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PR19 reconciliation rulebook consultation – final policy approach and response document

Ofwat

About this document

Our approach to reconciling the price controls we set at the 2019 price review (PR19) is a significant evolution of our approach at the 2014 price review (PR14). It reflects further development in how we undertake reconciliations, through:

- additional and better targeted reconciliations, to ensure companies' allowed revenues are appropriate; and
- more in-period reconciliations to ensure changes to allowed revenue are undertaken in a more timely way.

The PR19 Reconciliation Rulebook provides guidance about how future PR19 Reconciliations should be implemented during, and at the end of, the 2020-25 price control period. It provides clarity on:

- how we will make changes to companies' allowed revenue and/or their regulatory capital value (RCV);
- which price controls are potentially affected; and
- when and how we will administer the process.

The PR19 Reconciliation Rulebook consists of:

- the 'PR19 Reconciliation Rulebook: Guidance Document': this brings together the overall approach and policy[1] with more detailed model guidance[2]; and
- an updated series of reconciliation models to show the practical operation of the PR19 reconciliation mechanisms.

To help make the PR19 Reconciliation Rulebook most helpful we are publishing it as a standalone document and set of models. Therefore, stakeholders' responses to our draft PR19 Reconciliation Rulebook and our assessment and decision regarding these are set out separately in this document. More detailed comments, for example about specific model issues, are addressed in an appendix called the minor issues log.

[1] Our proposed approach was published in PR19 Reconciliation Rulebook consultation – proposed approach and policy. Note that we previously consulted on matters related to the PR19 Blind Year adjustment. This work has now concluded and the matters were consulted are addressed at https://www.ofwat.gov.uk/regulated-companies/price-review/2019-price-review/final-determinations/pr19-blind-year-reconciliation-final-decisions/.

[2] Our proposed approach was published in PR19 Reconciliation Rulebook consultation - reconciliation model guidance.

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1. Implementation

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

- the annual process regarding in-period reconciliations (in-period determinations);
- reconciliation for 2020-25 performance (PR24 blind year adjustment); and
- the status of this document.

1.1 The annual process regarding in-period reconciliations (and in-period determinations)

1.1.1 Issue 1: Establishing a clear and proportionate process

Respondents' views

Dŵr Cymru, Thames Water and Severn Trent Water welcome the transparency and early publication of our rulebook. Yorkshire Water and Dŵr Cymru ask for the process to be clarified further in a timely way.

United Utilities says that if we intend to challenge companies as part of the in-period ODI determination process then we should be proactive in sharing our early view, i.e. before 15 September and set out a process for how we would do this. The company also asks for clarification around any information companies would need to provide in addition to the annual performance report (APR) and the process and format for companies to seek an in-period determination.

Severn Trent Water considers that, in light of the additional reconciliations, we should take a streamlined and pragmatic approach, e.g. ensuring our in-period determinations are closer to the routine reporting approach we took for other revenue adjustments during the 2015-2020 period. The company also comments on the interaction with charges setting which it completes in draft each September: it considers that either early feedback from us or deferring the impact of any difference between the company's view and our determination to the following year would help to ensure more predictable charges.

Thames Water considers the process should be as mechanistic as possible. Portsmouth Water considers we should neither make the process too time consuming, nor like an annual price review.

Southern Water advocates a risk-based approach to the in-period determinations. This would in large part involve relying on board assurance and sign off, similar to the approach for assuring compliance with our Charging Rules.

Anglian Water supports simplification of the process where possible. Additionally, it requests that we publish a workflow diagram to better visualise how the reconciliation models interact.

Our assessment and decision

We recognise the benefit of a transparent annual process and agree that we should further clarify the process. Our consultation document set out an initial overview of the process and we committed to setting out further details[3]. We have already provided guidance regarding the blind year process through the information notice, Approach to PR19 Blind year adjustments for 2019-20 performance. And we have set out more details around the in-period ODI determination process in our RAGS decision document.

For adjustments in relation to companies' performance commitments a determination from Ofwat is required to change allowed revenues. In other areas (such as the Revenue Forecasting Incentive (RFI), bilateral entry adjustment and the in-period bioresources reconciliation) allowed revenues adjust automatically in accordance with a formula so our role is to ensure compliance[4]. We agree that in both cases, we should take a risk-based, proportionate approach. What this means in practice is as follows.

- In all cases, we have a role in facilitating the process, including through publishing the PR19 Reconciliation Rulebook. Companies also have a role in ensuring the process works effectively by implementing the annual process in an accurate and timely way.
- For areas where we are not making a determination in relation to companies' performance commitments, we will neither move to an 'annual determination' level of scrutiny, nor undertake the level of detailed checking we undertook as part of our 'past delivery' work at PR19 on an annual basis. However, our experience at PR19 is that addressing issues in a timely way (rather than waiting until the end of the period as was the case during the 2015-2020 price control period) is in the interests of all parties. Therefore, we will aim to address key issues within the control period where this is possible and appropriate.
- Where specific Ofwat inputs are required, for example potentially adjusting allowed revenue in the RFI due to changes in developer services revenue, we have set out

[3] See page 17 of PR19 Reconciliation Rulebook Consultation – proposed approach and policy
[4] Although in specific instances, Ofwat may make a determination on a specific input which could affect companies' implementation, such as in the case of the blind year adjustment in the RFI.

the criteria that we will apply in relation to potential changes. We ask that companies engage with us as soon as possible to facilitate this process.
- When we need to make determinations, we aim to do so in a timely and transparent way and taking account of companies' annual charging setting timeline. As part of this we intend to consult with companies ahead of making a final determination.

We agree that workflow diagrams would aid clarity and so have published these in Annexes 1 and 2 of the Rulebook guidance document.

We intend to publish more detailed guidance regarding the annual process in due course. In doing so we will take account of lessons learned from the 2019-20 blind year process.

1.1.2 Issue 2: Supporting bill stability

Respondents' views

Severn Trent Water, South West Water, Portsmouth Water and the Consumer Council for Water (CCW) comment on the importance of bill stability and query the extent to which these will be considered in the in-period determinations.

Our assessment and decision

At PR19 we set companies' allowed revenues. This took account of companies' views – after consulting with their customers - on their bill profile. The in-period reconciliations should not be a means to fundamentally alter this profile.

That said, we do recognise that there may be specific circumstances when some flexibility is appropriate. For example:

- companies can decide how to spread the proportion of the PR19 blind year revenue adjustment recovered through the Revenue Forecasting Incentive (RFI) over the last four years of the control period;
- our outcome delivery incentives framework allows ODI payments to be deferred to later years, at Ofwat's discretion. The model allows for a one year deferral, companies have to ask for a deferral afresh in subsequent years;
- companies are able to collect less revenue than they are allowed for the residential retail and bioresources controls without the risk of penalty and would be able to recover this shortfall over the 2025-2030 period;
- the RFI contains a deadband in relation to the penalty calculation and furthermore we have provided for potentially additional flexibility to apply the RFI penalty to help

manage significant variation in developer services revenue as discussed in section 3.8.4; and
- as noted in section 1.3.1 we will consider the need for any ex post adjustments in light of the impacts of Covid-19.

We therefore consider that there is sufficient flexibility to help avoid undue bill instability that may arise over the PR19 control period.

1.1.3 Issue 3: Further development of the reconciliation models

Respondents' views

Northumbrian Water suggests combining all reconciliation models into a single model akin to the PR19 financial model. Severn Trent Water considers that the number of models should be kept to a minimum and to have a single model per mechanism (rather than, for example, duplicating models such as the RPI-CPIH wedge, ODI performance model and in-period adjustments model for each control or for each year).

Dŵr Cymru suggests that the input values for the models should be in their reported price base to ensure a clearer audit trail.

Our assessment and decision

We recognise that merging models has some merit, in terms of reducing duplication of some inputs and reducing the interfaces between models, and that further model development may be beneficial. At this stage, however, we do not intend to fundamentally change our models, because:

- a large, single model may introduce new complexity and merging models is not helpful when they have little or no interaction (for example, between the retail reconciliation model and RFI model);
- a modular approach would better facilitate any changes required to specific reconciliations, for example due to CMA redeterminations; and
- the case for merging models may be stronger for some end-of-period models (and making other model improvements) but it is a long time before these reconciliations will take place. We are currently developing our data strategy and we may choose to implement innovative software; in light of this it would be premature to further adapt our current modelling approach.

We do agree with Severn Trent Water that we should avoid undue model duplication, so we have ensured the ODI in-period adjustments model and RPI-CPIH wedge model cover all controls. However, the ODI performance model and in-period adjustments

model would need to be used each year by companies for the purposes of the in-period determination process, so making this a multi-year model would not be beneficial. We therefore retain our current approach.

1.1.4 Issue 4: Clarity around the inputs to the reconciliations

Respondents' views

Bristol Water agrees with our approach of not providing pre-populated models for each company, whereas Affinity Water and Yorkshire Water consider that we should.

Affinity Water, Anglian Water, Bristol Water, Dŵr Cymru, Northumbrian Water and Yorkshire Water suggest more detailed guidance, for example, through better cross-references to sources of inputs between table numbers in relevant final determination publication, the relevant line item from the APR and PR19 Reconciliation Rulebook.

Our assessment and decision

We consider that, consistent with the principle of company ownership, companies should populate their models. To help companies achieve this, we agree that our guidance should be as clear as possible. We will do this by adding more detailed guidance to make the nexus between our determinations, the Regulatory Accounting Guidelines and the PR19 Reconciliation Rulebook clearer.

1.2 Reconciliation for 2024-25 performance (PR24 blind year adjustment)

1.2.1 Issue 1: Not using forecast ODI performance in 2024-25 when determining PR24

Respondents' views

Severn Trent Water comments that our proposed approach would affect companies' own financeability assessments, requiring the production of an additional business plan at PR24 to reflect the impacts of the in-period ODI payments in 2024-25.

In addition, the company queries the treatment of end-of-period ODI adjustments under our proposal given that they can also only be fully calculated where performance in every year of the 2020-25 period is known.

Southern Water comments that the proposed approach may lead to more bill instability for its customers.

Our assessment and decision

We consider reconciling for 2024-25 performance in 2026-27 is consistent with a continuation of the annual ODI reconciliation process adopted in 2020-25. While we have not yet set the business plan reporting requirements for PR24, it is reasonable to expect that companies should take account of their expected performance when considering the impacts of reconciliation adjustments on the financeability and financial resilience of their actual structures. We do not consider this creates a business planning requirement on companies that is any more onerous than at PR19.

In terms of end of period ODIs, we acknowledge that a different approach may be required but this will need to be confirmed at PR24. Because many end of period ODIs are associated with the delivery of specific schemes which may affect the cost allowances we make at future price reviews, how we decide to reconcile them will need to be taken in the round at PR24. We currently expect companies to engage with us on relevant performance commitments so that we take account of appropriately-assured forecasts in the PR24 final determinations without the need for a subsequent reconciliation with outturn performance. However, if at PR24 we do not consider this to be appropriate, for example where end of period ODIs relate to significant performance-based ODIs or there is insufficient assurance, then we may reconcile the difference between forecasts and outturn performance following the PR24 final determinations. We could do this by designating individual performance commitments as in-period for the purposes of a blind year adjustment following the PR24 final determinations (our approach at PR19).

With regard to Southern Water's point, we note that companies can ask us to defer ODI payments, with keeping customers' bills stable one of the factors we may take into account during the in-period determinations. We consider this should be sufficient to address this concern.

1.3 The status of this document

1.3.1 Issue 1: The impact of Covid-19

Respondents' views

Several stakeholders raise issues around the impacts of Covid-19. Where this is in the context of a specific reconciliation, we summarise responses in the relevant section.

Our assessment and decision

In letters to the sector of 19 March and 14 July 2020, we explained that we would consider the need for any ex post adjustments to our regulatory system following an in the round assessment as part of our normal reconciliation process. We stand by this commitment and so will consider the need for any ex post adjustments once there has been sufficient time to understand the impacts of Covid-19.

