November 2025

PR24 Reconciliation Rulebook: Policy Approach and Response

Ofwat

About this document

Price Review 2024 (PR24) supports record levels of investment by water companies with £104 billion allocated over the next five years. This includes a fourfold increase in spending on new infrastructure and resources, reaching an unprecedented £44 billion. By 2030, we expect this investment to deliver tangible improvements for customers and the environment.

Our price controls are inherently forward-looking, but future uncertainties remain. Cost pressures on companies may shift unexpectedly and companies' performance can vary. Therefore, we need a framework that ensures customers' bills remain fair and appropriate as circumstances change. The process for adjusting companies' allowed revenue in response to such changes is known as 'reconciliations'.

Our approach to reconciliations is designed to:

- ensure companies collect the correct amount of revenue;
- minimise bill volatility for customers; and
- deliver positive outcomes for both customers and the environment.

Our implementation promotes regulatory certainty and transparency while avoiding unnecessary regulatory burdens.

We published our draft rulebook for consultation on 19 May 2025. The draft PR24 Reconciliation Rulebook consisted of:

- The 'PR24 Reconciliation Rulebook: Draft Guidance Document[1]', which outlines our proposed reconciliation approach during and after the 2025-30 price control period (1 April 2025 – 31 March 2030);
  - a spreadsheet summarising how the reconciliations will be implemented;[2]
  - a series of reconciliation models, demonstrating how the PR24 reconciliation mechanisms will operate in practice. These models are referenced throughout this document;[3] and
  - models maps to show how all the models work together.

This document sets out our response to stakeholders' feedback on the policies set out in the draft 'PR24 Reconciliation Rulebook: Guidance Document'. Model focussed issues will be set out in a separate 'Detailed modelling comments assessment table' and/or are captured in the relevant model's changes log. In some instances feedback covered both policy and model

[1] Ofwat, "PR24 Reconciliation Rulebook: Draft Guidance Document, May 2025.
[2] Ofwat, "Draft summary of the reconciliations" May 2025.
[3] We are also publishing the revenue feeder model and RCV feeder model.

points so may be addressed in both this document and the 'Detailed modelling comments assessment table.

Alongside feedback on the reconciliation models we received feedback which pertained to the developments to future price control periods or previously agreed policy. This consultation focusses on reconciling the activities which were covered by PR24. If stakeholders have views on the scope and design of future price controls then they can feed these into the consultation for the next price review.

Responses to our consultation were varied and sometimes contradictory. For example, some responses highlighting the need for simplifications due to the complexity of the price review and reconciliation mechanisms. In other instances greater functionality in models or additions to policy have been proposed, which would inevitably add further complexity into the regulatory process. Our approach to has been to make changes where we feel greater functionality is warranted but we have tried, where possible, to consider the overall complexity of the reconciliations and not add additional regulatory burden.

We have endeavoured to be transparent with our approach to reconciliation mechanisms and policies and have in many instances maintained existing mechanisms so that there is consistency and certainty across price reviews. In some instances, new mechanisms were introduced at PR24, for example the Delayed delivery cashflow mechanism (DDCM) was introduced due to the scale of the increase in the investment programme for PR24. This mechanism sits alongside a suite of measures to incentivise companies to deliver services and enhancement programmes in line with their determinations, and to protect customers from paying for service improvements that are not delivered or where delivery is delayed.

There may be instances where external factors mean model amendments or new reconciliations may need to developed, as occurred during PR19 with the introduction of capital allowance super deductions that required a change to the tax reconciliation models or the new models that needed to be developed in period because of the green economic recovery process.

Contents

1. Introducing the PR24 reconciliation rulebook

This section sets out the issues raised in our consultation and our assessment and decisions in relation to:

- the role of the reconciliation process;
- our approach to developing the PR24 Reconciliation Rulebook; and
- the status of this document and next steps.

Issue 1: Approach to developing reconciliations

Respondents' views

United Utilities recognise that the detailed implementation of our reconciliations must follow our final determinations. However, they consider insufficient detail was provided during the price control process. They ask that we consult on all reconciliation mechanisms, associated guidance and models no later than the time of the draft determination at PR29.

Our assessment and decision

We have maintained continuity for most reconciliations from the PR19 Reconciliation Rulebook. We consulted on PR24 reconciliations, including newly introduced mechanisms, as part of our PR24 draft determinations. Our consultation regarding the reconciliation rulebook focuses on the implementation of reconciliations. We have sought over recent price reviews to increase the transparency on reconciliation mechanisms, and aim where possible to continue this approach.

Issue 2: Approach to modelling

Respondents' views

Yorkshire Water appreciates the standardised approach to modelling carried over from PR19. Affinity Water, Anglian Water, South West Water, Thames Water, United Utilities, Dŵr Cymru and Wessex Water comment on the approach to modelling. Comments include:

- that the model inputs are not clearly set out in the models;
- there should be more comprehensive inclusion of changes logs and Quality Assurance should be implemented and recorded as completed;
- there should be more consistent adherence to the FAST standard;
- more guidance on how to use the models; and
- other suggestions to make the models simpler, clearer, and more consistent.

South West Water suggests that we create a database of inputs to make locating the data easier. Portsmouth Water suggests including values generated by Ofwat and which are not expected to change within the models.

Our assessment and decision

Our approach for the PR24 reconciliation rulebook is to:

- include model outputs and inputs descriptions in the associated models, rather than in the guidance document, to improve clarity and avoid repetition; and
- implement good modelling practice, including publishing models in the FAST standard as far as possible. Where required this will include rebuilding existing models to adhere to the FAST standard.

We have addressed comments on the models as appropriate. We have implemented a more standardised approach to setting out inputs, outputs, logging changes and recording the quality assurance completed.

We may continue to improve the models in future if errors are identified, we see opportunities for improvement or external factors required model logic updates. For example, changes in tax rules set out by HMRC.

Issue 3: Further model development and engagement

Respondents' views

South West Water appreciates the clarity in the consultation materials. Wessex Water, United Utilities and Yorkshire Water ask for further engagement. Yorkshire Water asks how to raise issues regarding models in future.

Our assessment and decision

We have taken account of feedback through the consultation. We have engaged further with companies on key areas, such as the ODI performance model, PCD model and the DDCM.

We will engage further with companies as required. We will update the rulebook (i.e. this guidance document and related files) when necessary. As set out in our response to issue 2 this could be due to a change from external factors. We will consult on appropriate areas and then update as required. If you have any questions or comments, these can be sent to PR24@ofwat.gov.uk

2. Implementation

This section sets out the issues raised in our consultation and our assessment and decisions in relation to cross-cutting policy issues, including time value of money, inflation adjustments, midnight adjustments, and tax.

Issue 1: Time value of money adjustments

Respondents' views

United Utilities supports our proposed use of the WACC for setting the discount rate. Severn Trent Water and United Utilities consider we have taken an inconsistent implementation to discounting across our models. Severn Trent Water supports the revision we made to the implementation of the discount rate during PR19 to include an additional half-year adjustment.

Our assessment and decision

We agree that a consistent approach should be taken. We have implemented changes in a number of reconciliation models for consistency across the model suite to ensure that discounting includes half-year adjustments.

Issue 2: Inflation adjustments

Respondents' views

United Utilities supports our approach to making inflation adjustments, noting that stability in this area is beneficial.

Our assessment and decision

We will continue to apply our inflation adjustments.

Issue 3: Taxation

Respondents' views

Issues raised by companies and WaterUK primarily relate to adjustments to tax adjustments for losses surrendered to group companies for which the regulated company received payment. The issues raised were largely the same as in companies' representations on draft determinations and were raised across this section and in response to the tax reconciliation. Companies were concerned that customers would benefit from tax losses whilst shareholders have borne the underlying expenditure giving rise to the tax losses. Companies have also argued that this disincentivises companies from managing their tax affairs efficiently. We responded to the issues raised in final determinations.

United Utilities identified issues whereby the tax implications of all other reconciliations was not considered within the guidance. They also stated that a companies tax position could change from year to year and that any tax implications are neutral across periods and there is no undue benefit or cost to customers or companies.

Our assessment and decision

We have retained the policy set out at PR24 in relation to the surrender of tax losses and payments received for group relief. We set out in our PR24 final determinations, that we will consider the appropriate treatment of carried forward surrendered losses when we set our determinations at PR29. We respond to the issues raised in relation to surrender of tax losses in section 3.16.

We have updated the guidance in relation to the tax impacts of the reconciliation models to include all reconciliation models. We will maintain functionality within the PR29 financial model that will allow any tax adjustments related to reconciliation items to be applied in any given year. We will consider further functionality in the PR29 financial model as part of its development.

Issue 4: Midnight adjustments at PR29

Respondents' views

In our draft guidance document, we proposed to retain the policy approach adopted at PR24 so that midnight adjustments to the RCV would apply on 31 March 2030. The ten companies that responded to this proposal supported this approach.

