December 2019

PR19 final determinations

Anglian Water – Aligning risk and return final decisions

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PR19 final determinations: Anglian Water – Aligning risk and return final decisions

In our draft determinations we published the 'Aligning risk and return actions and interventions', the 'Securing long-term resilience actions and interventions' and the 'Securing confidence and assurance actions and interventions' document for each company. This set out the required and advised actions in our initial assessment of plans, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we made as part of the draft determination.

This document sets out the decisions we are making for the final determination in response to representations received from companies on our draft determinations and changes for the final determination that are not resulting from representations received. We set out our response to thematic representations and representations from other stakeholders within the 'Aligning risk and return technical appendix' and the 'Allowed return on capital technical appendix'. Our 'Allowed revenue appendix' for the company is published alongside this document. These documents are intended to be fully consistent. In the event of any inconsistency, the other documents listed above take precedence over this document.

Table 1 below sets out the action/intervention reference, our assessment and rationale for the draft determination, a summary of the company representation, our assessment and rationale for the final determination and our decisions for the final determination.

Table 2 sets out any further decisions that are not resulting from an action and/or representation which we are making as part of the final determination.

Each action has a unique reference. The prefix 'ANH' denotes the company Anglian Water. The central acronym references the test area where the action has been identified, please see the 'Glossary' for a key to these acronyms. Actions whose numbers are preceded with an 'A' denote required actions and actions whose numbers are preceded with a 'B' denote advised actions. Draft determination interventions not resulting from an initial assessment of plans action are preceded with a 'C' and new interventions for the final determination not related to a previous action are preceded with a 'D.' For all other documents related to the Anglian Water draft determination, please see the final determinations webpage.

Table 1: Anglian Water – Representations in response to the draft determination

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
Risk and return	ANH.RR.A1	The company should provide further evidence of how the Board has assured itself that the company remains financeable on its actual capital structure given the statement in the business plan that it does not meet its S&P target.	No intervention but further action required. Anglian Water has provided further evidence in support of its target financial ratios. It has also set out that it will reduce gearing with dividends ultimately paid to shareholders restricted in order to achieve this de-gearing – this reduces forecast gearing from 78.5% as at 31	Representation made as per action ANH.LR.A5.	No change for the final determination.	N/A

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			March 2019 to 76.2% over 2020-25 based on the assumptions in its plan. However, Anglian Water maintains a high level of gearing under its actual structure. We are not intervening in respect of the financial ratios achieved under Anglian Water's actual financial structure in our draft determinations as it is Anglian Water that is responsible for ensuring it maintains financial resilience and the financeability of its activities over the long term. Pursuant to action ANH.LR.A5 we require the company to provide Board assurance to confirm how the financeability and financial resilience of the actual structure will be maintained in the context of our draft determination.			
Risk and return	ANH. RR.A2	The company should provide further evidence to explain why there are positive values for both upside and downside values for Totex (including uncertainty mechanism) or restate its RoRE downside.	No intervention required. Anglian Water has completed the action and the signage convention is now correct.	No representation made.	N/A	N/A
Risk and return	ANH.RR.B1	The company should provide further evidence to explain how the RoRE assessment takes account of Anglian Water's systems approach to resilience.	No intervention required. Anglian Water has satisfactorily completed the action.	No representation made.	N/A	N/A
Risk and return	ANH.RR.C1	Anglian Water's approach to setting PAYG rates is to recover operating expenditure including infrastructure renewal expenses included in operating costs. The application of efficient totex in our draft determination has resulted in a change to the mix of opex and capex in totex to the extent that PAYG rates are no longer aligned with Anglian Water's stated approach.	We are making a technical intervention to align PAYG rates to Anglian Water's stated approach of recovering operating expenditure for each year for each wholesale control.	Representation made. In calculating the PAYG rates the company provides its view on the split of operating and capital expenditure which drives the calculation of the 'natural' PAYG rate. In calculating the natural PAYG rate the company provides representations to	Change for the final determination. A number of companies and stakeholders have made similar representations in relation to the proportion of operating expenditure in cost allowances and the determination of PAYG rates.	Taking account of company representations, we revise our approach to determine the mix of operating and capital expenditure to take better account of the nature of our decisions on cost allowances. We apply the updated approach in our technical intervention to PAYG rates.