1.3.2 Issue 2: Future updates to PR19 Reconciliation Rulebook

Respondents' views

Dŵr Cymru suggests the rulebook should be a "live" document over the course of the price control period which can respond to new information. Anglian Water suggests we retain the ability to alter our Reconciliation Rulebook in light of redeterminations by the Competition and Markets Authority (CMA). Bristol Water suggests a process to agree any revised inputs that may be necessary following the CMA redetermination.

Our assessment and decision

There are benefits to maintaining a consistent approach, therefore we will avoid undue changes to our approach. However, there may be exceptional circumstances where changes are appropriate, for example, due to CMA redeterminations in the case of the four companies concerned or if a change due to Covid-19 is warranted.

We are publishing the PR19 Reconciliation Rulebook as a standalone document and set of models; this will make any updates easier to make. We will consider how best to reflect any changes to our reconciliations as they arise; for example whether to change the PR19 Reconciliation Rulebook or produce bespoke, supplementary guidance for specific companies.

2. Cross-cutting design issues

This section discusses our final decisions in relation to key cross-cutting policy issues, including time value of money, inflation indexation and tax.

2.1 Time value of money and inflation

Respondents either do not provide a response or were broadly supportive of our overall framework in relation to the time value of money and inflation adjustments. Our position is therefore unaltered. We discuss comments on the application to specific reconciliations in the relevant section below.

2.2 Taxation

Respondents either do not provide a response or are broadly supportive of the overall framework in relation to tax impacts of the reconciliation models and request more clarity in some areas to avoid ambiguity.

2.2.1 Issue 1: Clarity about the meaning of a tax adjustment

Respondents' views

United Utilities and Northumbrian Water suggest that further clarity on whether the definition of the meaning of the statement that "a tax adjustment is required" in Table 7 is necessary to avoid ambiguity.

Our assessment and decision

To clarify, "a tax adjustment is required" in table 4 of the Rulebook means that there is a reconciliation adjustment the company should bear, i.e. an additional adjustment for tax on that reconciliation. For the avoidance of doubt, the tax adjustment is an adjustment we will undertake – not a separate adjustment companies should calculate themselves.

In terms of implementation:

- for in-period reconciliations, if a tax adjustment is required this would need to be reflected as a specific adjustment to the relevant reconciliation model; and

- by default the financial model makes a tax adjustment – so for end-of-period reconciliations a specific adjustment to the financial model is required only when a tax adjustment is not required.

2.2.2 Issue 2: Tax treatment of reconciliations where companies over- or under-collect revenue in an earlier year (category 1)

Respondents' views

United Utilities agrees with our approach to category 1 reconciliations, i.e. there should be no tax adjustments, and adds that our approach removes any asymmetric treatment between under and over-recovery of revenues.

Our assessment and decision

We agree with United Utilities that our approach to category 1 reconciliations ensures the symmetric treatment of under and over-recovery of revenues.

2.2.3 Issue 3: Tax treatment of reconciliations where allowed revenue is changed at PR24 due to changes in cost (category 2 and 3 adjustments)

Respondents' views

Northumbrian Water queries the distinction we make in the treatment of reconciliations where allowed revenue is changed at PR24 due to changes in cost, i.e. how we categorise these into those where we would or would not make a tax adjustment. The company argues that all of these reconciliations in the two categories should be treated the same and that none should have a tax adjustment.

Bristol Water argues that there should not be a tax adjustment for developer services reconciliations because any expenditure difference between the actual and forecast number of connections will affect the capital allowance adjustment.

Our assessment and decision

Having reviewed our approach, we consider that a tax adjustment is not required for the cost of new debt, developer services and innovation competition[5] reconciliations.

[5] NB Our policy regarding the innovation competition is still being developed regarding this reconciliation. Therefore, we will keep our approach to tax adjustments under review.

This is because a tax effect will tend to net off without our intervention[6], so that a tax adjustment would introduce a risk of companies claiming or incurring tax twice on the same reconciliation.

The RPI-CPIH wedge (revenue element) and tax reconciliation do not suffer from the same issue, because the RPI-CPIH wedge (revenue element) and the tax reconciliation do not have in-period impacts on company profits. Therefore, we would make a tax adjustment for these reconciliations.

2.2.4 Issue 3: Impact of Pay As You Go (PAYG) rates on the tax adjustment

Respondents' views

South West Water supports the overall framework, but points out that the net impact of tax adjustments to the reconciliations where allowed revenue is changed at PR24 due to changes in cost (that is, category 3 reconciliations) depend on the PAYG rate matching the operating expenditure share of totex. The company says that where we increased PAYG rates for companies in the final determinations, this would generate a bigger revenue adjustment and associated tax charge at PR24 compared to the change in the PR19 tax charge resulting from the change in operating expenditure.

Our assessment and decision

The PAYG ratios we will use to allocate between revenue and RCV adjustments in the totex sharing model (see section 3.1) were based on the PAYG rates set out in company business plans taking into account the split between operating and capital expenditure. We recognise PAYG adjustments for financeability increase the proportion of totex recovered as PAYG, this would tend to make company profits in-period higher. The higher PAYG rates after adjustments for financeability would therefore increase the revenue adjustment of the totex models compared to the RCV adjustment. The tax impact of this is that there will be a relatively higher proportion of the total totex sharing adjustment on which we would not adjust for tax at PR24. We consider that these impacts are very small and we will use the PAYG ratio as it is not material.

[6] For example, because a tax increase arising from increased profits (because of lower costs) will be offset by a tax decrease arising from lower profits (due to lower revenues from a reconciliation).

3. Common reconciliation models

3.1 Cost reconciliations

This is the model we will use at PR24 to reconcile actual performance against the totex allowances from PR19. An early version of this model was published on 13 December 2017.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	RCV and Revenue	RCV and Revenue adjustments feeder model	2017-18 FYA CPIH deflated prices	Water Network Plus, Water Resources, Wastewater Network Plus	Company-specific wholesale allowed return on capital

3.1.1 Issue 1: Time value of money

Respondents' views

In the draft model for consultation, time value of money adjustments had been made prior to the application of sharing rates to avoid any potential incentive to delay expenditure to the later years. We asked for views on alternative approaches such as calculating the sharing adjustment on a year-by-year basis.

We received three responses from companies.

Two companies do not agree with the alternative approach of calculating the sharing adjustment on a year-by-year basis.

United Utilities states that the model worked as expected, whereas, for companies that do not have 50:50 sharing rates, it says that the alternative approach would always result in them incurring a worse sharing rate than that set within the final determinations.

Southern Water states that a year-by-year basis may lead to suboptimal outcomes as companies would have to try to match the precise profile of totex in the final determination in each year. If they do not, then they will be materially disadvantaged by the operation of the asymmetric totex sharing rates.

Thames Water puts forward another approach. It suggests that we could calculate which cost sharing rate is appropriate (out or underperformance) before applying a time value of money adjustment and then apply it after adjusting for the time value of money.

Our assessment and decision

We have considered the responses and looked at a range of scenarios for each approach. We agree that the alternative approach gives rise to effective cost sharing rates which are different than those accepted by companies as part of the final determinations.

Thames Water's suggested approach generally results in the same adjustment as that used in the draft model but it also gives rise to a possibility that an outperformance cost sharing rate could be applied to an underperformance adjustment. This outcome leads to higher costs being borne by customers which is not what we intended in setting out the cost sharing mechanism or reconciliation model.

We have decided to keep the time value of money adjustments as set out in the draft model. This results in the cost sharing rates as set out in the final determinations being applied while keeping an incentive for companies not to delay expenditure until later in the period.

3.1.2 Issue 2: Wage rate adjustment

Respondents' views

We received a range of responses on how we apply the wage rate adjustment in relation to the overall cost reconciliation in the draft model. In the draft model, the wage rate reconciliation and adjustment is calculated separately to the overall cost reconciliation and adjustment.

Two companies consider that the ordering of the adjustment calculations is important. Dŵr Cymru states that the wage rate adjustment will influence the amount of totex that would have been allowed and therefore the adjustment calculations should not be performed simultaneously. Thames Water states that it could be the case that the outperformance cost sharing rate was applied to one variance, but the underperformance rate to the other.

Portsmouth Water and United Utilities raise questions about whether water service Water Industry National Environment Programme (WINEP) costs should be included or

excluded from the wage rate adjustment calculation since the frontier shift challenge was not applied to these costs in the final determinations.

Portsmouth Water also considers that it would be more appropriate to apply a company-specific percentage to outturn totex rather than a flat rate of 38.6% to all companies.

South West Water asks what metric will be used and how it will be assessed.

Affinity Water suggests that that the Annual Survey of Hours and Earnings (ASHE) series could suffer significant disturbance from the coronavirus pandemic. It highlights concerns that it would be unfair to adjust totex downwards if earnings in the wider economy are affected by the pandemic and are therefore, temporarily, not a useful proxy for wage inflation in the water sector.

Our assessment and decision

We have considered the responses and agree that calculating the wage rate and cost reconciliations and adjustments separately is not the most appropriate approach.

The wage rate adjustment is a means of transferring risk from companies to customers. It protects companies from significant wage rate variations by adjusting allowances to what they might have been if we were able to more accurately predict wage costs. It is similar to the WINEP reconciliation model. We have amended the model so we add the wage rate adjustment to each company's allowed totex baseline. In doing this, the calculations are now consecutive rather than simultaneous and will result in one cost sharing rate being used for the total adjustment.

In the draft model for consultation there was a WINEP input for the water service. The wage rate adjustment includes metering costs for the water service and WINEP costs for the wastewater service. We have deleted the WINEP input for water and made this clearer in the PR19 Reconciliation Rulebook.

We do not intend to change our approach and apply a company specific percentage to companies' outturn totex. We set out in 'PR19 final determinations securing cost efficiency technical appendix' how we took account of companies' views to arrive at 38.6%, an increase from 35% at draft determinations.

In our PR19 final determinations we confirmed that we would apply an adjustment at PR24 for real price effect impacts on labour costs. We stated we would use the outturn position revealed by the ASHE index published by the Office for National Statistics.

We considered the ASHE manufacturing wage index to be the most appropriate index for the true up as it provides wages on an hourly basis which allows for the real price

effect to be isolated. Manufacturing wages were chosen as a good reflection of wage pressure in the water sector given the similar skills sets and labour markets. The ONS has not yet updated the ASHE index or set out how it expects to take account of Covid-19 impacts, including the furlough scheme, on the index. The adjustment for labour costs does not apply to revenue allowances in this regulatory period. The adjustment will not apply until PR24 when more information on the effects of Covid-19 will be better known.

While we continue to consider that the ASHE index is the most appropriate index, although we will continue to review this going forwards. We discuss the impact of Covid-19 more generally in section 1.3.1.

3.1.3 Issue 3: Revenue/RCV split

Respondents' views

Southern Water agrees with our approach to the split between revenue and RCV adjustments.

Three companies disagree that the wage rate adjustment should be a purely revenue adjustment. Severn Trent Water, Portsmouth Water and United Utilities argue that a proportion of wage costs are capitalised and are included in the calculation of the split between opex and capex at final determinations. Therefore, in practice part of the final determinations' totex allowance for these costs was funded through the RCV and the reconciliation should be split between revenue and RCV in accordance with the PAYG rate.

Severn Trent Water considers that the same argument applies to the business rates and abstraction charges adjustment.

South West Water considers that the approach has changed significantly since PR14 resulting in a less comparable view between periods with a higher proportion of any adjustment being revenue.

Our assessment and decision

We agree that we did not separately consider the proportion of capitalised wage costs, business rates or abstraction charges in the calculation of the split of opex and capex and therefore they influenced PAYG rates. We consider it would be more appropriate to split the adjustment between revenue and RCV consistently with how these costs were allowed for in the final determinations.

As discussed above, we have amended the model so that the wage rate adjustment is added to the net totex baseline and is therefore included in the cost sharing reconciliation. We have also changed the model to add the business rates and abstraction charges adjustment to the cost sharing reconciliation adjustment and the total will then be split between revenue and RCV according to PAYG rates.