Severn Trent Water and South West Water consider that further guidance is needed in how this change would interact with their regulatory reporting.

Severn Trent Water disagreed with using this version of the RCV for other regulatory measures, such as the calculation of RoRE and the sharing mechanism in the ODI performance model.

Our assessment and decision

We will implement our proposal. The midnight adjustments reflect reconciliations that relate to the 2025-30 period and it therefore the best calculation of period-end RCV at that time. As such we would expect the RCV including the midnight adjustments to apply to all 2029-30 reporting and regulatory measures. Based on previous determinations, the RCV adjusted for midnight adjustments will be published in final determinations, for use by companies ahead of the 2029-30 year end

3. Common reconciliations

This section sets out the issues raised in our consultation and our assessment and decisions in relation to the common reconciliations. (That is, those reconciliations that would apply to all water and/or sewerage companies.) These are listed in alphabetical order.

3.1 Bioresources revenue reconciliation

Issue 1: Graded approach on penalties

Respondents' views

Thames Water proposed a graded approach to calculating the forecasting accuracy incentive penalty. The company argued that the current 6% threshold approach is overly punitive.

Our assessment and decision

We retain the decision to apply the forecasting accuracy incentive penalty above a 6% threshold. This was also the approach taken in the PR19 version of the model. A graded approach would be overly complex given the nature of the incentive. The penalty is designed to discourage significant errors in forecasting, not minor deviations. A threshold is sufficient to achieve this without adding complexity to the calculation. This approach also aligns with the forecasting penalty in the retail revenue reconciliation model.

3.2 Cost of new debt reconciliation

Issue 1: Calculation of the benchmark index

Respondents' views

United Utilities, Wessex Water, Portsmouth Water and South East Water requested further clarity on the source and calculation of the "1-year average of iBoxx adjusted for ‘outperformance wedge". United Utilities and Wessex Water recommended including a sheet for calculating average iBoxx rate and the combined benchmark. Portsmouth Water also requested clarity on how any company specific adjustments are applied to the benchmark index.

Our assessment and decision

Our license with the curator of the iBoxx A/BBB £ 10+ non-financials index (IHS Markit, now integrated into S&P Global) does not permit us to publish or systematically redistribute large amounts of raw iBoxx data. For these reasons, we propose to continue to publish populated models using hardcoded financial year averages, rather than formulas that link to the underlying data. We confirm going forward that we will use the indices as published by S&P Global as the provider of these averages, while recognising that different data providers may have different rules concerning inclusion of particular dates.[4] Notwithstanding the constraints around publishing raw iBoxx data, we are receptive to engaging with companies to demonstrate the averaging formula in order to provide additional assurance, if required.

For improved transparency we have separated out the iBoxx index values from adjustments (e.g. the benchmark index adjustment, or company-specific adjustment) in the model's input sheet. In addition, we will publish 1y average iBoxx A/BBB 10+ index values each year during the AMP as part of the Financial Flows Data Source. Further details on these can be found in the models change log and input source log.

3.3 Cost sharing reconciliation

Issue 1: PAYG rates

Respondents' views

Severn Trent Water and United Utilities requested that the opex/capex split used to separate the final adjustment into revenue and RCV be disaggregated by price control. Additionally, United Utilities requested that this information be included in the 'Other inputs' worksheet in the cost sharing dataset that we published alongside the model.

Our assessment and decision

We agree that due to the potentially large differences in opex/capex splits between the various price controls, it is logical to disaggregate this model input by price control. We have updated the model accordingly.

We have also updated the 'other inputs' worksheet in the cost sharing dataset to include the relevant opex/capex splits.

[4] For instance S&P appear to publish the data featuring in the iBoxx A/BBB 10+ non-financials index every weekday including bank holidays and also month end dates that fall on a weekend.

Issue 2: ASM application

Respondents' views

South East Water requested clarity on the timing and methodology of the Aggregate Sharing Mechanism (ASM) as this was not included in the draft guidance.

Our assessment and decision

We set out how the ASM would be applied in our PR24 final determinations.[5] We have updated the inputs in the model to specify where they are sourced from. We have included an explanation of the cost sharing ASM in the final guidance.

Issue 3: Interaction between cost sharing reconciliation and bioresources revenue reconciliation

The bioresources revenue reconciliation adjusts companies' allowed revenue to reflect the difference between forecast and actual sludge volumes based on the variable cost of sludge.

As the bioresources control is now included in cost sharing (unlike at PR19), there is an overlap between the bioresources revenue and the cost sharing reconciliations. When comparing allowances to actual expenditure in the cost sharing reconciliation, the allowances should be based on the actual sludge volumes. Therefore an adjustment will need to be made to both the standard base totex allowance for cost sharing and the related real price effects adjustment, to account for the revenue adjustment made in the bioresources revenue reconciliation model.

We have updated the model to multiply these items by a 'bioresources variable cost allowance adjustment factor' prior to the cost sharing calculations. This adjustment factor is calculated on an annual basis by dividing the actual volume of sludge by the forecast volume of sludge.

Issue 4: In-period adjustments to cost sharing rates

Respondents' views

Thames Water raised the issue that since there is only one input for each cost sharing rate, in the event that there were in-period adjustments to sharing rates the model would be unable to reflect this.

[5] Ofwat, 'PR24 final determinations: aligning risk and return – appendix', December 2024, pp. 13-15

Our assessment and decision

We do not anticipate cost sharing rates varying materially over the period. However, should the situation arise where changes are made that do not apply across the full five years the model would be updated to accommodate this.

3.4 Customer measure of experience (C-MeX)

Issue 1: The timing of the C-MeX calculation

Respondents' views

Yorkshire Water and South East Water raised potential timing issues with the calculation of the C-MeX performance scores because they rely on the UKCSI results published in July, which would not allow companies time to incorporate these into their APRs.

Our assessment and decision

We do not expect companies to include the UKCSI scores in their APRs, just their survey scores. We will then calculate their final C-MeX performance post companies submissions. The UKCSI scores published in July are based on survey data from the previous 12 months, which means it covers the same time period as the C-MeX surveys themselves. For example, the July 2026 UKCSI figures will relate to performance in 2025-26. The alternative suggestion, using July 2025 figures, would mean using UKCSI data from 2024-25, so we would not be comparing results from the relevant year.

Issue 2: Clarification on the price bases of the C-MeX model

Respondents' views

Several companies asked for further clarification on the price bases used in the C-MeX model.

Our assessment and decision

The prices used in the model are 2022-23 FYA CPIH prices. For PR24, C-MeX payments will be included within the ODI Aggregate Sharing Mechanism (this is a change from PR19).

The ODI performance model calculates ODI payments for all PCs (apart from MeXes which are calculated in separate models), and then applies the ASM. Adjustments for inflation happen at the end, to all ODI payments. Adjustments to price bases happen in subsequent models.

We have amended the model to make this clearer. This is reflected in the change log of the model.

3.5 Delayed delivery cashflow mechanism (DDCM)

Issue 1: Interactions with other mechanisms

Respondents' views

Companies remain concerned that the introduction of the delayed delivery cashflow mechanism (DDCM) may create double-counting with other incentive and clawback mechanisms.

Our assessment and decision

Any delay to the enhancement programme means it is possible that customers will have provided some funding up front for investment that has not yet been delivered. The DDCM will operate as a fairness mechanism for customers and to encourage delivery of PR24 investment by companies.

The DDCM is designed to repay cash flows for those companies materially behind on delivery. We were clear in the final determinations that there is no penalty element to the DDCM. The DDCM will operate separately and independently of the price control deliverables, which already incentivise timely delivery, and cost sharing arrangements which already incentivise cost efficiency. The DDCM does not alter expenditure allowances or cost sharing incentives, and any revenue foregone would automatically be reversed before other reconciliation mechanisms are applied at PR29.

Issue 2: Efficient delivery and thresholds rates

Respondents' views

Thames Water argued that if service improvements are delivered, but below the in-year allowance, they would be penalised for efficient delivery.

Anglian Water also argued that the threshold for enacting the DDCM "lacks definition on what the optimal level of underspending would be from the DDCM perspective and does not seem being 'just' with this proposed categorisation of Companies in view of the specificities of different Regions that they serve."

Our assessment and decision

In response to Anglian Water, we do not consider there is an "optimal level of underspending from the DDCM perspective". We have deliberately set the threshold for enacting the DDCM high to ensure it only applies to those companies with significant levels of underspending, which will be difficult to make up over the remainder of the price control period. The level at which the threshold is set, and the fact that the adjustment covers only 50% of the associated revenue, means that we would not expect any company to trigger the DDCM due to efficient delivery.

Issue 3: PAYG rates

Respondents' views

In assessing the relevant PAYG rate to apply, Wessex Water recommends this is considered for each project, as (i) operating expenditure may be incurred ahead of capital costs; and (ii) each project is likely to have different opex/capex splits. As such PAYG revenue may be clawed back for operating expenses that have or will be spent.

