

July 2022

Creating tomorrow, together:  
consulting on our methodology for PR24

# Appendix 13 – Data and modelling

## About this document

This document sets out further details of the models that we will use as part of the PR24 process. It covers:

- our proposed approach to modelling at PR24 (section 1); and
- our assessment of reconciliation mechanisms that would be in place for 2025–30 (section 2).

Many of the models have already been shared with stakeholders, for example, we have published a draft financial model alongside our draft methodology. All but two of the PR19 reconciliation models, which will be applied as part of the PR24 determinations, have previously been published alongside the PR19 reconciliation rulebook. The further models described in this appendix will become available as we move through the PR24 process with our base cost models due to be published for consultation in spring 2023.

Data populating these models will be collected using [business plan tables](#). More information on the business plan tables is available in chapter 10 of our consultation document.

# 1. Approach to PR24 modelling

## 1.1 Introduction and background

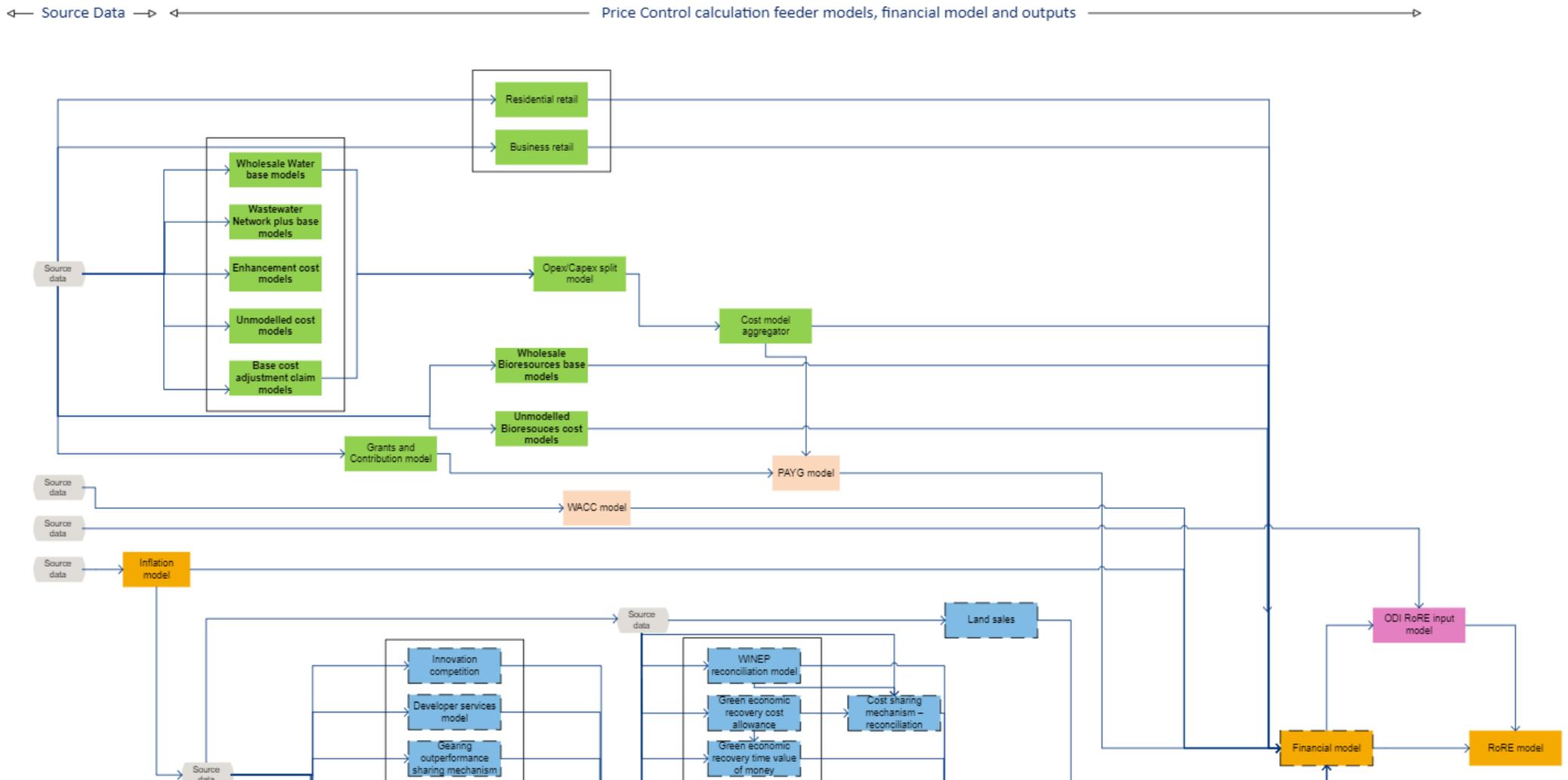
We are proposing to use a number of data models to calculate water companies' price controls. We need specific information from companies and statistical sources to populate these models.

