.99%	6.10%

Source: CMA analysis.

Table 14.9: Wessex's indicative annual bills

	2024/25	*2025/26*	*2026/27*	*2027/28*	*2028/29*	*2029/30*
Customer bills	£508	£575	£579	£607	£637	£669

Source: CMA analysis.

14.38 In addition, we update Wessex's bioresources control such that its tonnes per dry solid revenue average is set to £651.87 in years 3 to 5 of the AMP.

14.39 We also updated Wessex's retail cost to serve to reflect our decision on frontier shift, resulting in a 5-year average retail cost to serve of £31.34.

[476] Inclusion of Ofwat's Blind Year Reconciliation FD would decrease the bill by less than £1.