South East Water argued that the guidance should be clear on how the enhancement PAYG rate, used to calculate the split of fast and slow money, should be deduced for this mechanism. They also argued that the current approach to using the year 2 rate for year 2 adjustments and year 3 rate for year 3 adjustments does not take into account the cumulative nature of the adjustments.

Our assessment and decision

We can confirm that the PAYG rate used within the mechanism will reflect the split of enhancement opex and capex included within the modelling of allowed revenues in the PR24 FD financial model. These are available in the published opex capex split model. Our approach to recovering revenue is that it should follow the same split as in our funding allowances. However, we may consider a different allocation of opex and capex based on evidence of actual expenditure to date put forward by companies.

We agree that the approach in the draft model did not take into account the cumulative nature of the adjustments in the relevant year. We have modified the model to apply a weighted average rate for the respective year based on the cumulative expenditure clawback to date. Further information on this can be found in the model change log.

Issue 4: Application of adjustment at the combined water and wastewater level

Respondents' views

Severn Trent Water and United Utilities argued adjustments should be made at the control level not at the combined as the in period model as the existing In-period adjustments model already accommodates the control level of disaggregation

Our assessment and decision

The reconciliation calculates the claw back at individual control level. However, we have chosen to apply the adjustment in the network controls to avoid adjustments to bioresources revenue.

Issue 5: Reversal of revenue adjustment

Respondents' views

Severn Trent Water has suggested that we set out the calculation steps to reverse revenue clawed back under the DDCM to provide greater clarity that companies are not penalised.

Our assessment and decision

We have included additional outputs to the model which demonstrate the revenue amount to be reversed at PR29. This adjustments will include a time value of money adjustment consistent with our approach to TVM adjustments to ensure companies are not penalised through the use of this mechanism and that it remains a cashflow mechanism.

Issue 6: Impact on financeability

Respondents' views

Thames Water is concerned about the impact on financeability of revenue being clawed back.

Our assessment and decision

We do not consider there will be any impact on financeability as the DDCM seeks to claw back revenue that has not been spent and, as such, this should not affect the sufficiency of cash available within the company.

Issue 7: Enhancement allowance

Respondents' views

Thames Water requested clarity on the definition of enhancement expenditure in scope for this adjustment.

Our assessment and decision

In determining whether a company has passed the threshold for the DDCM to operate, we will just consider the enhancement allowances set out in the final determinations made by Ofwat or, where relevant, the CMA. As such, companies will not be disadvantaged should additional totex allowances be provided in-period through interim determinations, the cost change process or delivery mechanisms. However we note that it will be difficult for a company to justify significant increases in costs through the cost change process if it is significantly behind with its delivery, so it is unlikely that this situation will materialise.

3.6 Developer services measure of experience (D-MeX)

Issue: Clarification on the price bases of the D-MeX model

Respondents' views

Several companies asked for further clarification on the price bases used in D-MeX model.

Our assessment and decision

The prices used in the model are 2022-23 FYA CPIH prices. For PR24, D-MeX payments will be included within the ODI Aggregate Sharing Mechanism (this is a change from PR19).

The ODI performance model calculates ODI payments for all PCs (apart from MeXes which are calculated in separate models), and then applies the ASM. Adjustments for inflation happen at the end, to all ODI payments. Adjustments to price bases happen in subsequent models.

We have amended the model to make this clearer. This is reflected in the change log of the model.

3.7 Innovation and Water Efficiency fund and competition

We had no feedback on the policy aspects of the Water efficiency or Innovation fund. Thames Water, United Utilities and South East Water raised minor points on the innovation fund model and these have been addressed in the revised model change log.

3.8 In-period adjustments model

Issue 1: Retail modification factor

Respondents' views

Dŵr Cymru and Thames Water stated that the in-period adjustments model should produce the Modification factor (M) as an output rather than the Total revenue (TRt) for Residential Retail to be consistent with PR24 notifications.

Our assessment and decision

We agree that the form of the output for the retail control should be the Modification factor (M). We have amended the model to calculate the Modification factor after ODI adjustments.

Issue 2: Deferred payments and future revenue adjustments

Respondents' views

Thames Water agreed that deferrals should prioritise customer interests but that other considerations on deferrals should be considered, such as company cashflow. Wessex Water suggested the inclusion of functionality in the model that allows deferrals to be spread over multiple years, and the capacity to assess the smoothing effect on allowed revenues and k-factors.

Our assessment and decision

We will maintain our approach to deferrals in that they should be to focus on customer benefits. Any proposal to defer ODI payments should be submitted alongside companies' annual performance reports and in-period determination information. We will consider such requests considering the company’s expected performance and our statutory duties in the round. We also plan to maintain our approach for deferrals to the next year only, any further deferrals will be considered in the running of the next year's in period determinations. For increased transparency we have included additional functionality in the model to include known revenue adjustments for future years' revenue adjustments in the PR24 periods. These adjustments will not impact k-factors associated with future years.

Issue 3: Marginal tax rates

Respondents' views

Wessex Water argued that the marginal tax rate for them should be set to 0% as they are not tax paying and there is there is no tax benefit in the year of payment resulting from an underperformance payment.

Our assessment and decision

Companies should set out their expected marginal tax rate for the following charging year in their requests for an in-period determination, including whether they expect to pay corporation tax, with appropriate evidence. We will take this information into account when making our determination, as well as upcoming changes to tax policies and any other relevant factors.

Whilst most companies are not expected to pay tax over the period and would set the marginal tax rate to 0%, we have retained the ability to adopt a different marginal rate of tax should any companies become tax paying over the period.

Issue 4: K-factors

Respondents' views

Severn Trent Water argued that re-setting K-factors leads to inaccuracy when setting allowed revenues because Ofwat sets K-factors using a forecast level of inflation which will usually be different to the actual November rate once this is published in December. This leads to a difference between the intended value of an ODI and the actual result of the change in K. We should instead move away from K-factors and add any adjustments to base revenues.

Our assessment and decision

K factors are a longstanding and well-understood feature of price controls in the water sector that is set out in the form of the controls we have determined and required by companies' licences for the Network Plus controls. We accept there is a small element of forecasting required when determining the in period adjustments however we believe the difference between forecast and actual inflation would net out over time.

Issue 5: ODI payments and MeX payments

Respondents' views

South East Water requested clarity on the inputs coming into the model for ODI payments and MeX payments. South West Water requested clarity on the granularity of the inputs for C-MeX as the C-MeX model produces an output for both the South West and Bristol controls.

Our assessment and decision

We have simplified the model to bring in a single net ODI payments line from the ODI performance model which includes values for the MeX adjustments, including BR-MeX and BCEW. These payments will be post outturn adjustment mechanism. The payments for South West Water will be aggregated in the ODI performance model with any adjustments via the ASM/OAM applied at the aggregated level, we will then apportionment the water ODI payments to the South West and Bristol controls to use in the in periods adjustment model.

3.9 Land sales

We received feedback on the model from four companies. Anglian Water and United Utilities agreed that the model follow the same logic as the PR19 model. United Utilities and South East Water made minor comments on model corrections which are addressed in the detailed model comments assessment table.

Issue 1: Inclusion of the additional controls in the model

Respondents' views

South West Water have asked for the model be updated to include the Bristol Water price controls.

Our assessment and decision

We will amend the model to incorporate the additional 1 and additional 2 controls that are used elsewhere to model the Bristol Area price controls.

Model rebuild

Considering wider feedback on the reconciliation suite regarding simplicity and consistency we have chosen to rebuild the Land sale models. This removes the need for company specific models and will bring the models in line with the FAST modelling standard as set out in our annual report as our preferred modelling approach.

3.10 Major projects

Issue 1: Profiling of gated allowances

Respondents' views Anglian Water requested that the allowance split between RAPID gates is updated based on changes to gate timings subsequent to the PR24 final determination decisions for the Fens and Lincs reservoirs.

Our assessment and decision

We retain the decision that the PR24 Major Projects Reconciliation Model is based on the allowances that were decided in the PR24 Final Determinations.

We recognise that there has been changes to gate timings for a number of major projects since the PR24 Final Determinations. However, the reprofiling of existing gate allowances as a consequence of these changes, will need to be requested and agreed with Ofwat separately. This request will need to clearly set out what expenditure is needed for each gate, in accordance with the envelope of funding that was decided at PR24. Until a reprofiling request is made and agreed, the model will reflect the allowance decisions made at PR24. Once a request is agreed, the reconciliation model can then be adjusted based on the reprofiling, and this will be picked up in the ‘Ofwat Adjustment Log’ tab in the model.

Issue 2: Clarification on the process of new Major Projects joining the process

Respondents' views

United Utilities requested further clarification on the process of where a new major project is accepted.