Figure 1.1 below sets out the models we anticipate using to set the PR24 final determinations for all companies in England and Wales for the 2025-30 period.<sup>1</sup> In particular, it highlights their interactions and dependencies.

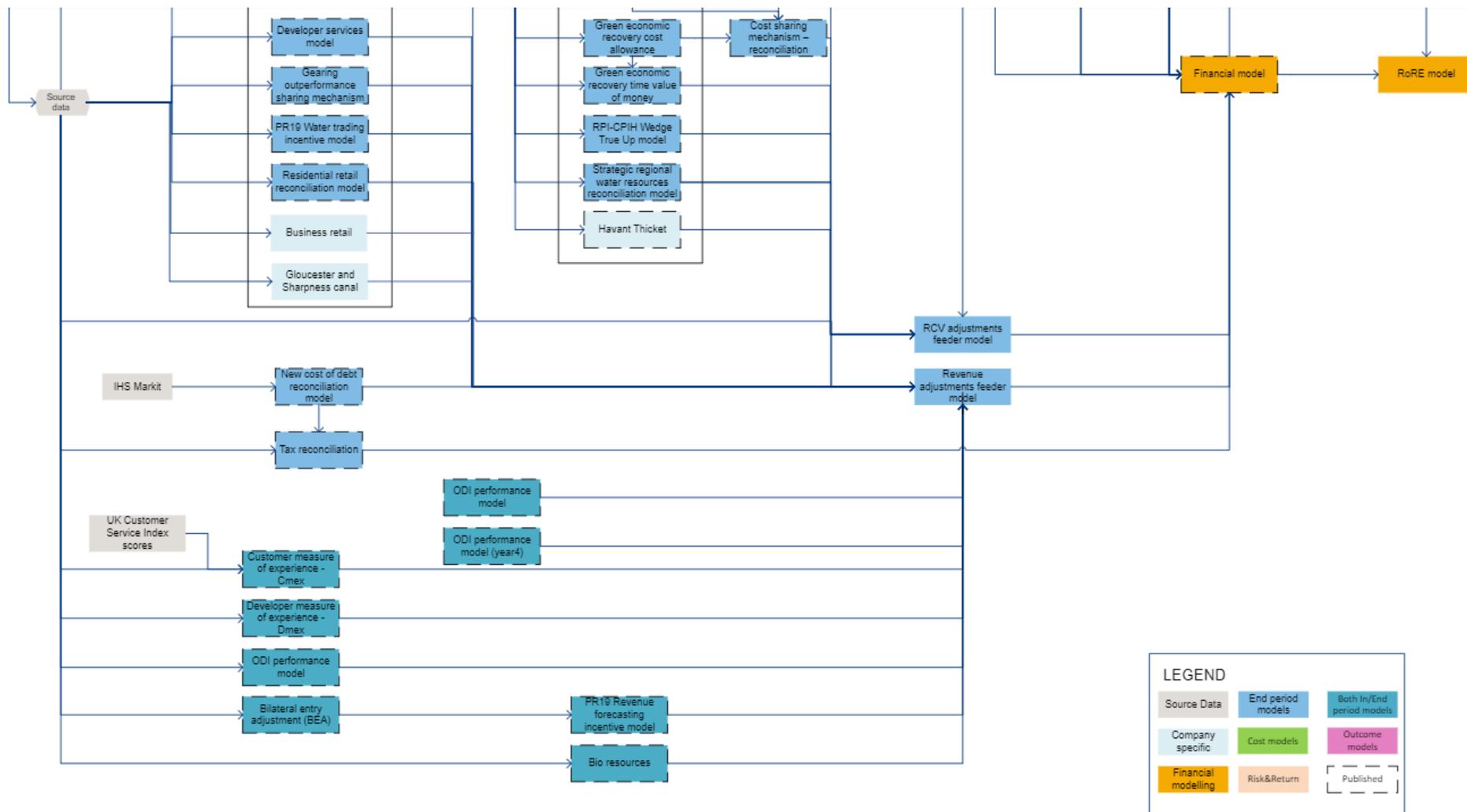
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<sup>1</sup> We have also published a standalone version of our [model suite diagram](#) as shown in figure 1.1