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
				reflect a number of changes that reduce the net totex driven by extra efficiencies and reduction in scope. It provides a breakdown of opex, capex and totex and the natural PAYG rate.	We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.	In order to calculate the mix of operating and capital expenditure we follow the approach set out in 'Securing cost efficiency technical appendix'. We set out how we apply the technical intervention in the 'Aligning risk and return technical appendix' and we have published our calculation of the PAYG rates for each company alongside our determinations. We set out our approach to assessing notional financeability and for addressing financeability constraints for the notional company for final determinations in the 'Aligning risk and return technical appendix'. We set out the specific interventions we make for Anglian Water in relation to notional financeability in the 'Anglian Water final determination' document.
Risk and return	ANH.RR.C2	We are intervening to adjust Anglian Water's risk range for the cost of new debt to 100 bps on the upside and 25 bps on the downside. This is consistent with historical data on bond issuance costs in the sector compared to our benchmark index for the cost of new debt.	We are intervening to reduce Anglian Water's financing risk range associated with the cost of new debt to 100 bps on the upside and 25 bps on the downside. This intervention is consistent with the PR19 methodology. It is also consistent with historical data on bond issuance costs in the sector compared to our benchmark index for the cost of new debt. However, as set out in the 'Aligning risk and return technical appendix', we are considering the assessment of debt cost risk further for the final determination.	Representation made. Although Anglian Water does not refer specifically to this intervention in its representation, it does raise concerns about the allowance for new debt costs included in the draft determination. The company: • does not agree with the assumption of a 'halo effect'; and • raises concerns with respect to the indices used for setting the cost of new debt because it says the notional company cannot achieve a Baa1 rating based on the draft determination.	Change for the final determination.	See ANH.RR.D4
Risk and return	ANH.RR.C3	We assess Anglian Water's C-Mex RoRE range to be wider than the maximum range implied by the cap	We are intervening to reduce the C-MeX RoRE range to be consistent with the retail revenue exposure cap	Representation made. Anglian Water considers that its updated P10 and P90 RoRE risk range values for	Change for the final determination.	See ANH.RR.D4

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		on retail revenue exposure of +/- 12%.	of +/-12% as set out in section 5 of the company specific appendix.	C-MeX correspond to maximum penalty/reward levels.		
Risk and return	ANH.RR.C4	We are intervening to algin the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework. This approach seeks to take account of covariance in performance on individual outcome delivery incentives.	We are intervening to align the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework.	Representation made. In its representation, Anglian Water sets out a view that the proposed ODI component of the draft determination RoRE ranges shows a clear asymmetry between Ofwat's range of expectations for outperformance and underperformance payments.	Change for the final determination.	In our final determination for Anglian Water we: • make changes on mains repair to take account of historical levels of performance and the implications of leakage reduction levels for mains repairs; • adjust the water supply interruptions 2024-25 level taking account of wider evidence to calibrate the stretch of the performance commitment for an efficient company and reduce the ODI underperformance rate to be symmetrical with the outperformance rate. • amend the deadband on the Compliance Risk Index, reducing the risk of underperformance payments in the last three years of 2020-25. • are aligning the company's leakage performance commitment levels with the approach to enhancement funding. Further information is provided in the 'Anglian Water company specific appendix'.