Our assessment and decision

The process of a new project being accepted into the RAPID gated process is detailed under section 5 in each of the gate guidance documents published on the Ofwat website. For the purposes of the reconciliation model, new major projects and their relevant data will be included into the model to allow for a reconciliation to be made, depending on decisions made as part of the gated process.

Issue 3: PAYG Rates

Respondents' views

Wessex Water have requested that we set an appropriate PAYG rate that is specific to each project.

Our assessment and decision

We retain the decision to use the PR24 final determination PAYG rates. We extensively consulted upon this issue at PR19, and having taken account of the views that were expressed across water companies at that time, we concluded that using the final determination PAYG rates was the most appropriate approach for major projects. We received opposing views against the approach of having PAYG rates specific to each project due to the challenges of establishing an appropriate project specific PAYG rate and we want to continue alignment to the overall price controls. While we have considered the points that Wessex Water have raised, a lot of the challenges raised at PR19 still exist now, and therefore for continuity we will be retaining the same approach as we did at PR19.

Issue 4: Partnership Arrangement Changes

Respondents' Views

Anglian Water have raised that the model does not account for changes in partnership arrangements.

Our assessment and decision

We agree that changes to partnership arrangements was not included in the first draft of the model which was clearly signalled in the guidance worksheet within the model. The model published alongside the final guidance has now been amended to include an input adjustment into the model for any changes in partnership arrangements that are agreed over the period.

We have opted to use an input for PR24, rather than the model calculating changes in partnership arrangements as it did in the PR19 Strategic Resource Option reconciliation model, as this calculation resulted in multiple errors. An input adjustment will allow for more transparency and less complexity when accounting for various changes in the model. There will be an error check within the model to check that the value inputted is correct.

Issue 5: Model errors and improvements

Additionally, we have addressed other specific errors as highlighted by companies and implemented improvements to model clarity. Please see the model change log in the revised model for detailed changes.

3.11 ODI performance model

As noted in section 1, we engaged further with companies on the ODI performance model. We have considered issues raised through this engagement, as well as through our consultation on the draft reconciliation rulebook, in this section.

Issue 1: Inclusion of CMA disputing companies in the outturn adjustment mechanism (OAM)

Respondents' views

Severn Trent Water and United Utilities argued that companies who have not appealed their PR24 final determination to the Competition and Markets Authority (CMA) could be disadvantaged in the Outturn Adjustment Mechanism (OAM) if the five disputing companies were granted more favourable outcomes packages and this was reflected in an updated OAM calculation. Both companies suggest that Ofwat should apply the OAM to companies' final determination outcomes packages to maintain consistency across companies.

South West Water highlights that the CMA also noted this potential option in its provisional determination for disputing companies that Ofwat run the OAM for non-disputing companies using PCLs and incentive rates consistent with the original determination.

Our assessment and decision

As outlined in our final determinations, we will calculate the median benchmark across all companies including any changes to disputing companies' outcomes packages.[6] The alternative calculation would add additional complexity; and the CMA also noted that its provisional determination has largely retained the same package for disputing companies as for other companies and so it may not make much difference to the calculation of the OAM.[7] We therefore consider that there is insufficient reason to add this extra complexity to the design of the OAM and so retain the final determination policy for non-disputing companies.

We note that this issue is currently under review by the CMA as part of its final determinations for disputing companies. If the CMA has a different approach to the implementation of the OAM for disputing companies, we will update the reconciliation rulebook for them to follow the CMA approach.

[6] Ofwat, PR24 final determinations: Aligning risk and return – appendix, December 2024, p.17
[7] CMA, October 2025, Water PR24 references Provisional Determinations Volume 4, para. 8.189, p.240

Issue 2: Use of RCV in model

Respondents' views

South East Water have asked for clarification around the RCV values used in the ODI performance model.

Our assessment and decision

Consistent with our approach to calculating the ASM in the model, we will use a single value of the RCV within the model, consistent with the values included in our annual publication of 'Regulated capital values'. This is aligned to the final determination view of the RCV.

Issue 3: ODI payments taken as RCV adjustments

Respondents' view

South West Water and Southern have asked for clarification on how ODI payments will be translated into RCV adjustments.

Our assessment and decision

ODI payments calculated in the ODI performance model will be inputted into the In-period adjustments model as a revenue adjustment. If a company requests its ODI payments as an RCV adjustment, the relevant ODI payment will be inputted into the RCV adjustments feeder model to calculate the RCV adjustment. As outlined in the PR24 Reconciliation Rulebook, any ODI payments taken as RCV adjustments will be applied in the next period. More information on RCV adjustments can be found in the PR24 Reconciliation Rulebook.[8] ODI payments for the PCs effected by RCV adjustments will be removed from the ODI performance model.

Issue 4: Price control allocation for Business customers in Wales (BCEW) performance commitment

Respondents' view

Dŵr Cymru highlights the exclusion of BCEW from the ASM and OAM, due to the performance commitment not being allocated to either the water or wastewater price controls. The company recommends BCEW payments should be applied to the ASM and OAM in line with the approach for all other common performance commitments.

[8] Ofwat, PR24 Reconciliation Rulebook: Final Guidance , November 2025, pp. 39-40

Our assessment and decision

In line with our final determination approach, all common performance commitments, including BCEW, should be included in the ASM and OAM. This aligns with the approach taken for measure of experience performance commitments.[9] We will split BCEW payments evenly between water and wastewater for the OAM and the ASM. This is consistent with our approach to allocating BR-MeX for the ASM and OAM for English companies. Post-ASM and OAM adjustments, the final payments are allocated to the business retail price control in line with the performance commitment definition. This is also consistent with the approach to applying the ASM and OAM to C-MeX, in which we apply the same price control allocation (PCA), with the adjusted payments allocated to residential retail. This will apply to Dŵr Cymru and Hafren Dyfrdwy.

Issue 5: Implementation of the ODI performance model

Respondents' views

Some companies asked for clarification on our approach to reconciling ODI payments to implement PR24. Thames Water seeks clarity over whether this model is for Ofwat or companies to use and how the submission of APR tables 3A-3I is impacted by our PR24 approach.

Our assessment and decision

Over the 2020-25 period companies were required to populate the relevant APR tables and submit their own version of the ODI reconciliation model with data consistent with these tables.

Over the 2025-30 period we will take a different approach to calculating company ODI performance payments. To implement PR24, we require a sector wide model to capture companies' performance relative to each other for use in the OAM. To achieve this, we will use performance data submitted by companies through APRs to calculate ODI payments in the ODI performance model.

To provide financial performance in APRs, companies will calculate their ODI payments through the ODI payments calculator model which will be published in due course. We will update the existing calculator to align to the functionality of the PR24 ODI performance model. As it is the payment calculator stakeholders will use, we will consider respondents' comments on how to make it user friendly.

[9] Ofwat, PR24 final determinations: Aligning risk and return – appendix, December 2024, p.17

We have set out our approach to implementation the PR24 Reconciliation Rulebook: Guidance Document.

Issue 6: Combination of Northumbrian Water regions for ODI payment calculations

Respondents' views

Northumbrian Water asked whether we plan to calculate ODI payments for their two regions separately or at a company level.

Our response

We plan to calculate ODI payments at a company level for Northumbrian Water. As the company is not subject to any region-specific treatment (e.g. region-specific ODI rates), it would add undue complexity to the model to calculate ODI payments for the two regions separately.

Issue 7: Performance reporting for MeXes

Respondents' views

Thames Water noted the lack of input space for survey scores in the model.

Our response

ODI payments for the MeXes (apart from BCEW) are calculated in separated MeX reconciliation models. BCEW payments are calculated within the ODI performance model. Survey scores can be entered in those models. The ODI performance model uses the outputs from these models (MeX ODI payments) in the ASM and OAM to help calculate company's overall ODI payments.

3.12 Price control deliverables

Issue 1: Revenue and RCV adjustments split

Respondents' views

United Utilities disagreed with the application of PAYG rates to price control deliverables (PCDs), citing that enhancement expenditure is primarily capital investment and that PCD payments should apply fully to the RCV.

Southern Water welcomed the application of an adjusted PAYG rate that reflects the heavier capex nature of enhancement activities for PCDs and asked for further information on whether it would apply to all enhancement expenditure or only PCD associated expenditure. Wessex Water and Yorkshire Water were also supportive of an adjusted PAYG rate, with Yorkshire Water enquiring about any interactions with the wastewater uncertainty mechanism PAYG.

Dŵr Cymru suggested that in addition to the base and enhancement split, it would be appropriate to have different PAYG rates by price control, as did South East Water.

Our assessment and decision

We agree that enhancement activities are typically of a heavier capex nature than base activities. Therefore, as proposed in our draft reconciliation rulebook, we will apply separate PAYG rates for base and enhancement expenditure to reflect the heavier capex nature of enhancement activities.

We agree with the application of different PAYG rates by price control within base and enhancement, and we have reflected this in the updated version of the PCD aggregator model which accompanies this publication.