We do not necessarily consider that maintaining a comparable view between regulatory periods should be a barrier to evolving our approach. However, as a result of the changes we have made as set out above, the proportion adjusted as revenue is reduced and more comparable to that in the PR14 cost reconciliation.

3.1.4 Issue 4: Water resources and network plus combined reconciliation

Respondents' views

Two companies provided a response on the treatment of the water resources and water network plus price controls' reconciliation.

Portsmouth Water states that it is appropriate to consider the expenditure totals for the two controls together but was unsure how the final adjustments will be calculated as the two controls have different PAYG rates.

Thames Water questions the inconsistency between the reconciliation rulebook and the model. The company notes that in the reconciliation rulebook we state that:

'Over/under expenditure totals for the water resources and water network plus price controls for each company are considered together.'

The company also note that this is consistent with the PR19 methodology, which, for the water resources and water network plus price controls, aimed to 'ensure that companies are not unduly biased in favour of expenditure on one control over the other'.

However, the draft model for consultation calculated the cost sharing adjustments separately for the two controls. Thames Water state that this could give rise to counterintuitive incentives, where one price control is outperforming, and the other is underperforming, particularly where there is a significant difference between the outperformance and underperformance cost sharing rates. It proposes an alternative modelling approach which would calculate whether the outperformance or underperformance cost sharing rate should be used based on the combined water

resources and water network plus totex. This sharing rate could then be used for each of the two wholesale water price controls.

Our assessment and decision

We agree that the draft model was inconsistent with the reconciliation rulebook and PR19 methodology. We consider that the controls should be considered together to be consistent with our methodology and with how the cost sharing rates were calculated at final determinations. Therefore, we have updated the model so that it considers the costs of the two price controls together when calculating which cost sharing rate is used. The resulting rate will be used for both water resources and water network plus.

3.1.5 Issue 5: Business rates reconciliation for bioresources

Respondents' views

Thames Water highlights that the cost reconciliation model does not include any adjustments for the bioresources price control. It states that business rates apply to each of the wholesale controls and that the December 2019 final determinations define a reconciliation mechanism with special sharing arrangements for business rates.

The final determinations do not exclude the bioresources price control from these special sharing arrangements for business rates. The company therefore recommends that the calculation of the sharing mechanism for business rates for bioresources is added to the cost reconciliations model.

Our assessment and decision

The cost sharing mechanism applies only to the water resources, water network plus and wastewater network plus price controls and therefore no inputs were included in the model for consultation for the bioresources price control.

In the final determinations we said that the reconciliations for wage costs, and business rates/abstraction charges applied to the wholesale price controls, which includes bioresources.

We have updated the model to include these uncertainty mechanism reconciliations for the bioresources price control. This covers the wage rate adjustment and the business rates and abstraction charges reconciliation.

3.1.6 Issue 6: Identification of errors and areas that need clarification

Respondents' views

Five companies asked for clarity on the model's inputs, in particular specific references to final determinations and Annual Performance Report inputs.

Dŵr Cymru suggests that as many calculations as possible should be performed within the model and that the current approach requires offline calculations for net totex and deflating from outturn prices.

Thames Water notes that the draft model does not include calculations for its Thames Tideway Tunnel control.

Our assessment and decision

We agree that greater clarity is needed on exact inputs and definitions, particularly the definition of net totex for cost sharing. We have updated the reconciliation rulebook to provide further guidance as well as clarifying and updating references to where data can be found in the final determinations or Annual Performance Report tables.

We have considered Dŵr Cymru's suggestion that as many calculations as possible should be performed in the model. We consider that it is preferable to have common calculations performed by the model, such as deflating and inflating costs. We have updated the model to include these calculations. This will ensure consistency between companies and make the calculation process more transparent.

We have considered where best to perform the reconciliation for the Thames Tideway Tunnel control's costs and consider that it does sit best alongside the reconciliation for the other price controls. Therefore we have updated the model to perform this reconciliation.

3.1.7 Issue 7: Business retail bad debt liability cap

Since we published the PR19 reconciliation rulebook for consultation we have consulted on liquidity measures for the business retail market in light of the Covid-19 pandemic.

In April 2020 we published 'Covid-19 and the business retail market: Proposals to address liquidity challenges and increases in bad debt – decision document' and in May 2020 we published 'Questions raised in response to Ofwat's final decision

published on 30 April 2020'. We stated that, in the case of a business retailer defaulting, we would cap the wholesalers' additional bad debt liability arising from the provision of liquidity We have updated the model to include a mechanism to calculate any adjustment necessary after applying the cap.

3.2 Innovation fund and competition model

This is the model we will use at PR24 to calculate the total amount of unused funds collected by the 17 water companies to be returned to customers. This is done in line with the original allocation methodology set out in PR19 Final Determinations.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2017-18 FYA CPIH deflated prices	Water Network Plus, Water Resources, Wastewater Network Plus and bioresources	Company-specific wholesale allowed return on capital

3.2.1 Issue 1: Price base of allocated funding

Respondents' views

United Utilities suggests that the allocated funding input in the model should be in real terms and prepopulated to align with the values in the final determinations before being converted to nominal prices in the model.

Our assessment and decision

We have considered United Utilities' suggestion and will amend the model to prepopulate the allocated funding input to in real terms. This will provide greater consistency between the model and the final determinations and ensure there are no discrepancies with companies' forecast inflation values. This value will then be converted into nominal terms within the model to align with all other inputs.

3.2.2 Issue 2: Model users and timetable

Respondents' views

South West Water and United Utilities ask for clarity on how the model would be used and whether the model would be run centrally by Ofwat or by individual companies.

Dŵr Cymru raises a concern on the timetable of the model use and how it aligns with the RAGs as the model requires data from all companies but the revenue adjustment is an output required by the RAGs.

Our assessment and decision

We are expecting that this model will be completed by Ofwat to calculate the value to be returned to customers by each company after collection of data from all companies at the end of the period.

We will amend the APR table to remove the revenue adjustment line. Further clarity on the completion of the APR tables will be provided in the final Regulatory Accounting Guidelines 2020-21.

3.2.3 Issue 3: Expenditure profile and validations

Respondents' views

Severn Trent Water comments that a validation error would be triggered in the model where expenditure differs from the allocated funding profile. It comments that the model would be better to focus on expenditure over the 2020-25 period in order for companies to remain efficient.

Portsmouth Water comments that expenditure may not be evenly spent across the 2020-25 period and requests clarity on how funding would be returned to customers.

United Utilities comments that under the current mechanism a net overspend on projects would identify additional funding that would need to be recovered from each company's customers.

Our assessment and decision

The innovation reconciliation model applies across the 2020-25 period. We have amended the negative funding check to ensure funding across the 2020-25 period remains positive instead of the current year-on-year approach.

A validation has also been included to ensure that no additional funding is recovered from customers as a result of any overspend on projects.

3.2.4 Other feedback

Anglian Water, Dŵr Cymru, United Utilities and South West Water acknowledge that this was an emerging area with ongoing consultations. Dŵr Cymru comments that its views were provisional pending the finalisation of the wider framework. United Utilities raises a number of points related to the wider implementation of the innovation fund.

Our assessment and decision

We accept that this is an emerging area with the wider innovation funding and competition consultation ongoing at the time responses on the reconciliation were required. Further information on the wider implementation of the innovation fund has been provided in our decision document following the Innovation funding and competition consultation. Following the appointment of our innovation fund partner, we will be providing additional information on the design and implementation of the competition.

3.3 ODI performance model

We received no substantive comments related to the policy enacted by the ODI performance model. We have addressed more detailed comments in minor issues log.

We separately consulted on the reporting arrangements for the ODI performance model and how this could be integrated into the Annual Performance Reports process; we have set out our conclusions to this in the Regulatory Accounting Guidance response to consultation document.

3.4 In-period adjustments model

The in-period adjustments model adjusts price controls to reflect the in-period determinations we will make each year based on each company's performance against its PR19 performance commitments which have in-period outcome delivery incentives (ODIs), including the customer measure of experience (C-MeX) and developer services measure of experience (D-MeX).

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In-period	Revenue	Revenue adjustments feeder model	Nominal	Water resources, water network plus, wastewater network plus, bioresources, residential retail, business retail, Thames Tideway Tunnel	Wholesale allowed return for the wholesale controls, appointee allowed return for the retail controls

3.4.1 Issue 1: Deferrals of incentive payments

Respondents' views

United Utilities suggests that companies should have the option to defer any size of ODI payments and not be limited to the ±1% threshold, arguing customers prefer reduced bill volatility and this could help mitigate the bill impacts.

South West Water requests further clarity on whether the threshold of ±1% of notional regulatory equity mentioned relating to the deferral of ODI payments is calculated at the appointee or price control level.

Our assessment and decision

When making a request for an in-period determination, companies can seek to defer any amount of ODI payments, but will need to provide sufficient justification and evidence. In the PR19 final determinations we set out the ±1% threshold as an expectation rather than a rule (see p59 of 'PR19 final determinations: Policy summary'), and we will base our decisions on any such request in light of the company's expected performance and our statutory duties.

For the avoidance of doubt, the ±1% threshold relates to notional regulatory equity at an appointee level.

3.4.2 Issue 2: Treatment of inflation

Respondents' views

Affinity Water says if inflation forecast errors are larger than expected, Ofwat may be tempted to intervene if doing so would benefit customers. The company says that if we decide not to reconcile outturn inflation, we should firmly commit to this approach.

South West Water argues that it might be better to rely on an inflation forecast that is based on a range of sources rather than relying on a single forecast.

United Utilities agrees with our proposed approach but query the need to overwrite company assumptions of forecast inflation given that companies already set their charges based on actual inflation each year.

Our assessment and decision

Because of the timing of the in-period determination process, we will need to use a forecast of November to November inflation. To ensure this is as accurate as possible, we will use a range of sources to inform our decisions, including those put forward by companies, and publicly available short-term inflation forecasts from reputable sources as applied in the PR19 final determinations.[7]

We continue to consider a uniform forecast should be applied to all companies, to ensure a simple approach and consistent treatment for all companies' customers. This is more important for the 2020-25 period given the increased number and materiality of in-period ODIs compared to the 2015-20 period.

We do not intend to correct for differences with actual inflation because we continue to consider the impact will be relatively minor. We commit to maintaining this approach during the 2020-25 period.

While companies may have set charges based on actual inflation in the 2015-2020 period, the reconciliation models which ultimately reconciled revenue adjustments to reflect ODI performance were based on companies' forecasts of November to November inflation in their in-period ODI determinations.

[7] See section 2 of 'PR19 final determinations: Allowed return on capital technical appendix'.

For the avoidance of doubt, this forecasting approach is only relevant for the in-period determinations of ODIs. Other in-period reconciliation can use actual inflation figures. For example, a company will not need to use forecast inflation for RFI adjustments as Nov-Nov inflation will be known if it publishes its final charges in January prior to a charging year starting in April.

3.4.3 Issue 3: Treatment of taxation

Respondents' views

Affinity Water says we should specify in what circumstances we will intervene on the marginal tax rate and how we would set it. The company also notes we have not committed to reconciling any differences with actual tax rates.

South East Water raises concerns with how the tax adjustment is calculated and asks us to confirm the basis of the adjustment. The company also ask for clarity on the tax treatment of performance in the final two years of the 2020-25 period.

Our assessment and decision

In terms of **how we will make a tax adjustment** in our in-period determinations, 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 would normally expect to use the headline rate of corporation tax if the company is expecting to be in profit, but we will take the company's submission into account when making our determination, as well as upcoming changes to tax policies and any other relevant factors.

In respect of **reconciling the tax adjustment**, it is possible that the marginal rate of tax that a company pays in the following charging year differs from the assumption made in our in-period determination, for example due to a change in government policy or if the company is no longer subject to corporation tax. While we expect this to be fairly unlikely, if there is a material impact on either customers or companies we will reconcile the differences at the 2024 price review (PR24) to ensure that neither customers and companies over- or underpay due to a late change in tax rates relative to the assumptions made in our in-period determinations.