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
Risk and return	ANH.RR.C5	We expect companies to update their RoRE risk ranges in response to the draft determinations.	We expect companies to update their overall RoRE risk range analysis in updated App26 submissions as part of their response to the draft determination. This should take account of the guidance we have provided in the 'Aligning risk and return technical appendix' that accompanies our draft determination and 'Technical appendix 3: Aligning risk and return' published with the IAP, and the context that achieved cost and outcomes performance has been positively skewed at a sector level in previous price review periods. Companies are strongly incentivised to achieve and outperform regulatory benchmarks. Therefore where companies consider there to be a potential downward skew in forecast risk ranges for returns, we expect companies to provide compelling evidence that this is expected to be in the context of expected performance delivery of the company, taking account of the company's reported level of actual performance delivered in 2015-19 and taking account of the steps it is already taking or plans to take to deliver against regulatory benchmarks and mitigate downside risk.	Representation made. In its representation on our draft determination, Anglian Water makes a number of points in relation to risk ranges for totex. It says: • The draft determination introduces significant new risks with cost challenges across the sector and an efficiency step change not supported by theory or evidence. • There is an 'even balance' of companies out and under-performing on overall RORE - not consistent with historical systematic outperformance by companies. • Whilst some companies have been 'above' or 'below' base RORE in all three years, others have seen significant variation in their performance year-to-year. • The limited time period for which the RORE analysis is feasible cannot provide reliable evidence on the persistency of outperformance. • It finds no correlation between the distribution of RORE risk and efficiency across companies Anglian Water also represents that a downside skew in its RoRE risk range for ODIs reflects an asymmetry to our interventions on ODIs. Based on customer research it considers that ODIs should have a symmetrical RoRE range of +/- 2%. The company says that its RoRE risk ranges reflects significant new risks in its draft determination. We present our assessment of the RoRE risk range provided by the company in its representation in the 'Anglian Water company specific appendix' which presents a downward skew to the overall	Change for the final determination.	Our approach to the risk ranges for a company with a notional structure are set out in the 'Aligning risk and return technical appendix'. We comment on the overall level of stretch in our determinations in an annex to the 'Securing cost efficiency technical appendix' See ANH.RR.D4

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				risk range relating to totex risk and outcome delivery incentives.		
Risk and return	N/A	N/A	N/A	Representation made. The company states that advancing cash flows by increasing the PAYG rate above the natural rate does not enhance credit worthiness or financeability and it therefore seeks to solve PAYG at the natural rate.	Change for the final determination. Our view remains that if the financeability challenge results from insufficient levels of cashflow headroom, then the appropriate response is to alter cash flows through the use of PAYG or RCV run-off levers, provided that the use of PAYG or RCV run-off levers does not lead to a material depletion of the RCV. We consider our approach best protects the interests of existing and future customers. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.	RCV growth for Anglian Water's final determination is more than 10% before advancing revenue to improve financeability. Therefore consistent with our policy approach set out in the 'Aligning risk and return technical appendix' we restrict the base dividend yield to maintain gearing around the notional level of 60% in 2025, consistent with the gearing level that underpins the calculation of our allowed return. The resulting dividend yield we assume is 1.84% with dividend growth of 1.18%. Following our assessment of financeability we are advancing revenue through the use of PAYG rates to align the financial ratios targeted by the company on a notional basis. We increase PAYG rates by 1.92% to bring forward £80m of allowed revenue from future periods.
Risk and return	N/A	N/A	N/A	In its April revised business plan, Anglian Water uses additional revenue from past performance reconciliation adjustments to improve the financeability for the notional structure. In our draft determination we accepted this as a	Change for the final determination. For final determinations, taking account of the lower allowed return, we apply a consistent approach across companies. Our approach is	We discuss our assessment of financeability in the 'Anglian Water final determination' and the basis on which we consider Anglian Water's final determination to be