We do not consider interactions with the uncertainty mechanism would affect PAYG rates, and will apply PAYG rates consistently across reconciliation models, RPEs and the cost sharing model. The separate PAYG rates for enhancement will therefore cover all enhancement expenditure.

Issue 2: Time value of money adjustment

Respondents' views

Dŵr Cymru disagreed with the application of time value of money adjustments to time incentives, considering the latter are in themselves time value of money adjustments and that our approach contradicts the approach taken for Outcome Delivery Incentives (ODIs).

Our assessment and decision

ODI adjustments are applied in period, whereas time incentive adjustments are applied at the end of the 2025-30 period. Because of the time that elapses between when delays or on-time delivery happens and when the revenue/RCV adjustment is applied at the end of the period, we need to apply a time value of money adjustment.

Issue 3: Time incentives outperformance rate

Respondents' views

Severn Trent Water highlighted a difference in the formula used to calculate outperformance payments between the PR24 reconciliation rulebook draft guidance[1], and the formula as presented in the final determination PCD appendix.[10]

Our assessment and decision

We confirm the correct formula is as per PR24 reconciliation rulebook draft guidance, which for the avoidance of doubt calculates outperformance payments as the lesser of:

- cumulative PCD output delivered minus the cumulative PCD output target in the previous year (this is the incremental output delivered in the year compared to the previous year's target); and
- cumulative PCD output target minus the cumulative PCD target in the previous year (this is the incremental output target a company needs to deliver in the year).

We have updated the PCD aggregator accordingly and will update the final determination PCD appendix to reflect this correction.

Issue 4: Dealing with change and flexibility around PCDs

Respondents' views

A number of stakeholders expressed the view that there should be greater flexibility around PCDs and that there should be the opportunity to communicate and apply changes to PCDs. [11]

---

[10]Ofwat, PR24 final determinations: Price control deliverables appendix - Ofwat, December 2024
[11] The stakeholders who expressed this view were United Utilities and Wessex Water.

Our assessment and decision

In our September 2025 PCD consultation[12] , we provided further clarity on the flexibility afforded by our PCD framework. We also set out our proposal to introduce a proportionate PCD change control process. We received feedback from stakeholders on these proposals and considered this in developing our final guidance[13] which we have published alongside our final reconciliation rulebook.

Issue 5: Treatment of Cook's Distance outliers in scheme-level PCD reconciliation models

Respondents' views

Dŵr Cymru disagreed with the cap on the allowance for the substituted efficient Cook's outlier schemes and asks that we follow the same approach as for inefficient Cook's allowances.

Our assessment and decision

The rationale for having a cap on efficient outlier schemes is to address our concern that, in the absence of a cap, companies could have the incentive to not deliver the efficient scheme and substitute this for another scheme (potentially less efficient) to receive a higher allowance. We therefore consider it appropriate to retain this cap. If the substitute scheme has a higher cost compared to the efficient outlier scheme, the cost difference will be shared between customers and companies through cost sharing.

Issue 6: scheme-level PCD reconciliation model functionality

Respondents' views

We received extensive feedback from stakeholders[14] that the scheme level PCD reconciliation models should be reviewed for consistency and accuracy. We also received feedback from Wessex Water that we will need to review the scheme level models following CMA final determinations. A number of stakeholders[15] also commented on the complexity of the models and asked for these models to simplified. Wessex Water suggested that there should be company specific models.

---

[12] Ofwat, [Consultation on changes to PR24 price control deliverables - Ofwat](), September 2025
[13] Ofwat, [Price control deliverables guidance](), November 2025
[14] The stakeholders who expressed this view were Severn Trent Water, Wessex Water, Dŵr Cymru and South West Water.
[15] The stakeholders who expressed this view were South West Water, Dŵr Cymru and Wessex Water

Our assessment and decision

We have reviewed the models for consistency and made improvements where appropriate. Where there were formula errors identified, these have been fixed and undergone internal and external quality assurance. There are a number of changes that were made to the models to ensure that they are compliant with model standards and that they are consistent. For example, changes logs and input logs were added to all models to ensure that they meet model standards.

To simplify the models, we have removed the delivery mechanism functionality from the models, recognising that this is only relevant for Thames Water and Southern Water. We intend to develop and publish PCD reconciliation models specific to these two companies (which incorporate the delivery mechanism functionality) in due course. We note that although we have sought to reduce the complexity of our models, this complexity is in part a reflection of the flexibility requested by the sector.

We will continue to engage with stakeholders to further test and validate our PCD reconciliation models as outturn data becomes available throughout the price review period and update the models where appropriate. This will help to ensure that the models are robust ahead of them being used to reconcile PCDs at the end of the period.

We note that as part of its provisional determinations for disputing companies, the CMA has adopted a different modelling approach to assess phosphorus removal and supply interconnectors scheme costs. If the CMA confirms this approach in its final determinations, we will update our PCD models to reflect this for the disputing companies.

3.13 Real price effects

Issue 1: Additional guidance on model logic and inputs

Respondents' views

United Utilities asked for additional guidance on the reconciliation model, including clearly identifying the source of model inputs and interactions between the RPE reconciliation model and the cost-sharing reconciliation model.

Additional information

We have provided further guidance within the model itself regarding the sources of model inputs.

With regards to the interactions between the RPE reconciliation model and the cost-sharing model, the RPE reconciliation model first sums all the reconciliations (for energy, labour, and materials, plant, and equipment) to give total RPE adjustments for each price control. These adjustments are split into:

- Real price effects adjustment – standard base
- Real price effects adjustment – standard enhancement
- Real price effects adjustment – 25:25 cost-sharing
- Real price effects adjustment – 40:10 cost-sharing

These feed into the cost sharing reconciliation model to be combined with other adjustments and totex allowances available for cost sharing, to be used in the cost sharing calculations.

Issue 2: Inconsistency in application of time value of money adjustments across reconciliations

Respondents' views

Our draft RPE reconciliation model included time value of money adjustments to calculate NPV-neutral adjustment figures. Severn Trent Water highlighted an inconsistency in how time value of money adjustments were being applied across our reconciliation models. South East Water also noted that a time value of money adjustment is applied in the cost sharing reconciliation model and so the inclusion of such an adjustment in the RPE reconciliation model would lead to double-counting.

Our assessment and decision

We have reviewed the linkages between the RPE reconciliation model and the cost sharing reconciliation model.

The RPE reconciliation model outputs to both the revenue/RCV feeder models and the cost sharing model. The whole over or under funded amount, adjusted for the time value of money, is output to the revenue/RCV feeder models. The adjustments, not adjusted for the time value of money, are output to the cost sharing model to adjust the baseline allowances. Only the incremental cost sharing impact is included in the outputs of the cost sharing model. This is different to the PR19 cost sharing model which both adjusted for the amount over or under funded and calculated the cost sharing impact as well.

Issue 3: Use of PAYG rates in calculation of RPE reconciliations

Respondents' views

Several companies commented on the use of PAYG rates in the calculation of RPE reconciliations. South East Water and United Utilities said that the reconciliations should use PAYG rates specific to each price control, rather than a single rate. Southern Water said that the RPE reconciliations should be made via an in-period adjustment to PAYG revenue, rather than an end-of-period adjustment through an RCV adjustment and PAYG revenue, to reduce the impact of cashflow issues.

Our assessment and decision

The model for consultation used different PAYG rates for base and enhancement as we recognised that they have a different mix of opex and capex. We appreciate that different price controls have a different mix of opex and capex as well and therefore we have updated the model to apply a base and enhancement PAYG rate for each price control.

We maintain our view that any true-up made through the RPE reconciliation calculations should be implemented through both RCV and revenue adjustments. This is to ensure consistency with how the original ex-ante adjustments were implemented at final determinations. Our position was informed by the discussion of the issue as contained in CEPA's report, 'Frontier Shift, Real Price Effects and the energy crisis cost adjustment mechanism'.[16]

Issue 4: Incorporation of PCD adjustment within RPE reconciliation

Respondents' views

[16] CEPA, PR24 Final Determinations – Real Price Effects and the energy crisis cost adjustment mechanism, December 2024.

United Utilities requested an explanation for why a PCD adjustment is made within the RPE reconciliation model.

Our assessment and decision

A PCD adjustment is made within the RPE reconciliation model due to the way in which the PCD reconciliation, RPE reconciliation and cost sharing reconciliations are applied sequentially. As set out in our PCD reconciliation guidance[17], the reconciliation will include an adjustment to reflect the frontier shift and RPE assumptions made at final determinations, for consistency with how expenditure allowances were set at final determinations. Accordingly, we consider it appropriate to include the PCD adjustment in our RPE reconciliation such that the PCD adjustment reflects outturn RPEs where relevant.

Issue 5: Approach to energy cost adjustment reconciliation

Respondents' views

Several companies commented on the approach to the energy cost adjustment reconciliation:

1. Thames Water requested a more detailed explanation of the logic to the reconciliation.

2. South Staffs Water and Wessex Water asked whether the ex-ante adjustment would be updated immediately to use the non-seasonally adjusted DESNZ energy price indices or whether this change would be made at the end of period.