To clarify the **basis of the tax adjustment**: we make this adjustment to ensure that the size of the ODI payments are equal to what was intended in the PR19 final determinations for a given level of performance. Without any adjustment, a company's marginal tax rate would reduce or increase the impact on a company's profit after tax.

For example, if a company has a profit before tax of £100m and a marginal tax rate of 19%, then its profit after tax is £81m. Applying an unadjusted underperformance payment of £3m would reduce profit before tax by £3m (but reduce profit after tax by only £2.4m to £78.6m). Because this impact on profit after tax (£2.4m) is less than what was intended (£3m) we need to make a tax adjustment. The model increases the £3m underperformance payment to £3.7m which reduces profit before tax to £96.3m, which after a 19% tax rate leads to a profit after tax of £78m (as intended, a £3m reduction on the original profit after tax of £81m).

In respect of **tax adjustments in years 4 and 5** of the 2020-25 period, we do not intend for the in-period adjustment model to be used for performance in year 4 because we intend for it to be reconciled by the relevant PR24 model, which will have its own tax adjustment and any revenue profiles will be considered as part of PR24. As set out in the consultation, we do not plan to make a blind year adjustment for year 5 performance (and so will not make assumptions in PR24) and will instead use the in-period adjustments model in late 2025 leading to a revenue impact in 2026-27, which will result in a tax adjustment.

3.4.4 Issue 4: Time value of money adjustment

Respondents' views

Severn Trent Water says if the two-year difference between the year of performance and when the revenue adjustment is applied is not reflected in the final ODI payment, then the actual strength of payments will be lower than what companies report in terms of their return on regulatory equity (RoRE).

Wessex Water says that a time value of money adjustment should be applied to the final ODI payment, otherwise companies will be incentivised to not undertake improvements that customers would otherwise support.

Our assessment and decision

We continue to consider such an adjustment is not required, because unlike other reconciliations, ODI payments are intended to be paid after two years, causing no timing difference between when money has been intended to be paid and when it is recovered. We do not consider it necessary to change the approach we initially adopted at PR14. In addition, we consider applying a time value of money adjustment in this way to in-period ODIs would require a similar adjustment for end-of-period ODIs, which would add excessive complexity.

However, we do consider it appropriate for a time value of money adjustment to apply where ODI payments are deferred to future years. This is because incumbents have an influence on the timing of revenue adjustments (subject to our in-period determinations) and applying such an adjustment removes potentially perverse incentives on companies to not defer payments.

3.4.5 Issue 5: Application of incentive payments to the residential retail control

Respondents' views

Anglian Water says that because the residential retail control is an average revenue control, either the modification factors will need to be recalculated or a 'below the line' adjustment should be added to the residential retail reconciliation model.

Our assessment and decision

We do not consider a change is necessary. In the average revenue control for residential retail, the modification factor (**M**) is designed to adjust allowed revenue if actual customer numbers differ from forecasts. For in-period ODIs, our intent is to increase or decrease the allowed revenue based on companies' performance, and in our consultation we proposed to do this by changing total revenue (**TR**) only. If the modification factor was also changed, and customer numbers were different to forecast, then this would scale the ODI payments earned or incurred by the change in customer numbers, leading to over- or under-recovery of ODI payments. We do not consider this to be in the interests of customers because this over- or under-recovery would weaken incentives on companies to perform, and because the customers impacted by the ODI payments will not necessarily have been affected by the outperformance or underperformance in the relevant year.

3.5 Customer measure of experience (C-MeX)

The customer measure of experience (C-MeX) is designed to incentivise companies to provide excellent levels of service to their residential customers. Based on its relative performance, each company can receive outperformance or incur underperformance payments each year.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In-period	Revenue	In-period adjustments model; and/or PR24 revenue adjustments feeder model.	2017-18 FYA CPIH deflated	Residential retail	N/A

3.5.1 Issue 1: C-MeX model

Respondents' views

Thames Water comments that the C-MeX model is not fully aligned to the FAST[8] modelling standard.

Our assessment and decisions

We agree that the design of the draft C-MeX reconciliation model does not fully take account of the FAST modelling standards, and have amended the model.

3.5.2 Issue 2: Reconciliation process

Respondents' views

Dŵr Cymru queries how the deadline for submitting C-MeX outperformance and underperformance payments, for inclusion in table 1F of the annual performance report, is compatible with the timetable for the C-MeX performance reporting process, given that calculating the higher performance payments depends on third-party data

[8] The FAST modelling standard is the most widely adopted, independently administered financial modelling standard in use today. **FAST stands for Flexible, Appropriate, Structured and Transparent models**.

which may not be available in time for the 15 July submission date for annual performance reports.

South West Water questions if each company will be required to input all other companies' revenue data into the C-MeX model, and, if so, how this data will be made available.

Severn Trent Water queries why the C-MeX model only covers a single year of the 2020-25 period.

Our assessment and decisions

Submissions of C-MeX outperformance and underperformance payments data for the financial flows table (1F) relate to the previous reporting year. Therefore, because financial incentives do not apply in 2019-20, no outperformance or underperformance payments for C-MeX or D-MeX will be reported in the 2020-21 annual performance reports. Payments resulting from C-MeX and D-MeX performance in 2020-21 will be reported in table 1F of the 2021-22 annual performance reports and so on.

Companies requesting an in-period determination must do so by 15 August (in line with the arrangements set out in each company's licence) making use of the relevant third-party data (e.g. UKCSI and companies' complaints data) which will be published by all companies in the annual performance report tables on by July each year.

We can clarify that companies are not required to input other companies' revenue data into the C-MeX model. This facility is included for us to use when calculating the outperformance or underperformance payments for all companies. However, companies will need to complete other data, such as other companies' C-MeX scores, complaints and UKCSI scores, to inform their request for an in-period determination. Most of this information will be accessible from other companies' annual performance reports. We will provide companies with the relevant UKCSI data each July to support consistency across companies.

Because the C-MeX reconciliation model is intended to form the basis of in-period determinations, it only covers a single year to avoid unnecessary complexity during the annual process.

3.5.3 Issue 3: Data provision

Respondents' views

South West Water asks for clarity on what data will be provided to companies after the end of each reporting year, and whether it will be provided at an individual company or all company level.

Our assessment and decisions

We confirm that the data to be shared with companies at the end of each reporting year is set out in 'C-MeX guidance for the 2020-25 period' (March 2020).

3.5.4 Issue 4: Covid-19

Respondents' views

South East Water suggests that the impacts of Covid-19 should be excluded from, or otherwise taken account of within the assessment of, C-MeX.

Our assessment and decisions

As set out in section 1.3.1 we will consider the need for any ex post adjustments to the regulatory system following an in the round assessment as part of our normal reconciliation process, once there has been sufficient time to understand the impacts of Covid-19.

3.6 Developer services measure of experience (D-MeX)

The developer services measure of experience (D-MeX) is designed to incentivise companies to provide excellent levels of service to their developer customers. Based on its relative performance, each company can receive outperformance or incur underperformance payments each year.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In-period	Revenue	In-period adjustments model; and/or PR24 revenue adjustments feeder model.	2017-18 FYA CPIH deflated	Water network plus, wastewater network plus	N/A

3.6.1 Issue 1: Developer services revenue

Respondents' views

United Utilities suggests that the reconciliation rulebook should clarify the components of 'industry developer services revenue'.

Our assessment and decisions

We agree that the definition of 'industry developer services revenue' should be clarified in the rulebook, and have added a reference to the companies' PR19 outcomes performance commitment appendices, where the full definition of industry development services revenue is set out.

3.6.2 Issue 2: Data provision

South West Water asks for clarity on the data that will be provided to companies after the end of each reporting year, and also questions if companies are required to input all other companies' revenue data into the D-MeX model, and, if so, how this data will be provided.

Our assessment and decisions

We confirm that the data to be shared with companies at the end of each reporting year is set out in 'D-MeX guidance for the 2020-25 period' (March 2020).

We can clarify that companies are not required to input other companies' revenue data into the D-MeX model. This facility is included for us to use when calculating the outperformance or underperformance performance payments for all companies.

3.6.3 Issue 3: Covid-19

Respondents' views

South East Water suggests that the impacts of Covid-19 should be excluded from, or taken account of within the assessment of, D-MeX.

Our assessment and decisions

As set out in section 1.3.1 we will consider the need for any ex post adjustments to the regulatory system following an in the round assessment as part of our normal reconciliation process, once there has been sufficient time to understand the impacts of Covid-19.

3.7 Residential retail reconciliation model

The residential retail reconciliation ensures that companies comply with their retail price controls. The model reconciles for any differences between allowed and collected revenues and implements a 'financing adjustment' penalty for material revenue variances.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2024-25 FYA CPIH deflated	Residential retail	Company-specific real appointee allowed return on capital

3.7.1 Issue 1: The impact of Covid-19 on social tariffs and residential retail revenues

Respondents' views

A number of respondents comment on the significant impact of the Covid-19 pandemic on the provision of social tariffs and how this impacts the residential retail revenue control. Companies are concerned that falling residential retail revenue, due to increased social tariff provision could lead to financeability impacts and a large end-of-period adjustment impacting on 2025-30 bills.

Northumbrian Water, Severn Trent Water and Dŵr Cymru argue that the retail reconciliation should be altered to be in-period to alleviate these concerns. In addition, Severn Trent Water considers that such a change would enable companies to act more quickly to help more customers with social tariffs.

Severn Trent Water also considers that applying the time value of money adjustment only when the forecast error is more than 2% would penalise companies that act faster to help customers.

Our assessment and decision

As set out in section 1.3.1 we will consider the need for any ex post adjustments to the regulatory system following an in the round assessment as part of our normal

reconciliation process, once there has been sufficient time to understand the impacts of Covid-19.

3.7.2 Issue 2: Real or nominal adjustment in the residential retail model

Respondents' views

Thames Water supports the use of the nominal allowed appointee return on capital, rather than real CPIH-deflated appointee allowed return on capital for time value of money adjustments in the residential retail reconciliation model and seek clarity on this point.

Our assessment and decision

To clarify the approach for the residential retail reconciliation, this would use the real (i.e. CPIH-deflated) appointee allowed return on capital to implement time value of money adjustments. This is consistent with the approach implemented to the legacy PR14 residential retail reconciliation model in our final determinations. It remains an appropriate way to make a time value of money adjustment.

3.8 Revenue forecasting incentive (RFI)

The RFI is a symmetric revenue adjustment applied in-period to reconcile any revenue under- or over-recovery in an earlier year. Where differences between actual and allowed revenues are greater than 2% the RFI applies a financial penalty.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In-period	Revenue	Revenue adjustments feeder model	2024-25 FYA CPIH deflated	Water Network Plus, Water Resources, Wastewater Network Plus, Thames Tideway Tunnel	Company specific wholesale allowed return on capital

3.8.1 Issue 1: Impact of Covid-19

Respondents' views

South East Water and Thames Water argue that there is an increased likelihood of RFI penalties due to forecasting errors driven by unforeseen impacts on wholesale revenue due to Covid-19. They consider that waiving penalties caused by Covid-19 prior to penalty calculation might be appropriate. Portsmouth Water considers that if there are exceptional circumstances then companies should be able to challenge penalties. South West Water asks how our proposals around the deadband would work particularly in light of Covid-19.

Thames Water suggests that companies should be able to accelerate recovering revenue shortfalls with a one-year lag rather than the standard two-year lag to minimise the impact of wholesale revenue shortfalls on company cash flows from Covid-19.

United Utilities draws a parallel to the accelerated return of revenue over-recovery functionality in the PR14 Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) model and argue that a more flexible profiling of revenue adjustments across the 2020-25 period in the RFI model could help smooth the impact on customer bills of Covid-19 impacts. Dŵr Cymru argues that to promote bill stability there should be the functionality in the model for voluntary temporary abatement of wholesale revenues without compromising the incentive mechanism.

Our assessment and decision

In section 1.3.1 we said we would consider the need for such ex post adjustments to anything set out in our PR19 Reconciliation Rulebook following an in the round assessment as part of our normal reconciliation process. As part of this, we will consider whether waiving RFI penalties and/or other adjustments would be appropriate due to the impact of Covid-19 after an appropriate assessment has been completed.

