

Materials on future indexation of price controls (RPI-CPI/H)

This information notice provides background to a number of materials we have published in relation to the future indexation of price controls. It also provides links to the materials.

Background

In our consultation [Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#) published in December last year, we put forward a number of proposals relating to the indexation of future price controls ('RPI versus CPI/H').

We set out proposals to:

- amend company licences so that price controls that are currently linked to RPI are switched to CPI (or CPIH) from 2020
- commence a transition of the RCV to CPI from 2020, with 50% of the RCV indexed to RPI and 50% indexed to CPI from March 2020
- state a single nominal weighted average cost of capital (WACC) for the next control period (with the real WACC stated separately for the RPI and CPI linked RCV)
- provide a true-up (in NPV neutral terms) for outturn differences between forecast and actual RPI and CPI (for the RPI related elements of the control)
- allow water companies, if supported by customers, to propose the use of pay as you go and RCV run-off to smooth the

impact on customer bills of a move to CPI indexation

We committed that, in implementing a CPI based approach, we will ensure that the impact of this is neutral in net present value terms over time.

For more detail on the proposals we set out, see pages 109-128 of [Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#).

Requests for clarification

In responses to our December consultation, a number of stakeholders asked for further clarification on the technicalities of how the NPV neutral true-up mechanism would work in practice.

To help provide such clarification, we held an industry workshop in March where we presented an illustrative excel model to demonstrate how the true-ups could be calculated in practice. We received a number of suggestions and comments at this workshop, and committed to publishing the updated model.

The true-up model is pre-populated with industry data which users may adjust. While assumptions have been inserted on the speed of transition in future regulatory price control periods, the assumptions are illustrative and should not be interpreted as Ofwat policy.

At the workshop, Oxera also set out the main findings of their analysis on the potential benefits and costs of different options for change. This work was commissioned by Ofwat.

We have now published the illustrative true-up model and the Oxera report on our website.

Materials published

Following on from this engagement, we have now published the following.

- [RPI-CPI illustrative true-up model \(Excel file\)](#)
- [RPI-CPI illustrative true-up model assumptions and user guide](#)
- [Oxera final report on 'Indexation of future price controls in the water sector'](#)

Next steps

In May, we will publish our decision on the indexation of future price controls (as part of our decision document on proposals we consulted on in [Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#)).

More information

[RPI-CPI illustrative true-up model \(Excel file\)](#) April 2016

[RPI-CPI illustrative true-up model assumptions and user guide](#), April 2016

[Indexation of future price controls in the water sector](#), Oxera, April 2016

[Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#) December 2015

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