Figure 1.1: Overview of proposed PR24 modelling



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 Appendix 13 – Data and modelling



## 1.2 Cost assessment models

The aim of cost assessment models is to set efficient totex allowances, informed by companies' business plan submissions.

Below is a list of models we anticipate using at PR24, which are also shown in Figure 1.1 above. These models are subject to change. We plan to publish a base cost modelling consultation in spring 2023, which we envisage will include a selection of econometric base cost models and accompanying excel files. The remaining models will be published during the price review process.

Further details on our approach to cost assessment can be found in Chapter 6 of our consultation document. The models cover different cost types as well as different parts of the supply chain in the water sector:

- **Wholesale water base cost model(s)**: a suite of models that produce our efficient wholesale water base cost allowances.
- **Wholesale wastewater base cost model(s)**: a suite of models that produce our efficient wholesale wastewater base cost allowances.
- **Unmodelled base costs model(s)**: a suite of models that set out our assessment and allowance for operating costs not included in our base cost models. For example, business rates. See [Appendix 9 – Setting expenditure allowances](#) for more details.
- **Enhancement feeder models**: a suite of models that produce our efficient wholesale enhancement cost allowances.
- **Cost adjustment claims feeder model(s)**: these models include our assessment of companies' cost adjustment claims.
- **Wholesale bioresources cost model(s)**: calculates the efficient revenue allowance per unit of sludge production.
- **Unmodelled bioresources costs model(s)**: a suite of models that set out our assessment and allowance for operating costs not included in our bioresources econometric models. For example, business rates. See [Appendix 4 – Bioresources control](#) for more details.
- **Grants and contributions model**: calculates the grants and contributions that input into the financial model.
- **Residential retail model(s)**: a suite of models that produce our efficient residential retail cost allowances.
- **Cost model aggregator**: will aggregate information from our cost assessment models for use later in our modelling process.
- **Opex/capex split model**: splits our efficient total expenditure allowances into operating expenditure (opex) and capital expenditure (capex).

## 1.3 Financial models

To set revenues at PR24, we have developed a new [PR24 draft financial model](#). The new financial model is an evolution of the PR19 model. It takes inputs from the other models in the suite and converts them into a number of key outputs for the price review. It determines the:

- wholesale price controls;
- revenues arising from the retail price controls;
- financeability of the companies by calculating financial metrics around a notional capital structure; and
- indicative household bills.

The model is built around an efficient company with a notional capital structure. It calculates the financial metrics used in the financeability assessment before taking account of the revenue impact of any adjustments relating to the previous price control periods. The allowed revenues and indicative bills in the model are shown after the application of these revenue adjustments. A draft PR24 financial model has been developed and published alongside the draft methodology. We welcome comments and views on the draft model.