3.8.2 Issue 2: High metering penetration

Respondents' views

South East Water argues that companies with a relatively high metering penetration are at a higher risk of incurring penalties due to weather-driven demand volatility impacting on wholesale charges.

Our assessment and decision

In our PR19 final methodology we estimated that, at a sector level, a 2% revenue over-recovery, without correction, would be equivalent to an impact of around 0.9% on the return on regulated equity (RoRE)[9] in companies' favour. Moreover, large systematic over- or under-recoveries may drive end of period movement in customer bills. It may also mean future customers may pay more or benefit at the expense of current customers.

This issue was raised previously during PR19 and in the context of the licence modification to enable the Revenue Forecasting Incentive. All companies agreed to this licence change and the RFI formula was formally notified to companies alongside their final determinations. In developing our approach, we considered that the 2% deadband is appropriate for all companies.

Linked to this, in our PR19 Reconciliation Rulebook Consultation – reconciliation model guidance, we said we did not intend to waive the RFI penalty ex post, for example in light of exceptional weather. We said that we allow for some variation in companies' revenues around their allowed revenue by setting a deadband and that we consider that generally companies should be able to collect revenue within this range.

[99] The impact on RoRE was calculated as the average of total revenues over five years divided by the average regulated equity. It was based on sector figures that underpinned the 2014 final determinations, it wasn't adjusted for bioresources, and will vary between companies depending on the relationship between revenue and the regulatory capital value (RCV).

We have seen no new evidence to suggest that a change in the deadband (which would require a licence change to change the effect of the RFI formula during the price control period) would be appropriate.

3.8.3 Issue 3: Potential cross-subsidy and form of control

Respondents' views

South East Water wants us to confirm that developer services are within the single till which will help them to recover any shortfall in developers' revenues.

Portsmouth Water, Severn Trent Water and South West Water comment on the impact of differences in outturn developer services revenue relative to forecasts in our final determinations on the wholesale charges for other customers. The companies consider that the inclusion of such revenues within the scope of the RFI means that there could be a potential cross-subsidy. Severn Trent Water and Portsmouth Water consider that a cross-subsidy would be inappropriate.

South Staffs Water considers that developer services revenue should be outside of the scope of price controls, and therefore the RFI, and would welcome early engagement about how this can be addressed at PR24.

Our assessment and decision

In our PR19 methodology, we decided to retain developer services income inside our price controls in order to protect customers from any potential abuse of market power by water companies. The RFI covers all price control revenue, including price control developer services revenue. At PR19 we considered what Grants and Contributions would be within the price control and what should be outside it; for example, we agreed with companies that certain diversions revenue should be covered by a new "Excluded Charge" (as defined in licence condition B) and therefore fall outside the wholesale price controls.

The inclusion of relevant developer services within the network-plus control can help to stabilise companies' allowed revenue, but also means that the network-plus related charges of other customers are affected by changes in developer services revenue.

We do not accept that this necessarily gives rise to a cross-subsidy in the long term. This is because the end-of-period developer service reconciliation will adjust companies' allowed revenues at PR24 if actual connections are different from forecast connections; this would tend to offset any impact on other customers' charges within the control period.

We considered issues around the inclusion of developer services in our final determinations appendix 'PR19 final determinations: Our approach to regulating developer services'. We said that we recognised that there is merit in reviewing the inclusion of developer services within a single till in future and we still intend to review this issue as part of developing our PR24 methodology.

Linked to this, we also considered the merits of taking a flexible approach in applying the RFI penalty. We subsequently consulted on implementing a flexible approach in PR19 reconciliation rulebook consultation – reconciliation model guidance. We consider this is the most appropriate approach to address potential issues around bill volatility in the short-term. Our decision on this specific issue is discussed in more detail below.

3.8.4 Issue 4: Approach to managing significant variation in developer services revenue

Respondents' views

Southern Water agrees with our approach. South East Water also agrees with our proposals and suggest that it may apply for the change in the RFI penalty deadband in multiple years. In contrast, Severn Trent Water questions the magnitude of the 1% materiality threshold, suggesting that it is unlikely that it would experience sufficient variation to reach the threshold.

South West Water asks for further clarity on how this approach would work in practice.

Our assessment and decision

We note that while one company considered the threshold too high to be effective, another company has a contrary view. We consider that the 1% threshold is an appropriate level, because it is right to only consider changes if there is a significant potential benefit to customers and if a company faces a significant risk of an RFI penalty if no changes were made.

We set out our proposed guidance for how we would apply this approach in our 'PR19 Reconciliation Rulebook Consultation – reconciliation model guidance'. We recognise that implementing this may benefit from more detailed consideration and engagement with companies. Changing the effect of the RFI formula during the price control period would ultimately require a licence change. However, at this stage we are neither setting out more guidance, nor initiating a licence change because it is unclear how often this mechanism will be applied in practice. We would need to understand companies' proposed basis for any adjustment and appropriate justification in good

time so that we can consider and, if necessary, implement any adjustment in a timely and effective manner.

3.8.5 Issue 5: Allocation of penalties between water wholesale controls

Respondents' views

Southern Water agrees with our proposed approach. However, Severn Trent Water disagrees with us providing discretion to companies to allocate the penalty between water resources and water network plus and our proposal that we expected companies to provide evidence to support their decision of how they propose to allocate any applicable penalty and be clear on why they have chosen their preferred approach. The company argues that it would be more proportionate for Ofwat to prescribe a methodology for this allocation because in their experience the value of the penalty has been a trivial share of their total wholesale revenue.

Our assessment and decision

We recognise that the amount of money involved may not be significant in most circumstances and that the risks of misallocation of the penalty are low. This is why we gave companies discretion about how to allocate this penalty as part of the RFI formula. We still consider that this approach is appropriate for this reason. Changing the effect of the RFI formula during the price control period would require a licence change which itself would create an administrative burden – therefore, we consider that such a change is not the best way to deliver the reduced regulatory burden that the company seeks.

We consider that companies should be able to justify the allocation of the penalty, but we also agree that this should not create undue administrative burden. We agree that having to provide evidence in all circumstances implies a level of administrative burden that was not intended. Therefore, in the PR19 Reconciliation Rulebook we are adjusting the requirement that companies should in their APR either:

- state they have allocated any penalty proportionately to the control that creates a revenue imbalance resulting in RFI penalties; or
- explain why they have chosen a different approach.

3.8.6 Issue 6: Temporary abatement of revenue

Respondents' views

Dŵr Cymru said it should be able to take less revenue in one year, and make up the revenue in later years, without the risk of a penalty under the RFI. The company considered there should be additional capability in the model to allow this.

Our assessment and decision

At PR19 we ensured that companies' profiles of allowed revenues reflected customers' views. We want companies to take responsibility for accurately forecasting revenues they will collect, to align their interests with those of customers and so provide a small but meaningful financial incentive applied to each year's revenue to achieve this aim. Large systematic over- or under-recoveries may drive end of period movement in customer bills. It may also mean future customers may pay more or benefit at the expense of current customers. As such the RFI has a symmetric deadband.

There may be exceptional circumstances when a different approach to the standard one set out in our Final Determination may be appropriate such as those discussed above.

We note that the change proposed by the company would require a licence modification (since the RFI formula has already been formally notified to companies alongside their final determinations), unless the changes were made ex post at PR24.

We do not intend to implement an additional licence change to enable the temporary abatement of revenue (beyond the existing deadband) because:

- the existing approach achieves the objectives of the RFI and was fully consulted on during PR19;
- in light of our approach regarding Covid-19 and developer services, there is no demonstrable need for additional flexibility; and
- making the required licence change would create an administrative burden.

3.8.7 Other feedback

We note Thames Water agrees with our proposal to apply the RFI to allowed revenues for the Thames Tideway Tunnel (TTT). We have updated the RFI model and rulebook to cover the TTT control.

3.9 Developer services revenue adjustment mechanism

This model is designed to reconcile developer services revenues within the network plus control for PR19. We explain further details in 'PR19 final determinations: Our approach to regulating developer services'.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2017-18 FYA CPIH deflated	Water Network Plus, Wastewater Network Plus	Company-specific wholesale allowed return on capital

3.9.1 Issue 1: Accuracy of the reconciliation

Respondents' views

South Staffs Water, Severn Trent Water and South West Water argue that where there will be differences between the complexity of connections assumed for the purposes of the forecast unit rate in our final determinations and the actual complexity of connections, the developer services revenue adjustment mechanism (DSRA) will not take this into account.

South Staffs Water suggests that there should be a mechanism to review the outturn complexity of connections and consider changes where differences are material. South West Water and Severn Trent Water suggest that further dialogue is required into the 2020-25 price control period to ensure that the DSRA reflects performance over the period and the interactions with the RFI are fully recognised (see section 3.8.4).

Our assessment and decision

We consulted on our approach to developer services as part of the PR19 process, which included consultation on this issue. Our conclusions were set out in, 'Our approach to regulating developer services'. Consultation responses raised on this issue do not give us cause to change our approach. As we noted previously:

- the unit rates are company and year-specific and therefore ensure a degree of cost reflectivity by taking account of the forecast mix of connections for each company already;
- ex-ante, our approach is a “fair bet”, that is, the forecast mix of connections implicit in our final determinations unit rate is just as likely to be an over or under-estimate compared to the outturn mix;
- an ex post assessment is likely to be detrimental to customers, since such an assessment would only be initiated by companies if it was in their interests to do so; and
- we only undertook such an exercise at the end of the 2015 to 2020 period since there was no automatic developer services reconciliation mechanism covering the 2015 to 2020 period that we set out in advance.

As noted in the section concerning the Revenue Forecasting Incentive above, we welcome engagement with companies to ensure interactions between our approach to developer services and the RFI are appropriate.

3.10 Bioresources revenue reconciliation model

The model shows how allowed revenue changes based on the difference between outturn and forecast sludge production and corrections for any under or over-recovery of revenue in earlier years. It also shows how we would apply the bioresources forecasting accuracy incentive.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In period	Revenue	Revenue adjustments feeder model	2024-25 FYA CPIH deflated and 2017-18 FYA CPIH deflated	Bioresources	Company-specific wholesale allowed return on capital

3.10.1 Issue 1: Unadjusted revenue input

Respondents' views

United Utilities notes an inconsistency between the level of Unadjusted Revenue (**URt**) set in its 'Notification of the PR19 final determination of Price Controls' and our proposed calculation in the draft PR19 Reconciliation Rulebook; it suggests that companies need to comply with the price control for bioresources activities set in our PR19 final determinations of price controls and therefore the reconciliation should be simplified to use the **URt** set out in the relevant 'Notification of the PR19 final determination of Price Controls' for each company.

Our assessment and decision

We agree with United Utilities that there is an inconsistency between the Unadjusted Revenue (**URt**) in our PR19 final determinations of price controls for bioresources activities and the one derived in the reconciliation model.

We wrote to companies on 24 August 2020 to clarify that each companies' allowed revenue should be calculated in accordance with the price control set out in our final determination. We also said our forthcoming PR19 Reconciliation Rulebook would change to make it clear that the reconciliation at PR24 will be based on companies' final determinations and that there will be no net present value (NPV) adjustment. We noted that this less complicated approach is appropriate and proportionate because it

is consistent with companies' final determinations and an NPV adjustment would in this case generally make very little difference to allowed revenue. We have updated the reconciliation model and accompanying guidance to reflect this change.

3.11 Cost of new debt reconciliation model

For PR19 final determinations we have set an initial allowed cost of new debt of 0.53% in CPIH terms. This allowance is based on our assessment of the average value of our benchmark index over 2020-25, adjusted for an 'outperformance wedge' representing our assessment of the ability of the notional company to outperform this index. We will carry out a reconciliation adjustment as part of PR24 based on the actual evolution of our benchmark index over 2020-25.