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				departure from the PR19 methodology on the basis it was an approach proposed by the company that we consider protects the interests of customers. Anglian Water notes in its representations that the draft determination financial model excludes legacy reconciliation adjustments in the assessment of financeability for the notional capital structure.	consistent with the PR19 methodology, which is to assess financeability before taking account of any reconciliation adjustments. We discuss this further in the 'Aligning risk and return technical appendix'.	financeable on the basis of the notional capital structure.
Risk and return	N/A	N/A	N/A	The company provides representations that the Ofwat financial model incorrectly calculates AICR by assuming a recovery of pension deficit costs through the price controls but not deducting them as a cost which thereby inflates ratios artificially.	We consider the reparation of pension deficits over and above the allowance is a matter for companies and their shareholders. Our approach is to exclude these costs from our assessment of financeability to protect customers from the potential impact of this. For the final determination, we are not changing the principle of the adjustment however we note our approach for the draft determination also removed costs which are funded through allowed revenue. For the final determination, we match the pension deficit recovery costs to the revenue allowance in our assessment of notional financeability.	A number of companies and stakeholders have made similar representations in relation to the inclusion of revenue from the pension deficit recovery charges. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.
Securing confidence and assurance	ANH.CA.A7	On dividend policy the company is required to confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' to include: clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders; and commitment to transparency about how the dividend policy in 2020-25	No intervention but further action needed by Anglian Water. We expect Anglian Water to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our position statement. We expect the company to respond to	No representation made. But in further correspondence with the company, it confirms that the level of performance delivery considered will be as set out in the final determination.	Change for the final determination. We have updated our assessment of the reasonable base dividend for water companies in 2020-25 as set out in the 'Aligning risk and return technical appendix'. Under our current assessment the company falls short in a number of areas set out below. We expect	We expect Anglian Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25, to demonstrate how it has delivered on the commitments in relation to its dividend policy and to ensure it meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning risk and return technical appendix'.

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		takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25 and when determining dividends. Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.	this issue in its response to our draft determination. We expect Anglian Water to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. In doing so, the company should refer to the examples of best practice we have identified among companies.		Anglian Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25 and demonstrate how it has taken account of obligations and commitments to customers and other stakeholders, specifically how performance delivery has impacted on the dividends paid.	

Securing confidence and assurance	ANH.CA.A8	On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:
		visibility and evidence of substantial linkage of executive remuneration to delivery to customers;
		clear explanation of stretching targets and how they will be applied;
		clearer explanation of how the policy will be rigorously applied and monitored;
		commitment to report how changes, including the underlying reasons, are signalled to customers; and commitment to publish the executive pay policy for 2020-25 once it has been finalised.
		Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.
			No intervention but further action required by Anglian Water.
			There remain some details to be finalised, for example details of the underlying metric and associated weightings. Once finalised, we expect Anglian Water to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations we have set out in 'Putting the sector in balance' position statement.
			We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25.
			We expect the company to report transparently, in its annual performance report, about further
				Representation made.
				
				In its response the company has provided some additional information to that previously provided, in that it states that:
				• The deferred element of the bonus will be subject to additional performance conditions which require stable serviceability to be maintained over the whole of the deferral period
				• It has carried out further engagement with its online community showing
				    • The 3 measures being evenly weighted
				    • The identification of top 5 key metrics, being leakage, pollution incidents, water supply, external sewer flooding and mains bursts
				• The results of the online survey will now be validated as they are surprised external sewer flooding came higher than internal sewer flooding
				• It will also be consulting other stakeholders as vulnerability measures rated low amongst the group surveyed.
				• Further discussion will take place in September with options being presented to the November
					Change for the final determination.
					
					Anglian Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance: position statement'. Based on our calculations, the overall percentage of alignment of incentives to customers is 100%, which we acknowledge as being sector leading and best practice compared to the 60% we highlighted as evidence of good practice amongst the companies we regulate in our document, 'PR19 draft determinations: Aligning risk and return technical appendix'.
						We expect Anglian Water to be transparent when explaining and reporting the application of its performance related executive pay policy over 2020-25, to demonstrate how it exhibits a substantial alignment to the delivery of service for customers and meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning risk and return technical appendix'.