3. Southern Water and United Utilities commented on the choice of index for the energy cost adjustment, suggesting that a different index should be used.

   Both companies highlighted some recent policy developments which may mean that the DESNZ index is no longer reflective of water company power costs. Specifically, the companies highlighted that the British Industry Supercharger: Network Charging Compensation Scheme will reduce network charges for energy intensive industries, while the British Industrial Competitiveness Scheme will exempt some industries from policy levies such as those funding the Renewables Obligation, Feed-in-Tariffs and Capacity Market.

[17] Ofwat, PR24 Reconciliation Rulebook: Final Guidance , November 2025. Section 3.12

Southern Water said that the DESNZ indices are not forward-looking, are overly optimistic and create unnecessary cashflow risk, and instead suggested using energy price forecasts taken from the Green Book.[18]

United Utilities said that we should consult further on the appropriate index for use in the energy cost adjustment reconciliation.

4. Dŵr Cymru noted that the DESNZ price index data for April-June 2024 have been revised and said that we should use this data.

Our assessment and decision

We provide additional explanation of the energy cost adjustment reconciliation in the following section.

We will not update the ex-ante adjustment to use the non-seasonally adjusted DESNZ energy price indices. Instead, the change will be made at the end of the period as part of the reconciliation process. The true-up will be calculated as the difference between the ex-ante adjustment using the seasonally adjusted DESNZ price indices, and the correct outturn adjustment values calculated using the outturn values of the non-seasonally adjusted DESNZ energy price indices. In other words, the reconciliation will ensure that the overall adjustment received by companies is consistent with the non-seasonally adjusted DESNZ energy price indices.

With regards to the choice of index, we note that several of the points raised by Southern Water have been raised as part of the ongoing PR24 CMA appeals, including the suggestion to use Green Book price forecasts.[19] Neither United Utilities nor Southern Water have suggested a viable alternative index for use in the energy cost adjustment reconciliation. Specifically, Southern Water's suggestion is to use *forecasts* rather than an index of outturn figures, while United Utilities did not suggest an alternative index. Therefore, we maintain our original position to use the DESNZ non-seasonally adjusted energy price indices.

We will use the latest data when implementing the reconciliation at the end of the period. We will also make any necessary updates to the energy cost reconciliation model for the disputing companies following the CMA's final determination.

Additional information

At a high level, the energy cost adjustment reconciliation involves using the same approach to calculating the ex-ante adjustment but using outturn energy price index data. The true-up

[18] Southern Water suggested taking forecasts from Department for Energy Security and Net Zero (DESNZ), November 2023, Green Book supplementary guidance: valuation of energy use and greenhouse gas emissions for appraisal, Table 4, Retail electricity price, Industrial user.
[19] Southern Water, Southern Water PR24 Redetermination Statement of Case, March 2025, p. 197, paragraph 341.

is then calculated as the difference between these figures and the ex-ante adjustment applied at the final determinations. More specifically, the reconciliation uses the following steps:

1. Calculate outturn, CPIH-real, annual growth rates in the relevant DESNZ and Ofgem energy price indices using financial year averages of each index and outturn CPIH inflation.
2. Compound the outturn, CPIH-real, annual growth rates over time to calculate outturn, CPIH-real indices of for delivered electricity prices, delivered gas prices, wholesale electricity prices and wholesale gas prices.
3. Calculate outturn 'uplift factors' using each of these indices, by dividing the value of the index in each year of AMP8 by the average value of the index over 2011-12 and 2023-24. These factors reflect the level of energy prices in each year of AMP8 relative to the historical modelling period of 2011-12 and 2023-24.
4. Subtract 1 from these outturn 'uplift factors' to calculate the outturn energy RPEs for each type of energy price.
5. Calculate the implicit allowance for energy using the same cost shares as used in the ex-ante adjustment multiplied by efficient base totex allowances after the PCD adjustment.
6. Multiply these implicit allowances by the relevant energy RPEs (as per the approach to ex-ante adjustment) to calculate the energy cost adjustment based on outturn prices.
7. Apportion the adjustment for wholesale water between water resources and water networks plus using the same ratio as the ex-ante adjustment.
8. Calculate the true-up as the difference between ex-ante adjustment as applied at final determinations and the adjustment based on outturn price series (using the non-seasonally adjusted DESNZ energy price indices).
9. Apply a frontier shift adjustment to be consistent with the implementation of the ex-ante adjustment at final determinations and to ensure the net reconciliation is consistent with the totex allowances used in the cost sharing reconciliation model.

Issue 6: Approach to labour RPE reconciliation

Respondents' views

Severn Trent Water said that it was not appropriate to apply the energy cost adjustment reconciliation to the totex values used in the labour RPE reconciliation calculation. It said that any outturn energy adjustment reconciliation will purely reflect changes in actual energy prices and their impact on the indices used relative to the assumptions at final determinations and will not affect a company's exposure to wage inflation.

Wessex Water asked whether the labour RPE mechanism is intended to be a temporary or permanent feature of the regulatory framework.

Thames Water said that was a 'bizarre' decision to 'only to apply RPE to labour and MPE costs for new infrastructure projects'.

Our assessment and decision

Our approach to the energy cost adjustment and labour RPE reconciliations as presented in the draft RPE reconciliation model aimed to be consistent with the manner that the ex-ante adjustments were applied at the PR24 final determinations.

In the final determinations, the ex-ante energy cost adjustment was incorporated into total modelled cost allowances before frontier shift and RPEs. A frontier shift and RPEs adjustment was subsequently applied, which incorporated our frontier shift assumption and ex-ante labour RPE forecast.

For consistency with this approach, the energy cost adjustment reconciliation needs to calculated first, and then the labour RPE reconciliation needs to be calculated using totex figures which incorporate the energy cost adjustment reconciliation. This is the approach that we took in the draft RPE reconciliation model. We maintain this approach in the revised version of the model.

With respect to whether the labour RPE mechanism is intended to be temporary or permanent, we will revisit the suitability of the mechanism at PR29.

Finally, with respect to Thames Water's comment on the application of the RPE, we clarify that a labour RPE and reconciliation is applied to both base and enhancement costs.

Issue 7: Approach to Materials, Plant and Equipment (MPE) RPE reconciliation

Respondents' views

Thames Water said that it disagreed with the decision to only apply an RPE reconciliation to MPE enhancement costs.

Wessex Water asked whether the MPE RPE mechanism is intended to be a temporary or permanent feature of the regulatory framework.

Our assessment and decision

With regards to the decision to only apply an MPE RPE mechanism to enhancement MPE costs, we note that Thames Water previously raised its view that an RPE mechanism should be applied to base MPE costs in its response to the PR24 draft determinations. We considered this point in the development of our final determinations. We concluded that an RPE was not appropriate since there is not a material wedge between MPE inflation (as measured by the ONS's repair and maintenance construction output price index) and CPIH inflation, based on historical data.

With respect to whether the MPE RPE mechanism is intended to be temporary or permanent, we will revisit the suitability of the mechanism at PR29.

Issue 8: Model errors and improvements

Additionally, we have addressed other specific errors as highlighted by companies and implemented improvements to model clarity. Please see the model change log in the revised model for detailed changes.

3.14 Residential Retail

Issue 1: Materiality threshold

Respondents' views

Severn Trent Water proposes the removal of the 2% materiality threshold for the time value of money adjustment on the grounds that it complicates the calculation and is inconsistent with the revenue forecasting incentive model. Thames Water and Wessex Water agree with the continued use of the 2% threshold.

Severn Trent Water also disagrees with the threshold amount for the business retail control. This is addressed in the company-specific reconciliations section of this document.

Our assessment and decision

We have removed the 2% materiality threshold as a condition for the application of the time value of money adjustment. The adjustment is now automatically applied for both residential and business controls. This is now consistent with the treatment of the time value of money adjustment across other reconciliation models.

3.15 Revenue Forecasting Incentive

Issue 1: Single Till

Respondents' views

Severn Trent Water agree in principle with a revenue correction tool. However, it is concerned that a single till could increase bill volatility, increase administration costs and disincentive expenditure (such as to connect industrial developments or fluoridation). It considers that more activities should be removed from the single till or, alternatively, other mechanisms should be introduced to address these issues.

Our assessment and decision

We will retain our approach. A revenue cap protects customers from excessive charges. We considered the scope of the price controls and application of the RFI as part of the PR24 methodology and further consultation.[20,21] At PR24 we have removed some activities where there is effective competition, notably certain site-specific developer services activities, from the price control and therefore the RFI. We have provided funding for activities within the RFI through our PR24 determinations; this also provides adjustments to allowed revenue where appropriate, such as the cost sharing reconciliation. Our third-party services reconciliation model allows company to recover unforeseen costs for activities including fluoridation.