We propose that the reconciliation adjustment will be applied to revenues for the 2025-30 period.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2017-18 FYA CPIH deflated	Water Network Plus, Wastewater Network Plus, Water Resources, Bioresources, Dummy	Company-specific appointee allowed return on capital

3.11.1 Issue 1: Unclear interaction between the cost of new debt reconciliation model and the RPI-CPIH wedge model

Respondents' views

Dŵr Cymru argues that the reconciliation rulebook does not outline the relationship between the cost of new debt reconciliation model and the RPI-CPIH wedge model. Dŵr Cymru would like to see the relationship between the two models and how they interact.

Our assessment and decision

The RPI-CPIH wedge reconciliation is a comparison of the final determination against what it would have been if the actual RPI-CPIH wedge had been known in PR19, all other things equal. Therefore we consider it is appropriate to recognise the cost of new debt and RPI-CPIH as independent reconciliations. This avoids the extra complexity entailed with considering interactions.

3.11.2 Issue 2: Tax reconciliation impact of new debt reconciliation

Respondents' views

Northumbrian Water suggests that data and calculations on embedded debt are not needed within the model and should be removed to reduce complexity.

United Utilities suggests that the tax reconciliation impact of the cost of new debt reconciliation should be calculated within the cost of new debt reconciliation model rather than as part of the tax reconciliation mechanism. The company suggests that our proposal of using the former model to provide an outturn cost of debt input to the tax reconciliation mechanism risks double counting.

Our assessment and decision

We affirm our consultation approach of using the post-reconciliation cost of new debt to provide an updated 'overall cost of debt' input to the to the tax reconciliation mechanism. This requires embedded debt inputs to calculate.

There is no adjustment for tax in the debt reconciliation model, so it is not clear how the tax impact from any change in debt rates would be double counted under our approach. We consider it to be clearer and more straightforward to include the tax impact as part of the tax reconciliation tool, rather than build it into the debt reconciliation model.

3.11.3 Issue 3: The model calculates a reconciliation even when the outturn cost of new debt is the same as our final determination estimate

Respondents' views

Northumbrian Water, South East Water, and South Staffs Water raise an issue that the model calculates a reconciliation even when the outturn cost of new debt used for the reconciliation is the same as our final determination estimate. South West Water in their response mention that they support the feature of the consultation model which drives this result (i.e. a straight-line increasing profile for the share of new debt).

Our assessment and decision

We confirm that this scenario is a result of the model working as intended. It is due to the difference in the profile of the new debt as a share of total debt. While both the

financial model and this model assume new debt is on average 20% over the period, the former model uses a constant and fixed 20% assumption across all years. This is in contrast to the latter model's assumption of an increasing straight-line profile. We recognise that this feature may cause a positive or negative reconciliation against the final determination revenue allowance even if the cost of new debt is the same as assumed at final determinations, unless the quantum of notional debt is stable over 5 years.

We assess from analysis of this scenario that the impact of using the reconciliation model's increasing straight-line notional new debt profile would not be material over 2020-25, and is defensible on the grounds that this new debt profile is the more realistic of the two possibilities set out above. We further note that this profile has not been contentious in the run-up to this publication:

- New debt indexation workshop (Jan 2017): [10] Attendees supported the principle of an increasing straight-line profile of new debt being more realistic than assuming all new debt is issued on day one of the new control period.[11]
- PR19 draft methodology consultation (Jul 2017): We published an early iteration of the model including an increasing straight-line profile of new debt as part of the consultation.[12] We received feedback on other aspects of the calculation methodology but not this issue.[13]
- PR19 draft determinations consultation: We published an updated version of the model which still included an increasing straight-line profile of new debt.[14] The issue of new debt profile did not feature in consultation responses.

[10] Ofwat, 'Water 2020: Risk and Return, Cost of debt workshop' 20 January 2017
[11] Ofwat, 'Workshop discussion summary', 20 January 2017, pp. 2-3
[12] Ofwat, 'Consulting on our methodology for the 2019 price review', 11 July 2017
[13] Ofwat, 'PR19 Final Methodology Appendix 15: Responses to our draft methodology', pp. 204-205
[14] Ofwat, 'PR19 Draft Determinations', July 2019

3.12 Gearing outperformance sharing mechanism

Companies and their investors are responsible for the decisions they make about their actual financial structure. However, where companies adopt high levels of gearing, they may reduce financial resilience and transfer some risk to customers and / or potentially taxpayers in the event that a company fails. Therefore, in our 'Putting the sector in balance: position statement', we set out a mechanism where the benefits of high levels of gearing are shared with customers.

The mechanism was updated in our final determinations to include a glide path on the level of gearing which triggers sharing payments. This mechanism is applicable to all companies in 2020-25, with any sharing payments applied in the form of a reconciliation adjustment to revenues at PR24.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2024-25 present value, 2022-23 FYA CPIH deflated	Appointee level calculation applied to the water network plus and wastewater network plus controls.	Company-specific appointee allowed return on capital

3.12.1 Issue 1: Mechanism should use 'Shadow RCV'

Respondents' views

United Utilities raises that the gearing number from the annual performance report table 1E.7 allows net debt to vary each year, but assumes RCV is fixed at the profile forecast set for PR19 final determinations.

The company notes that RCV can vary against its final determination profile due to end-of-period reconciliations or price control re-openers (e.g. an interim determination). The company considers that a gearing calculation using a dynamic RCV which reflects these adjustments (the 'shadow RCV') is liable to be more accurate as a measure of gearing. In the company's view, our consultation approach could result in companies inappropriately triggering sharing payments with a gearing which (on a shadow RCV basis) was lower than our stated trigger gearing level.

The company suggest that the gearing calculation should use 'shadow RCV' (provided in annual performance report table 4C.6), and that this might be achieved through using line 8 ('adjusted gearing') of Table 1e in the Annual Performance Report, noting that this may require additional adjustments to exclude certain RCV adjustments (e.g. ODI performance).

Our assessment and decision

We are not convinced that United Utilities' suggestions would improve the approach we set out for consultation. Firstly, company-derived shadow gearing calculations are themselves subject to forecast error, and secondly, it could dilute incentives to maintain totex within the final determination allowance, which would not be in customers' interests.

The table providing 'shadow RCV' (4C in the Annual Performance Report) is not subject to an audit opinion, and is itself a forecast liable to subsequent revision. This raises the prospect that gearing calculations using shadow RCV from historic performance reports may over time prove inaccurate as a measure of gearing. In addition, using 'adjusted gearing' (line 8 of APR Table 1E) as the input would also import company-specific accounting policies around recognition of debt, potentially introducing further measurement error and resulting in the sharing calculation being inconsistently applied across companies.

Underspending on totex may increase shadow gearing through end-of-period sharing of overspends in the form of a downward RCV adjustment. This means a mechanism based on shadow gearing could distort incentives to deploy totex efficiently. For example, a company might be less incentivised to bear down on totex spending if doing so risked breaching the trigger gearing level for making sharing payments. This issue does not arise under our consultation approach as companies are incentivised to reduce gearing through reducing net debt rather than increasing the RCV.

We have therefore decided to retain the profile of final determination RCV as the basis for the gearing calculation.

3.12.2 Issue 2: Mechanism should use year-end closing RCV

Respondents' views

Northumbrian Water states that the model's gearing input (taken from table 1e of the Annual Performance report) uses year-end RCV from PR19 final determinations inflated using the appropriate CPIH and RPI values. The company states that we have previously published RCV updates only in year-average terms, and that it would not be correct to

use this latter formulation as an RCV input to the model's gearing outperformance sharing calculation.

Our assessment and decision

We confirm that the input for RCV used in the model is March 31 financial year end RCV in nominal/current prices. This is published in our annual RCV updates.

3.12.3 Issue 3: Mechanism should distinguish between debt raised for appointed and non-appointed activities

Respondents' views

Affinity Water and South East Water consider that the model should distinguish between debt raised for the appointed business and non-appointed business, to ensure that the incentive applies to the correct measure of indebtedness.

Our assessment and decision

High gearing secured on companies within the regulatory ring-fence contributes to the risk of financial failure and can also drive gearing outperformance, irrespective of whether it relates to appointed or non-appointed activities. We therefore continue to consider it appropriate to retain our existing definition of gearing.

3.12.4 Issue 4: Mechanism should use wholesale allowed return on capital and allowed return on cost of equity

Respondents' views

South East Water states that the wholesale allowed return on capital and allowed return on cost of equity should be used in the mechanism calculation, rather than the appointee return. The company understands that all gearing is relating to the wholesale element and therefore considers it would be more appropriate to use the wholesale allowed return and allowed return on cost of equity.

Our assessment and decision

Companies raise finance priced on the risks of the appointed business rather than controls (or control groupings), therefore we continue to consider the appropriate discount rate to be the notional CPIH real allowed return on capital reflecting the risks of all controls, which is the appointee allowed return.

3.12.5 Issue 5: Tax allowance for PR24

Respondents' views

South East Water asks if for tax purposes there is an assumption that this adjustment is included within the PR24 tax allowance calculation if a payment from a company is incurred.

Our assessment and decision

We confirm that sharing payments calculated by the model will be reflected as adjustments to revenue for the PR24 (2025-30) control period. Our PR24 policy on tax is not finalised, however we currently expect to reflect negative revenue adjustments in tax which is funded by customers.

3.12.6 Issue 6: Company-specific measures of gearing

Respondents' views

South Staffs Water raises that its adjusted gearing should be used for the mechanism, rather than the unadjusted value. The company has raised the point on many occasions during the PR19 process that its covenant debt should be used to calculate gearing rather than book debt.

The company believes that using covenant debt is more appropriate since it reflects the company's actual debt and is the metric used by the lenders and rating agencies.

Our assessment and decision

We explained the reasoning for our decision in South Staffs Water's final determination.[15]

> "South Staffs Water proposes to use covenanted rather than regulatory gearing for the purposes of the calculation, arguing that our regulatory accounting definition is less relevant to its actual liability position and that using the higher gearing figure based on our definition could damage its credit rating. The company's definition of gearing is specific to its own financing arrangements and is a matter for the company and its investors. South Staffs Water already publishes its own definition of gearing in its annual performance report, therefore we conclude our use

[15] Ofwat, PR19 final determinations: Aligning risk and return technical appendix, December 2019, p. 128

> of regulatory gearing would not affect rating agencies' views in this instance. Overall, we consider that the company has not provided sufficient evidence that its proposed alternative mechanism would deliver equivalent benefits for customers in the round compared to our mechanism."

Our position on the issue remains the same since the company has not provided new evidence in its consultation response, therefore the company has not provided sufficient evidence that its proposed alternative mechanism would deliver equivalent benefits for customers in the round compared to our definition of gearing.

3.13 Tax reconciliation

We consulted on the tax reconciliation mechanism in the PR19 methodology consultation and our final methodology includes a reconciliation mechanism to account for changes in the corporation tax rate and writing down allowances under the capital allowance regime.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2017-18 FYA CPIH deflated	Water Network Plus, Wastewater Network Plus, Water Resources, Bioresources	Company-specific appointee allowed return on capital

In response to consultation responses we have updated the error check calculation in the model to include known PR14 reconciliation differences and we have also made some additions to the user instructions.

3.13.1 Issue 1: Adjustments required as a result of running the debt reconciliation model

Respondents' views

United Utilities raise concerns that including the tax impacts of the change in new debt rates risks double counting of mechanisms. Severn Trent Water thinks that adjusting the tax allowance for the adjustments arising from the cost of debt mechanism is an unnecessary complexity given the immateriality of the adjustment.

Our assessment and decision

There is no adjustment for tax in the debt reconciliation model, so it's not clear how the tax impact from any change in debt rates would be double counted. We consider it easier and more straightforward to include the tax impact as part of the tax reconciliation tool, rather than build it into the debt reconciliation model.

We acknowledge that for some companies the allowed cost of new debt will have limited impact on the tax allowance but as the reconciliation was introduced to ensure companies' allowed revenue is consistent with our view of the efficient new debt cost

allowance over the 2020-25 period, it is necessary to also consider the tax impact. We note that including the new cost of debt involves adjusting three rows of data which we do not consider as unduly complex.