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
			updates to the development of its policy that will apply in 2020-25.	remuneration committee, which will include for example a discussion / debate on the ranking of C-Mex / D-Mex. • Once the design of the performance conditions for the 2020 scheme has been agreed in November and it has received its final determination, the quantitative targets will be presented at the February remuneration committee meeting. The policy will receive formal sign off at the March remuneration committee meeting, and will be published in the AIR in June 2020.		
Tax	N/A	N/A	N/A	Representation made. Anglian Water provided updated tax information to reflect the change in forecast capital allowances as a result of our view of totex in the draft determination.	Change for the final determination. We set out in our draft determinations that our interventions in other areas may have impacted on forecast levels of capital expenditure, but the resulting impact on allowances used for the calculation of taxation had not been reflected. Where these changes result in significantly different inputs for capital allowances or tax deductions, companies could raise this as part of its representations on the draft determination.	We reflect the updated capital allowance information on tax provided by Anglian Water in our final determinations.
Securing long-term resilience	ANH.LR.A5	The company is responsible for maintaining its long term financial resilience. The company should Provide further detail and Board assurance about its plans to maintain its long term financial resilience also taking account of action ANH.LR.C1. In its future reporting, we expect Anglian Water to apply suitably robust stress tests in its long term viability statements in 2020-25.	N/A	Representation made. Anglian Water expresses concern that neither the notional nor the actual company is financeable at the level of WACC proposed in the draft determination. It says that the board can therefore only attest to the long term financial resilience of the company when the balance of risk, and the level of WACC determined by	No change for the final determination. We consider that our determinations are financeable for an efficient company with a notional capital structure. However, there is also a need for companies to ensure that that they are financially resilient under their actual structures. We have not accepted all of the company's representations and the allowed return is lower in the final determination reflecting market expectations on the cost of finance.	We will closely monitor changes in levels of the company's gearing, credit ratings and other key financial metrics during 2020-25 to test that adequate steps are being taken by management and that financial resilience is being maintained. In its future reporting, we expect the company to explain clearly in its long term viability statement how the Board has identified and assessed the potential risks to its

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				Ofwat, enables the company to finance the delivery of its business plan. Anglian Water's board says that its view on the financial resilience of the actual company is in line with the following statement. "We have stress-tested our financial resilience against a range of extreme scenarios, as we set out in our September Business Plan and its supporting appendices. Furthermore, we have taken a number of proactive steps to address Ofwat's comments, including a commitment to de-gear to the mid-70s during AMP7, and accepting Ofwat's gearing sharing mechanism. We are concerned about the financeability of the notional and actual company, in the light of Ofwat's current proposed Weighted Average Cost of Capital (WACC), the wider balance of risk and return, and recent reports reflecting on this from credit rating agencies." Anglian Water has committed to assess its financial resilience beyond 2025 in its next long term viability statement.	Therefore, on account of Anglian Water's high level of gearing, the cost of capital in our final determinations that is lower than the draft determinations and limited headroom in its credit ratings, the company may need to take steps to improve its financial resilience in 2020-25.	financial resilience and the mitigating actions it is taking to address those risks.
Securing long-term resilience	ANH.LR.C1	The Board assurance on actual and notional financeability and financial resilience in the revised business plan was provided on the basis of the assumptions made in the business plan, prior to any interventions we have made in the draft determination and our updated view of the cost of capital. There is evidence of further downward pressure on the cost of capital in very recent market data which will be considered for our final determination.	We expect companies to provide further Board assurance, in their responses to the draft determination, that they will remain financeable on a notional and actual basis, and that they can maintain the financial resilience of their actual structure, taking account of the reasonably foreseeable range of plausible outcomes of their final determination, including evidence of further downward pressure on the cost of capital in very recent market data as we discuss in the 'Allowed return on capital technical appendix'.	See ANH.LR.A5.	See ANH.LR.A5.	See ANH.LR.A5.