## 1.4 Risk and return models

We propose three models for risk and return. They are a Cost of Capital model, a Pay-As-You-Go (PAYG) model and a Return on Regulatory Equity (RoRE) model.

- **Cost of Capital model** will calculate our allowed return on capital, based on point estimates of parameters. It will provide the inputs for the PR24 financial model to generate the allowed revenue for financing costs in the wholesale controls. Further information on our proposed approach can be found in [Appendix 11 – Allowed return on capital](#).
- **Pay As You Go (PAYG) model** will calculate the PAYG rates taking account of any changes in opex and capex in our totex allowances and financeability. PAYG rates determine the proportion of totex allowances companies recover in each year ("fast money"). For further information on our proposed approach to PAYG see Section 5.1 of [Appendix 10 – Aligning risk and return](#).
- **Return on Regulatory Equity (RoRE) model** will calculate the forecast RoRE risk ranges against the base return on regulatory equity. At PR19 this was included as part of the financial model but to improve useability we propose to build a standalone model at PR24. Further details on our proposed approach to RoRE can be found in Chapter 7 of our consultation document and Section 1.2 of [Appendix 10 – Aligning risk and return](#).

## 1.5 Outcome models

In line with how we decide to estimate and present ODI risk at PR24 (see Section 5 of [Appendix 8 – Outcome delivery incentives](#)), we may produce an ODI RoRE input model. It will use annual regulatory capital value (RCV) data from the PR24 financial model, and feed into the overall RoRE model to generate ODI RoRE ranges.

We may produce additional analytical models that show our policy interventions during the determinations phase of PR24 in 2023 and 2024.

We expect to replicate and revise the reconciliation models currently in use for the 2020–25 period, accounting for policy developments and learnings from the in-period determinations process. See Section 2 for further details.

## 1.6 Past performance reconciliation models

At PR24 we will need to reconcile companies' 2020–25 expenditure and performance against the allowances and commitments set in their PR19 final determinations. We set a series of incentive mechanisms and reconciliation mechanisms at PR19 in order to do this, which we will apply in PR24.

Full details of the reconciliation models can be found in the [PR19 Reconciliation Rulebook](#). Table 1.1 below summarises the purpose of the models and indicates which apply in-period, which are end of period and which are both in-period and end of period.

**Table 1.1 – Summary of the PR19 reconciliations**

Reconciliation	Summary of the reconciliations' purpose
<b>In-period reconciliations</b>	
<b>In-period adjustments</b>	This adjusts price controls to reflect in-period outcome delivery incentives including the customer measure of experience (C-MeX) and the developer services measure of experience (D-MeX). It also sets out any allowed deferral, abatements or other adjustments that may have been determined during the in-period determinations.
<b>Revenue forecasting incentive (RFI)</b>	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. The RFI is applied to the network plus, water resources and Thames Tideway controls. <a href="#">Appendix 7 (wholesale revenue incentives) of our PR19 Methodology</a> provides background information with further changes available in <a href="#">our PR19 final determination</a> .
<b>Customer measure of experience – C-MeX</b>	The <a href="#">customer measure of experience</a> (C-MeX) incentivises 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.