3.13.2 Issue 2: Impact of Covid-19 on corporation tax rates

Respondents' views

Wessex Water asks that the scope of the tax reconciliation tool be extended to cover adjustments relating to revenue recovery through the RFI. Due to the specific circumstances around Covid-19 affecting revenue recovery and possible future tax rate increases, it considers that the mechanism should reflect the re-profiled recovery.

Our assessment and decision

The aim of the tool is to calculate what tax allowance would have been set at PR19, if the applicable corporation tax rates had been known at the time. Tax charges are calculated on taxable profits, so any differences in revenue or cost profiles will impact on the actual tax charge incurred. Attempting to reflect the actual recovery profile would add significant complexity to the tax reconciliation tool. Moreover, such a change may not be the most targeted and timely way to address any financeability concerns. Therefore, we have not extended the scope of the tax reconciliation to reflect the actual revenue recovery profile.

However, as noted in section 1.3.1, we will consider the need for such ex post adjustments to anything set out in our PR19 Reconciliation Rulebook in light of the impacts of Covid-19.

3.14 RPI-CPIH wedge reconciliation model

The RPI-CPIH wedge reconciliation is a comparison of the final determination against what it would have been if the actual RPI-CPIH wedge had been known in PR19, all other things equal. This comparison calculates the annual revenue difference in respect of the RPI-indexed RCV run-off and RPI-indexed RCV return. It also calculates the correct annual closing value of the RPI-indexed RCV.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue and RCV	Revenue adjustments feeder model, RCV adjustments feeder model	2017-18 FYA CPIH deflated	Water resources, Water network plus, Wastewater network plus, Bioresources, Dummy	Company-specific wholesale allowed return on capital

3.14.1 Issue 1: Unclear interaction between the cost of new debt reconciliation model and the RPI-CPIH wedge model

Respondents' views

Dŵr Cymru argues that the reconciliation rulebook does not outline the relationship between the cost of new debt reconciliation model and the RPI-CPIH wedge model. Dŵr Cymru would like to see the relationship between the two models and how they interact.

Our assessment and decision

The RPI-CPIH wedge reconciliation is a comparison of the final determination against what it would have been if the actual RPI-CPIH wedge had been known in PR19, all other things equal. Therefore we consider it is appropriate to recognise the cost of new debt and RPI-CPIH as independent reconciliations. This avoids the extra complexity entailed with considering interactions.

3.14.2 Issue 2: True up on RCV run-off

Respondents' views

United Utilities argues that any variation in the RPI-CPIH wedge should be value neutral as regards the impact on the RCV run-off. The natural rate of RCV run-off is derived from the £m expected value of current cost depreciation (CCD) of assets, and therefore the "natural rate" of RCV run off is a fixed £m figure, rather than a fixed % of RCV. United Utilities considers that any changes in other assumptions on RCV (such as changes in the wedge) would be exactly offset by changes in the % RCV run off required to arrive at the correct £m value. Consequently, United Utilities does not believe it is appropriate for the RPI-CPIH wedge reconciliation to include any component for RCV run off. The model should instead true-up only for the effect of any RPI-CPIH wedge variances in return on RPI RCV and the indexation of the RPI RCV.

Our assessment and decision

The RPI-CPIH wedge reconciliation is a comparison of the final determination against what it would have been if the actual RPI-CPIH wedge had been known in PR19, all other things equal. The comparison calculates the annual revenue difference in respect of the RPI-indexed RCV run-off and RPI-indexed RCV return in order to calculate the correct annual closing value of the RPI-indexed RCV. We therefore continue to consider it is appropriate to include the run-off element in the RPI-CPIH wedge reconciliation.

3.14.3 Issue 3: Full RPI growth up to 31 March 2020

Respondents' views

Wessex Water argues that the current suite of reconciliation models (either those consulted on in the reconciliation rulebook or for the PR19 blind year) will not reconcile the difference in the RPI-CPIH wedge that was forecast in the RCV feeder models. Wessex Water set out calculations to demonstrate that the opening RCV does not include the full RPI growth up to 31 March 2020. Wessex Water's view is that this could be corrected in the blind year reconciliation models which would be preferable to changing (and adding further complexity to) the RPI- CPIH wedge model.

Our assessment and decision

We intend that full RPI growth up to 31 March 2020 is reflected in the opening RCV at PR24. We have reviewed the models used in PR19 final determination, PR19 blind year and those consulted on in the PR19 reconciliation rulebook and agree that further RCV and revenue adjustments are required to reconcile the difference in the RPI-CPIH wedge that was forecast in the RCV feeder models. We also agree with Wessex Water that it is preferable to avoid adding further complexity to the RPI-CPIH wedge model.

We have included extra calculations in the PR19 blind year adjustments model to calculate the further RCV adjustment that will be included as part of the PR24 midnight adjustment. The associated revenue adjustment for the difference in respect of the return companies would have been allowed during the 2020-25 period had the closing 31 March 2020 reflected actual rather than forecast 2019-20 inflation has not been included in the PR19 blind year adjustments model. We will calculate the revenue difference in respect of the return at PR24 and adjust it for the time value of money within an appropriate model in the PR24 modelling suite.

3.15 WINEP/NEP reconciliation model

The purpose of this model is to account for the impact of ministerial decisions on the scale of companies' environmental enhancement programmes where this differs from our assumptions made at final determinations. Chapter 9 and Appendix 11 (Securing cost efficiency) of our PR19 Methodology provides background information.

The model will calculate a change in allowed totex as an adjustment to the RCV for only those schemes listed as amber in the WINEP spreadsheet we used to make our final determinations. The model is not a mechanism to add to companies' totex allowance for any additional environmental requirements that were not listed as amber in the 'Water Industry National Environment Programme' (WINEP) in England, issued on 29 March 2019, and the 'National Environment Programme' (NEP) in Wales, issued on a company specific basis between March and July 2018.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	RCV	RCV adjustments feeder model	2017-18 FYA CPIH deflated	Water Network Plus, Wastewater Network Plus, Water Resources, Bioresources	Company specific wholesale allowed return on capital

3.15.1 Issue 1: Nature of WINEP adjustment (RCV)

Respondents' views

Northumbrian Water, United Utilities, Dŵr Cymru, Southern Water and South West Water agree with our proposal to treat all WINEP adjustments as RCV adjustments.

Portsmouth Water noted that its programme is opex-driven so would want WINEP adjustments to be treated as revenue adjustments.

Severn Trent Water argues that although a 100% RCV based approach for adjustments would deliver simplification, it may offer a less welcome balance of costs between current and future customers. The company suggests an alternative approach using companies' PAYG ratios which it says would be more consistent with the wider totex regime.

Our assessment and decision

Although Portsmouth Water has a largely opex-based environmental improvement programme, no WINEP adjustment is required as it has no amber WINEP schemes. The model is not a mechanism to add to companies' totex allowance for any additional environmental requirements that were not previously listed as amber.

Our proposal, to treat 100% of WINEP adjustments as an adjustment to the RCV, will simplify the calculations. Since the majority of proposed enhancement expenditure is capex we do not consider a more complex calculation to be justified.

3.15.2 Issue 2: Input of WINEP schemes to the model

Respondents' views

Severn Trent Water draws attention to the unique design of its WINEP-related incentives. WINEP points are earned which are linked to outcomes rather than schemes. It notes that one of the model inputs required is the 'expected points as a percentage of approved points'. It suggests that the two numbers, expected points and approved points, should be input separately which would make it easier for the company and Ofwat to assure the inputs.

Thames Water requests further clarification in the model user guide on the steps required to input the necessary list of WINEP sites to the model.

United Utilities states that it would prefer the model to be pre-populated with the WINEP inputs.

Our assessment and decision

We recognise the unique characteristics of Severn Trent Water's WINEP-related incentives. Other companies have a variety of different units for WINEP incentives and the model has been developed to work in the same way for all companies. To achieve this the company-specific WINEP input data must be mapped across to a consistent format. We successfully tested this approach for several companies and for a wide range of the units used by other companies. Severn Trent Water is correct to state that in its case we will need to input both the number of points allocated to the scheme at the final determinations and the actual number of points that will be delivered. We will adjust the model so that the same inputs are used for all companies and the percentage difference will be calculated by the model.

Thames Water notes that the model user guide assumes that the list of WINEP schemes input to the model is the list that was available at the final determinations. We will update the user guide to specify that the schemes required as model input are those

that were amber in the PR19 final determination WINEP workbook but which are confirmed in December 2021 to be delivered. We make an adjustment for amber schemes that are not delivered and an opposite adjustment for amber schemes that are to be delivered but which weren't costed in our final determinations. We will expand the user guide to provide more clarity on how to input WINEP schemes to the model.

A wide range of different units have been used by the companies to quantify the WINEP schemes. Bespoke adjustments are required to map from the company units to those used within the WINEP reconciliation model. We will consider whether it would be possible to pre-populate the model with the WINEP inputs for all companies.

3.15.3 Other feedback

United Utilities warns that there is a risk of overstating the reduction to totex required by the WINEP reconciliation if the time value of money adjustment were to be applied in the WINEP reconciliation model and also in the cost reconciliation model. The WINEP reconciliation model calculates the WINEP reconciliation with and without an adjustment for the time value of money. We will adjust the baseline totex in the cost reconciliation model without first adjusting the WINEP reconciliation for the time value of money. In PR24 we will adjust the RCV by the WINEP reconciliation having first adjusted the WINEP reconciliation for the time value of money.

3.16 PR19 water trading incentive model

This model calculates PR19 water trading incentives for qualifying trades starting in 2020-2025.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue	Revenue adjustments feeder model	2017-18 FYA CPIH deflated	Water network plus, Water resources	Company-specific wholesale allowed return on capital

3.16.1 Issue 1: Treatment of forecast revenues

Respondents' views

Southern Water agrees in principle with the procedure of netting-off expected revenues at the start of the period and the company receiving half of the economic profit at the end of the period. However, the company notes that as bulk supply agreements usually have a volume related element, this mechanism requires a reconciliation mechanism for actual revenue and for the volume used.

Our assessment and decision

This reconciliation is aimed at water trades which are not included in the PR19 business plan but materialise over the course of the price control period and subsequently become eligible for PR19 water trading incentives. For all other trades, exporting companies forecast the potential bulk supply revenues in their business plan and we net them off the relevant price controls (water resources and/or water network plus).

Our policy intention is to treat trades that materialise after the conclusion of the PR19 process the same as pre-existing trades. Therefore, the consistent treatment is to net-off the forecast bulk supply revenues from future water trading incentive claims rather than the actual bulk supply revenues. The actual bulk supply revenues for the period in which the water trade is active in 2020-25 will separately influence the size of the NPV of the total lifetime economic profits of the export and therefore the size of the PR19 water trading incentive claim at PR24.

3.16.2 Issue 2: Consistent parameters

Respondents' views

Portsmouth Water notes the need for consistency in the water trading incentive claims parameters between the exporting and importing companies and suggests Ofwat could be more explicit in requiring this.

Our analysis and decision

We agree that the parameters should be consistent on both sides of the trade. This is essential in order to:

- calculate the appropriate forecast bulk supply revenues to net-off for the exporter / include in business plan cost proposals for the importer (we have already undertaken this); and
- ensure any subsequent PR19 water trading incentive claims at PR24 are claimed on the same basis i.e. the outturn bulk supply revenues of the exporter should match the outturn cost of the importer.

We have clarified this requirement further in 'PR19 reconciliation rulebook: guidance document'.