Issue 2: Widening the deadband

Respondents' views

Severn Trent Water argues that the penalty deadband should be widened to support tariff innovation. It argues that, for example, a tariff with a higher volumetric rate would lead to greater revenue volatility during hot weather.

Our assessment and decision

We are supportive of companies considering innovative tariffs. We previously consulted on the deadband that allows for some variation in companies' revenues. Generally, companies should be able to collect revenue within this range. Companies should aim to design and implement their tariffs (for example, through trialling innovative tariffs) so that they can manage revenue volatility.

[20] Ofwat, 'A consultation on the Revenue Forecasting Incentive,' July 2023.
[21] Ofwat, 'Draft Determinations: Revenue forecasting incentive,' July 2024.

We considered the size of the deadband as part of our further consultation.[22] We have seen no new evidence to suggest that a change in the deadband (which would require a licence change in relation to the in-period application of the RFI) would be necessary or appropriate.

Issue 3: Criteria for any penalty adjustments

Respondents' views

Severn Trent Water requested clarification on the criteria we would apply for a penalty waiver, noting that even during an extreme event like COVID, their request had not been granted.

Our assessment and decision

For the 2020-25 period we applied a penalty waiver where a company had deferred revenue to smooth bills for the benefit of customers and had notified us of their intention to do so in advance. This was consistent with our intention to support customers through cost of living pressures which followed our PR19 final determinations.[23]

We agree it would be helpful to clarify the criteria we would apply in relation to the 2025-30 period. As part of PR24 we said would clarify this in the PR24 reconciliation rulebook, ensuring that this meets our requirements that companies should notify us in advance of their intentions, that the benefits to customers are clarified and that we will hold companies to account for delivering what they have proposed.[24]

We have clarified this in the PR24 Reconciliation Rulebook: Guidance Document[8].

Model rebuild

Considering wider feedback on the reconciliation suite regarding simplicity and consistency we have chosen to rebuild the RFI models. This removes the need for company specific models and will bring the models in line with the FAST modelling standard as set out in our annual report as our preferred modelling approach.

[22] As above.
[23] Ofwat, "Supporting customers through cost of living pressures", 17 October 2022.
[24] Ofwat, "PR24 draft determinations: Revenue forecasting incentive", July 2024, p.5.

3.16 Tax reconciliation

Issue 1: Complexity of running the model

Respondents' views

United Utilities, Severn Trent Water, and South East Water have raised concerns around the complexity of running the model and asked for further guidance on the process. Severn Trent Water also suggest removing the cost of new debt adjustment to simplify the process.

Our assessment and decision

We have included further guidance on the input data in the guidance document[8]. We propose to maintain the adjustment for the cost of new debt.

Issue 2: Indexation uplift on carried forward tax loss balance

Respondents' views

Severn Trent Water ask us to include an indexation uplift on the carried forward balance of tax losses to help preserve the economic value of the losses, leading to lower tax allowances in the future.

Our assessment and decision

Our tax modelling will continue to reflect the economic reality of the losses, as such we will not include an indexation uplift. To avoid the complexity of maintaining shadow tax loss balances, we will continue to align with HMRC's valuation of tax losses carried forward.

Issue 3: Tax loss surrenders

Respondents' views

Severn Trent Water, Thames Water, United Utilities, Wessex Water, and Water UK have all provided comments disagreeing with our policy to make an adjustment for regulated companies that have surrendered tax losses to group companies and received payment. Several respondents argue that our policy assumes that all tax losses should be returned to customers but losses derived from shareholder funded cost increases (i.e. overspend against the regulatory allowances), should not be returned to customers. Several respondents also argue that this policy removes the ability of companies to efficiently manage their tax losses and removes the incentives for efficient tax planning. By automatically returning all tax benefits to customers, regardless of the source of the loss, the policy may discourage companies from making investments beyond the regulatory settlement—particularly where any resulting tax relief is not retained. This could ultimately reduce incentives for innovation, resilience, and efficiency that would otherwise benefit customers over time.

Thames Water raised an issue in relation to netting off losses the regulated company had surrendered, with losses it has received from group companies within the same 5-year period. The rationale being that its customers had received considerable benefit from tax losses transferred into the regulated company which should be considered against tax losses surrendered by the regulated company.

An additional issue was raised as to how the losses carried forward would be applied at future price controls, with concerns raised that had the losses being carried forward their use would be restricted to 50% of profits in any year.

Our assessment and decision

The adjustments made at PR24 and potentially to be made at PR29 are calculated outside of the tax reconciliation model. Therefore, our approach to group losses does not impact on the mechanisms of the tax reconciliation.

We have a long standing policy to consider any carried forward capital allowances and tax losses within our final determination modelling for calculating tax allowances in our price determinations. These balances have been taken forward irrespective of how they have arisen. Current tax legislation and levels of capital investment means that companies may generate tax losses for the foreseeable future.

There are many reasons why tax losses are generated and there are benefits to companies in transferring losses amongst group companies to utilise losses earlier and in full. We recognise that companies are able to reduce the overall group tax liability by transferring losses to and from the regulated company. The regulated company benefits from the effect of earlier cashflows where it receives full value for transferred losses in accordance with the transfer pricing requirements of RAG5.

Our objective for taxation is to provide reasonable tax allowances reflecting the expected position of companies, and in a way that is fair for customers. We would not expect our tax policy to drive decision making for tax planning. However, our approach for group relief should reflect our objective that customers are not disadvantaged where tax losses have been used elsewhere. We reiterate our position for our price review determinations that the regulated companies should pay or receive full value for that group relief, calculated at the headline corporation tax rate.

We have brought forward tax loss balances for a number of companies from PR19 reconciliations where those companies transferred losses over 2020-25. We also anticipate that companies will make further tax losses over the 2025-30 period and some will be transferred as group relief. We note that companies may not have closed tax computations for all the years 2020-25 and the position related to group relief may change. Companies can put forward representations at PR29 where they consider this affects the losses carried forward at PR24. We also recognise that companies are in a different tax position to when we last carried out a review of our approach to setting allowances for tax. We expect to carry out a further review and may update our policy approach for tax as part of the development of our approach for PR29.

In response to specific points raised:

- Our general approach for taxation is to treat the regulated company as a standalone entity. However, we recognise that decisions are taken in relation to group relief for the benefit of the group. We set out in our PR24 final determinations, that we will consider the appropriate treatment of carried forward surrendered losses when we set our determinations at PR29. In transferring losses, the regulated company is effectively monetarising those losses in the year in which they occur. Therefore, it would seem perverse for companies to receive full value immediately and then customers to wait beyond what is strictly necessary.
- Irrespective of whether a tax allowance was provided, where a regulated company has made payment for the receipt of group losses, this is generally in lieu of a payment the company would otherwise have made to HMRC. As such, we do not consider it appropriate to net the receipt of group losses with the transfer out of losses from the regulated company, when calculating adjustments.
- Some companies have provided examples of how surrendered losses could be allocated between shareholders and customers. We consider these models are over-simplified and would require further work to ensure that customers are not disadvantaged under all circumstances. We are open to exploring this with the sector ahead of PR29, although we consider there is a need to be proportionate in our approach to taxation, such that we do not create a need to maintain separate tax records for price control purposes.

3.17 Third party services

Issue 1: Application of the model to the non-potable activities

Respondents' views

Anglian Water, Severn Trent Water and United Utilities questioned the application of the model to the non-potable activities. They highlighted that longer-term investments may be needed in order to facilitate non-potable supplies and that the existing focus on opex alone means that the capex expenditure is not taken into consideration in the reconciliation model.

Our assessment and decision

We acknowledge that the PR24 methodology did not include third party services information for non-potable supplies at as granular a level as is being suggested. We do not think it is a material issue given revenue allowances will be updated end-of-period to reflect outturn cost.

We are consulting on our APR requirements for 2025-26. Our proposals include more granular data for third party activities which will more accurately track non-potable and other third-party activity. Respondents can of course suggest modifications to the reporting requirements that would help to inform future policy in this area.

Issue 2: Application of the model to rechargeable activities

Respondents' views

Severn Trent Water stated that the approach penalises water companies for investing in fluoridation during a price control period over and above the business plan assumptions when required. It recommends removing third-party services from the price control entirely.

Our assessment and decision

We have designed the model so that where unforecast additional revenues and costs for activities such as fluoridation occur, companies' recognised revenues can flex to the extent that there are additional costs incurred. We do not agree that companies are penalised.

Issue 3: Recovery rates for diversion costs and other errors

Respondents' views

Several companies pointed out that the model incorrectly had a single recovery rate for both NRSWA and other non-section 185 diversion costs and that there were some basic calculation issues which caused unexpected consequences where a revenue shortfall occurs.