Table 2: Anglian Water – Changes to the draft determination that are not in response to an action or representation

Test area	Actions/ intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
Allowed return on capital	ANH.RR.D1	We have revised our assessment of the allowed return drawing on market data up at 30 September 2019 and taking account of revisions to our approach following our assessment of representations. We have revised our assessment of the required retail margin deduction down from 0.11% to 0.04%, reflecting our view that the double-counted component of return in the household retail margin has reduced since PR14. We set out the basis for the allowed return on capital in our 'Allowed return on capital technical appendix'.	The sector allowed return on capital for the appointee price controls in our final determinations is 2.96% – CPIH deflated (1.96% – RPI deflated), 23 basis points lower than in the draft determination. The sector allowed return on capital for the wholesale price controls in our final determinations is 2.92% – CPIH deflated (1.92% – RPI deflated), 16 basis points lower than in the draft determination.
Gearing outperformance sharing mechanism	ANH.RR.D2	In our final determinations, we have amended our gearing outperformance sharing mechanism to contain a glidepath. We explain this in the final determination 'Aligning risk and return technical appendix'.	We have changed the trigger from a fixed trigger of 70% in the draft determination to a glide path which will start at 74% for the year 2020-21 and will reduce by 1% each year, ending at 70% for the year 2024-25 in the final determination.
Financeability	ANH.RR.D3	We consider that Anglian Water's final determination is financeable based on the allowed revenues which include a reasonable allowed return on capital. The final determination is sufficient to ensure it will be in a position to deliver its obligations and commitments to customers.	We discuss our assessment of financeability in the 'Anglian Water final determination' and the basis on which we consider Anglian Water's final determination to be financeable on the basis of the notional capital structure.
Return on Regulatory Equity (RoRE) - Financial Risk Assessment	ANH.RR.D4	We have revised our approach to assessing RoRE risk ranges for five of the risk areas set out in the PR19 methodology to take account of changes we have made in our final determinations to address concerns raised by companies on the overall level of stretch in our draft determinations, and evidence on past performance that we have observed in the sector. Our approaches are set out in the 'Aligning risk and return technical appendix' and the risk ranges for Anglian Water are set out in the 'Anglian Water final determination'. Taking account of changes in our final determination, the RoRE risk ranges at P10 and P90 confidence limits in our final determinations are, in most cases, more symmetrical than the risk ranges represented by companies. Our view of risk ranges also indicates more scope for outperforming companies to earn higher returns, but also for underperforming companies to receive lower returns.	The final determination risk range reflects the following interventions that we make for all companies: • The totex range is our assessment of the plausible range based on evidence of the historic sector performance and taking account of the company's cost sharing rates that apply in its final determination. • The financing cost risk range is based on our assessment of the range for a notional water company including both embedded and new debt. • The ODI risk range has been determined under our Outcomes Framework. • The C-MeX risk range is calculated as 12% upside and 12% downside of residential retail revenue, reflecting the cap and collar limits for this incentive. • The D-Mex risk range is calculated as 6% upside and 12% downside of developer services revenue, reflecting the cap and collar limits for this incentive.
Financial Risk Assessment – Uncertainty Mechanisms	ANH.RR.D5	We are including a PR24 reconciliation mechanism for business rates in our final determination for Anglian Water along with all other companies because: • There is uncertainty about business rates costs because the Valuation Office Agency (VOA) will be carrying out revaluation exercises during 2020-25, and increases (or decreases) in cost levels could be material. • Companies can only exercise limited control over cost levels by engaging with the VOA and, possibly, by considering the business rate implications of asset development choices.	In each case, the cost variance to the company's PR19 cost allowance will be subject to a 75 (customer share):25 (company share) symmetrical sharing rate in the totex reconciliation at PR24. This means that the company will still be incentivised to manage costs efficiently, whilst receiving appropriate protection against material cost increases. Conversely, customers will receive a benefit if outturn costs are lower than the allowance levels we have set. Details will be set out in the PR19 Reconciliation Rulebook.

Test area	Actions/ intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
		We are also including a PR24 reconciliation mechanism for Environment Agency abstraction licence costs in our final determination for Anglian Water along with all other companies serving England because: • The Environment Agency expects to consult on changes to its basis for setting abstraction licence fees during 2020 meaning that there is material uncertainty about company cost levels in 2020-25. • Companies can only exercise limited control over cost levels by engaging with the consultation process and providing accurate information when required for licence fee setting purposes.	

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

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