3.17 Land sales

The land sales model calculates the adjustment to the RCV for any disposal of land by the regulated business in the years from 2020-21 to 2024-25.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	RCV	RCV adjustments feeder model	2017-18 FYA CPIH deflated 2022-23 FYA CPIH deflated	Water resources, Water network plus, Wastewater network plus, Thames Tideway Tunnel (TTT)	Company-specific wholesale level allowed return on capital

3.17.1 Issue 1: Forecast land sales at PR19

Respondents' views

Under Thames Tideway's licence, customers should receive 100% of the net proceeds or losses for lands sales relating to the TTT control. For Thames Water to calculate the land sales adjustment for the TTT, it would require the land sales forecast in the PR19 final determination. However, Thames Water notes the following inconsistency in the PR19 Final Determination for the level of land sales forecast for the TTT:

a) Annex 1 of the 'Notification of the PR19 final determination of Price Controls for Thames Water' notes that "the value attributable to Relevant Disposals of Land allowed for in making the determination is zero";

b) The Thames Water Final Determination document included non-zero levels of land disposals, for example as documented in Table 3.7 (page 50).

Given this ambiguity, Thames Water asks Ofwat to clarify how the adjustment for TTT land sales should operate to ensure that any adjustment reflects 100% of the difference between the actual net proceeds and those assumed in the PR19 final determinations. This will ensure that, overall, customers will experience 100% of the actual net proceeds.

Our assessment and decision

In section 2.18.3 of our PR19 Reconciliation Rulebook Consultation – reconciliation model guidance (March 2020) we noted that in companies' 'Notification of the PR19 final determination of Price Controls' Ofwat gave notice, for the purposes of the PR19 final determinations, that for each of the five consecutive charging years starting on or after 1 April 2020:

- the value attributable to relevant disposals of land allowed for in making the determination is zero; and
- variations in value received or expected to be received from relevant disposals of land shall constitute a relevant change of circumstance.

We confirm that Annex 1 of the 'Notification of the PR19 final determination of Price Controls' for Thames Water contained an error because it did not reflect the value attributable to relevant disposals of land allowed for in determining Thames Water's price control for sewerage services for the Thames Tideway Tunnel project (the TTT price control). However, we included forecast land sales income as negative totex when setting the TTT price control. Table 3.7 of PR19 final determinations: Thames Water final determination correctly sets out the forecast land sales income.

3.17.2 Issue 2: Net proceeds

Respondents' views

Portsmouth Water notes that this model has effectively been in operation for many years. It states that Ofwat need to be clear how the value of Net Proceeds is agreed with the company. It says its experience suggests that it can take some time for both the company and Ofwat to agree significant transactions.

Our assessment and decision

The reporting requirements for land sales proceeds are set out in the Regulatory Accounting Guidelines (RAGs) and reported annually in the Annual Performance Report (APR). In general, we do not think that there will be many issues encountered by companies in reporting the value of Net Proceeds in the APR. However, we recognise that more complicated issues could arise when there are multiple land 'swaps' to enable relocation of operations, which may also overlap price control periods. However, rather than setting out all eventualities, we believe the best approach is for companies to engage with us early on potential issues so that we can discuss and address.

3.18 Strategic regional water resources

This model reconciles revenue allowances for the strategic regional water resource options. The reconciliation accounts for the extent of progression of strategic options through the gated approval process. More information about our final approach to strategic options is set out in 'PR19 final determinations – Strategic regional water resource solutions appendix'.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue and RCV	Revenue adjustments feeder model	2017-18 FYA CPIH deflated	Water network plus, Water resources	Company-specific wholesale allowed return on capital

3.18.1 Issue 1: Split of Revenue to RCV

Respondents' views

Thames Water and United Utilities argue that any adjustment to return money to customers should be made 100% to the RCV, rather than split between revenue and RCV because all totex allocated to strategic regional solutions was funded through capital expenditure at the final determination. Therefore, customers should get the funds back in the same manner as they would pay for the work to develop strategic regional solutions over the price control period.

Our assessment and decision

Our decision is to apply the same profile of the PR24 end-of-period adjustment between revenue and RCV as the opex/capex split profile of the final totex funding provided for strategic options in our final determination. This is 100% capex for the two companies. However, the opex/capex split differs for some companies that received funding for strategic regional water resources solutions. We will use each company-specific strategic options opex/capex split to calculate the revenue/RCV adjustment proportions, therefore ensuring that funding will be returned to customers in the same manner in which it was originally provided.

3.18.2 Issue 2: Approach to modelling

Respondents' views

United Utilities points out the importance of splitting the different pots of totex for totex sharing purposes, to assist companies in ring-fencing totex related to strategic solutions that were not funded in our final determinations from other wholesale expenditure. It also queries the need for all solutions for all companies to be in a single reconciliation model.

South West Water calls for further clarity on whether each company should submit the model, recognising that the consolidated position for every solution might be different.

Severn Trent Water supports our approach of sharing an illustrative model and welcomes further engagement on the final model at the time when all policy elements and the final set of solutions and participants become clear.

Our assessment and decision

The main benefit of having all solutions in one model is that we will be able to net off a multitude of adjustments for each company and have a single "one-stop-shop" for the overall changes and status of industry funding for strategic regional water resources solutions. We consider that this is preferable to having models per solution or per company which have to feed into further modelling to aggregate adjustments.

We set out in PR19 final determinations: Securing cost efficiency technical appendix that totex allocated for strategic solutions is separate to that allocated to other wholesale activities and is therefore outside of general cost sharing. We agree with United Utilities that the distinction should be made clear and have responded to this point in the Costs reconciliation chapter (see section 3.1.6).

We consider that each company should submit the model separately. We will aggregate the partial submissions of each company into a single industry model.

As set out in our draft PR19 Reconciliation Rulebook, we recognise that further work in finalising some policy elements (e.g. around delivery incentives) and the final set of solutions and participants will impact the reconciliation model. That is why we will publish the full reconciliation model with all solutions and all participating companies once these become clear around the deadline for gate three submissions in summer 2023.

3.18.3 Issue 3: Time value of money application

Respondents' views

Thames Water and United Utilities consider that we assumed companies get all funding in 2020-21 for the purposes of making time value of money adjustments. They state that strategic solutions funding has a different profile throughout the price control period broadly equivalent to the proportion of funding allocated to each gate. Therefore, they propose using this profile for time value of money adjustments.

United Utilities suggests that the time value of money adjustment should not be applied as a revenue-only adjustment as this would be inconsistent with other totex models (i.e. WINEP and totex sharing model). It also challenges the method of discounting, arguing that discounting should be to 2024-25 to be consistent with other reconciliation models.

Our assessment and decision

We agree with the company representations. Our updated approach is to:

- use the profile of strategic regional water resources spend in the final determination for the purposes of calculating time value of money;
- apply the time value of money adjustment to revenue and RCV using the same proportions as the opex/capex split for the funding of strategic regional water resources in our final determinations, rather than fully to revenue; and
- discount to 2024-25 i.e. a solution that does not progress beyond gate 1 (and is therefore abandoned in July 2021 for standard gate submissions) accrues three years of time value of money rather than four as in our approach at consultation.

Further details on the approach to time value of money application is given in the model guidance.

4. Company-specific reconciliations

4.1 Bilateral entry adjustment

The Bilateral entry adjustment (BEA) model shows how we will adjust relevant companies' revenues should bilateral entry in the water resources market occur.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
In-period	Revenue	PR19 Revenue forecasting incentive model	2017-18 FYA CPIH deflated	Water Resources	n/a

4.1.1 Issue 1: Clarification that the BEA does not apply to all companies

Respondents' views

Northumbrian Water notes that our draft guidance points towards companies' 'Notification of the PR19 final determination of Price Controls', but that this was incorrect in its case and go on to make a number of related comments. Severn Trent Water notes that, since its plan did not require new capacity to be delivered until the 2025-30 period, it understands that there could be no BEA adjustment until that point.

Our assessment and decision

The BEA only applies to English companies with a positive post-2020 capacity. Where this is the case, the details of the BEA adjustment is set out in 'Notification of the PR19 final determination of Price Controls'.

The BEA would apply to: Affinity Water, Anglian Water, Portsmouth Water, Southern Water, South East Water, South Staffs Water, Thames Water and Yorkshire Water.

We are re-classifying this reconciliation as 'company specific', rather than 'common', to make it clear that it does not apply to all companies.

We have considered Northumbrian Water's related comments and consider we do not need to change our approach. Given we are clarifying that the BEA does not apply to

Northumbrian Water, we do not address some of its related concerns here. If the company still has concerns though we are happy to engage with it.

4.1.2 Issue 2: Equalisation payment

Respondents' views

Severn Trent Water is concerned that there could be double counting between the equalisation payment and the BEA. This is because it was envisaged that companies would pay the equalisation payment to the new entrant, but the BEA also effectively gets returned to customers because it affects the RFI.

Our assessment and decision

We agree in principle that there should be no double counting. The calculation of the equalisation payment would ultimately depend on having clarity on the arrangements for bilateral markets. We recognise that there is still further work required on the equalisation payment to inform the appropriate adjustment and how this payment is treated in relation to companies' revenue control. We will review the interaction between the BEA and RFI as appropriate when this is further progressed. If necessary we will update the rulebook accordingly.

4.2 Business retail controls for Welsh companies

We received one response from Dŵr Cymru and note its support for our proposed approach relating to the business retail controls. We still consider that this approach is appropriate and therefore plan to implement this.

4.3 Notified Item for Bristol Water relating to Gloucester and Sharpness Canal abstraction charges

We received no comments from Bristol Water relating to the Gloucester and Sharpness Canal abstraction charges. The process as proposed will apply unless any changes are subsequently required to reflect the CMA's re-determination of Bristol Water's price controls.

4.4 Havant Thicket reconciliation model

The Havant Thicket reconciliation model applies adjustments to the revenue allowances and RCV balances that Portsmouth Water receives in relation to the Havant Thicket Winter Storage Reservoir. Further information about our approach to the Havant Thicket price control can be found in PR19 final determinations: Havant Thicket appendix.

Timing of adjustment	Nature of adjustment (RCV, Revenue, or both)	Which model(s) is this model outputting to?	What is the price base of the output?	What PR19 revenue controls does it affect?	What allowed return on capital does the model use?
End of period	Revenue and RCV	PR29 RCV and Revenue adjustments feeder models	2017-18 FYA CPIH deflated and 2029-30 FYA CPIH deflated	Havant Thicket Activities	Wholesale allowed return on capital

4.4.1 Issue 1: Trading and Procurement Code

Respondents' views

The company notes that the modelling checks of whether the company has a trading and procurement code happen after the economic profit calculations and question whether these should happen at an earlier stage.

Our assessment and decision

The trading and procurement checks represent a process point – unlike other trades, the Havant Thicket reservoir and the associated water trade has been subject to assessment in our final determinations. Therefore, we are satisfied that the trade would meet the relevant requirements and will work with Portsmouth Water to ensure that the company submits an updated trading and procurement code which confirms that the requirements are met.

If the trading and procurement checks are not met then customers will receive the entire economic profit. In this situation, the other calculations in the model will still be necessary to ensure this level of economic profit is correct.

4.4.2 Issue 2: Time value of money

Respondents' views

Portsmouth Water notes that the final version of the model includes a time value of money adjustment which might be significant where there are large variances against totex allowances early in the 2020-30 price control period.

Our assessment and decision

The time value of money adjustment is applied as standard in the other reconciliation models that apply totex sharing (totex sharing model and the strategic regional water resources model). We consider that a consistent approach should be applied to this model.

4.4.3 Issue 3: Totex clawback

Respondents' views

The company queries the totex clawback and whether it will only cover the capex related to construction of the Havant Thicket reservoir, excluding the operating expenditure of maintaining the bulk supply transfer. It also notes that the consultation suggests the company's share of economic profits and the totex sharing rate, both at 50% are not final and are still subject to change.

Our assessment and decision

The volumetric adjustment we implemented in the final determination ensures that if the trade does not commence by the end of March 2030, the reconciliation model will remove the underlying opex allowance in 2028-29 and 2029-30. The percentage of the construction project that is not delivered is then assessed against the profile of the capex allowance to calculate the required totex clawback. We use the 'totex clawback' term to be consistent with the term used in similar mechanisms elsewhere in our outcomes framework. We are now implementing this by adjusting totex after the volumetric adjustment is applied so that it is more transparent that a capex clawback occurs.

We can also confirm that the company share of the NPV of economic profits is fixed at 50%, consistent with our wider PR19 water trading incentives policy.

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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