Our assessment and decision

We agree that there should be separate recovery rates for the NRSWA and non-section 185 diversions and have included this division of the calculations in our latest version of the model. We have updated the model so that the correct treatment is applied when a revenue shortfall occurs in line with our intended policy. More detail about the error corrections are given in the detailed model comments published alongside this document

3.18 Wastewater Enhancement Uncertainty Mechanisms

Issue 1: Removal of the requirement for companies to overspend

Respondents' views

Southern Water requests that we remove the requirement for companies to overspend their allowances prior to triggering the storm overflow uncertainty mechanism. They argue that companies could have efficiently delivered their programmes but would not be able to access additional funding. Southern Water considers this approach would not adequately recognise company efforts in delivering efficient alternative solutions with their PR24 allowances.

Our assessment and decision

As we set out in our Final Determination,[25] we rejected the proposal to remove the requirement that companies need to have overspent before allowing additional expenditure allowances through the uncertainty mechanism. We do not consider that companies should be requesting additional expenditure allowances where they have not fully spent existing allowances. This will reduce public trust and confidence in the sector. We expect companies to go further in addressing storm overflows where funding is available. We expect companies to ensure that they are efficient in delivering the assigned enhancement allowance before requesting additional funding.

Issue 2: In period adjustments

Respondents' views

[25] Ofwat, PR24-final-determinations-Expenditure-allowances-V2 , December 2024, p342

Southern Water requests that we consider making adjustments for storm overflow allowances in period rather than as an end of period reconciliation, due to a potential cash flow risk, should it have overspent its allowances and require extra funding in period to invest in further schemes.

Our assessment and decision

Given the deliverability constraints highlighted by companies, our expectation is that the scale of changes is unlikely to be significant and therefore we do not propose to include this as part of the cost change process.

Issue 3: PAYG rates for PCD adjustments

Respondents' views

Wessex Water and Yorkshire Water agree with the principle of applying an adjusted PAYG rate that is more reflective of the capex/opex split for activities, and highlight that company views on these splits is available at driver level in the CWW3 table.

Thames Water highlights that different types of rates could be used for different types of expenditure (e.g. a storm overflow specific rate) if these are available.

Southern Water supports using a PAYG rate that reflects wastewater enhancement activities but requests additional clarity on how this would be calculated.

Our assessment and decision

In our draft guidance document, we set out that we want the revenue and RCV adjustments to reflect how companies have been funded for related output, for example, Storm Overflows, investigations, and P removal allowances. Companies are funded through revenue and RCV based on the PAYG rate. The PAYG rate is a blended rate that reflects the mix of capex and opex costs. The uncertainty mechanism applies to enhancement activities which are more capex heavy than base activities. Therefore, we will apply an adjusted PAYG rate that reflects the capex/opex split for enhancement activities.

For clarity, we will apply PAYG rates consistently across reconciliation models, RPEs and the cost sharing model. We will apply separate PAYG rates for enhancement, and we will apply different PAYG rates by price control within enhancement, and we have reflected this in the updated version of the PCD aggregator model which accompanies this publication.

3.19 Water trading incentive

Issue 1: Clarity and publication of inputs

Respondents' views

United Utilities asks how many years of data should be entered into the model and whether forecast or actual data should be used. It is also concerned whether commercially sensitive information could be revealed if we publish their information in full.

Our assessment and decision

We have clarified the inputs required within the model. Companies should input data related to the length of the trade. For example, if an export agreement spans 25 years, then 25 years of data should be entered. Actual data should be inserted where available and, for future years, forecast data.

Companies should set out what specific information in the model they consider commercially confidential and their reasons why. We will then assess what information it is appropriate to publish.

Issue 2: Reconciliation between actual and forecast data

Respondents' views

United Utilities asks whether the model will need to be resubmitted at future price controls to reconcile differences between actual and forecast data. They also ask for guidance on how new trades not part of a company's PR24 business plan should account for the mix of existing and new assets used to support such a trade.

Our assessment and decision

We expect companies to submit their water trading incentive reconciliation model at PR29. We will review these submissions and apply any adjustments where appropriate.

Our approach to reconciliation at future price controls will be proportionate. As part of their submission, companies should explain how projections have been developed and highlight any significant uncertainties.

In general, we do not intend to reconcile this information at future price controls, to minimise unnecessary administrative burden. However, for large trades or where economic profits are particularly uncertain, there may be a case for review at subsequent price controls.

As noted by United Utilities, we previously indicated that where a potential new trade is not included in the relevant company's business plan, but ends up going ahead and the company is eligible for export incentives, we would net off the forecast revenues derived by the company over 2025-30 period from the final awarded incentive at the next price control to take account of the fact that these revenues were not taken into account in our final determination.[26]

In principle, we agree that a similar adjustment could be made for costs. For example, we could account for the cost of new assets not funded at PR24.

So we can assess such potential adjustments, companies should also submit the relevant cost and revenue information. This includes the projected revenue and cost information used as the basis for our PR24 determinations and how this compares with their outturn data. This will allow us to make any adjustments as appropriate to ensure that companies receive half the economic profit from the trade.

Issue 3: Cost information

Respondents' views

United Utilities ask us to clarify what cost information to input into the model. In particular, whether capex or revenue building blocks using the depreciation and financing costs of the capex should be used. They recommend the latter.

Our assessment and decision

We set out information relating to costs in our PR19 Reconciliation Rulebook. The calculation of the PR19 export incentive is linked to the level of outturn economic profits from an export which consists of the revenues derived under the bulk supply agreement net of the revenue allowance building blocks associated with the outturn totex incurred. To calculate this, it is essential that companies have robust information on the underlying outturn totex attributable to the export.

This is reflected in principle 9 in Trading and procurement codes – guidance on requirements and principles[27] which states that:

> *"The trading and procurement code should provide reassurance that the costs of the export arrangement have been accurately estimated and will be fully recovered from the export agreement."*

[26] Ofwat, PR19 Reconciliation Rulebook: Guidance Document, August 2023, p.172
[27] Ofwat, Trading and procurement codes – guidance on requirements and principles, June 2023, p.9

We expect companies to account for costs on a more detailed basis and report to us on the breakdown of the costs when submitting their claims. We expect this information to be included in the report that sets out the trade's compliance with the company's trading and procurement code.

As reflected in the inputs required for the model, companies should use the outturn cost (inclusive of the return on capital) of an export. This is equal to the revenue allowance associated with the overall outturn totex requirement to operationalise the trade i.e. opex and the funding of the RCV.

4. Company-specific reconciliations

This section sets out the issues raised in our consultation and our assessment and decisions in relation to the company-specific reconciliations. (That is, those reconciliations that do not apply to all water and/or sewerage companies.) These are listed in alphabetical order.

4.1 Business retail

Issue 1: Materiality threshold

Respondents' views

Severn Trent Water disagree with the scale of the materiality threshold for the time value of money adjustment for the business retail control.

Our assessment and decision

We have removed the 2% materiality threshold condition for the application of the time value of money adjustment. This is consistent with the application of the adjustment in the residential retail control. See section 3.13 for more details on the change.

4.2 Business-Retailer measure of Experience (BR-MeX)

We had no feedback on the policy aspects of the BR-Mex model. We received feedback on the model including clarity on inputs and minor modelling amendments. These have been addressed in the revised model change log and detailed model comments table.

4.3 Delivery Mechanisms

We had no feedback on the policy aspects of the delivery mechanism. Thames Water raised a number of points on the model. These have been addressed in the revised model change log and detailed model comments table.

4.4 Havant Thicket

We had no feedback on the Havant Thicket reconciliation. We have set out our approach to the planned reconciliation including any changes in our updated guidance document.[8]

4.5 Havant Thicket – cost of new debt reconciliation

Issue 1: Interaction with generic cost of new debt model

Respondents' views

Portsmouth responded that it was unclear how this interacts with the generic "Cost of New Debt" model which also appears to include Havant Thicket in the additional 1 control.

Our assessment and decision

This model will calculate the adjustment for the Havant Thicket cost of new debt. We have included additional functionality in the 'generic' model which turns on/off the calculations for any given control. Further details of this can be found in the 'Detailed model comments assessment table' and the 'Cost of new debt model' change log.

4.6 Quality and Ambition Assessment (QAA)

Issue 1: Transparency of assessment

Respondents' views

Severn Trent Water said that it is important to clearly define the measures for each commitment from the outset to minimise the potential for ambiguity later.

Our assessment and decision

We agree that it is important to be clear how we will assess each measure. We have therefore engaged with Severn Trent Water and South West Water to explain how we will assess each criteria and have built the assessment into the model. The more standardised approach to setting out inputs to models also adds clarity to this assessment.

4.7 Reconciliations in scope of the cost change process

Wessex Water and South East Water noted they would provide more feedback on the interactions of the cost change process in response to the Cost Change Process consultation. We have now published our cost change process final decision[28] which includes details on interactions with PR24 reconciliations.

[28] Ofwat, Cost change process final decision, November 2025.

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

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA
Phone: 0121 644 7500

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to mailbox@ofwat.gov.uk.