<b>Developer measure of experience – D-MeX</b>	The <a href="#">developer services measure of experience</a> (D-MeX) incentivises 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.
<b>Bilateral entry adjustment (BEA)<sup>2</sup></b>	This adjusts relevant companies' revenues should bilateral entry in the water resources market occur during 2020-25.
<b>Bioresources revenue reconciliation</b>	This adjusts bioresources revenue over 2020-25 and applies a forecasting accuracy incentive.
<b>In-period and end-of-period reconciliations</b>	
<b>Outcome Delivery Incentive (ODI) performance</b>	This reconciles the outcome delivery incentives (ODI) payments that have been accrued by companies in each year of performance, based on the performance commitments set in the PR19 final determinations.
<b>End-of-period reconciliations</b>	
<b>Residential retail reconciliation</b>	This will reconcile residential retail revenues over the PR19 period at PR24, adjusting the total revenue allowance for actual customer numbers
<b>PR19 Water trading incentive</b>	This calculates revenue adjustment at the end of the period for any water trading incentives due for qualifying trades starting in 2020-25.
<b>Developer services revenue adjustment mechanism</b>	This reconciles actual with forecast developer services revenues within the network-plus control at the end of the period.
<b>Water industry national environment programme (WINEP) reconciliation</b>	This adjusts RCV at the end of the period for ministerial decisions on the scale of companies' environmental enhancement programmes where this differs from our assumptions made at PR19 final determinations.
<b>Cost of new debt reconciliation</b>	This indexes the cost of new debt by reference to a market benchmark in 2020-25, with an end of period reconciliation adjustment.
<b>Gearing outperformance sharing mechanism</b>	This calculates an end of period revenue adjustment from gearing outperformance sharing payments for highly-g geared companies.
<b>Cost reconciliations</b>	This reconciles actual company performance against the totex allowances from PR19 and makes revenue and RCV adjustments at the end of the period.
<b>Tax reconciliation</b>	This true-up mechanism makes an end of period revenue adjustment to take account of any changes to corporation tax or capital allowance rates.
<b>Land sales</b>	This calculates the adjustment to the regulatory capital value (RCV) for any disposal of interests in land by the regulated business in the years from 2020-21 to 2024-25.
<b>RPI-CPIH wedge reconciliation</b>	This adjusts for the difference between the actual RPI-CPIH (measures of inflation) wedge observed over the price control period, and the RPI-CPIH wedge included in the final determination.
<b>Strategic regional water resources reconciliation</b>	This reconciles revenue allowances for the strategic regional water resource options, accounting for the efficient spend and extent of progression of strategic options through the gated approval process set at PR19.
<b>Innovation fund and competition</b>	This calculates the total amount of unused funds to be redistributed to individual companies' customers.
<b>Green economic recovery reconciliation</b>	This consists of three models – <a href="#">the Green recovery cost allowance adjustment model</a> , <a href="#">the cost sharing total costs reconciliation model</a> and the <a href="#">Green recovery</a>

<sup>2</sup> The published Bilateral entry adjustment (BEA) and Water industry national environment programme (WINEP) reconciliation models are currently illustrative models only

	<a href="#">time value of money adjustment model</a> . These models allow reconciliation of the additional package of investment agreed in July 2021 to support the Green Economic Recovery at PR24.
<b>Business retail controls (Dŵr Cymru and Hafren Dyfrdwy only)</b>	This applies to the two companies, Dŵr Cymru and Hafren Dyfrdwy, that operate wholly or mainly in Wales where business customers using less than 50 megalitres a year cannot change supplier. This model reconciles ODI outperformance and underperformance payments based on how companies performed against their performance commitment levels. The ODIs will be reconciled through each company's business retail control via a common increase across each of the appointee's default tariffs. This will be achieved by a change in the allowed average retail cost component of the price controls, ensuring no undue focus on a subset of customers.
<b>Company-specific reconciliation</b>	
<b>Havant Thicket</b>	This reconciles revenue allowances for the activities related to the Havant Thicket reservoir. The PR19 rulebook envisages adjustments arising from the cost of new debt and tax reconciliations for the 2020-25 period will be applied at PR24 with the remainder of the reconciliation undertaken at PR29. Havant Thicket is also subject to a Cost Adjustment Mechanism, which will adjust certain cost allowances for the project at PR24 following the outturn of the procurement process. The cost of new debt indexation reconciliation, tax reconciliation adjustments and outcome of the Cost Adjustment Mechanism will collectively determine the revised building blocks of the calculation of the Havant Thicket control.  We continue to work with Portsmouth Water (PRT) to develop the Havant Thicket reservoir and keep the mechanics of the reconciliation under review.
<b>Gloucester and Sharpness canal</b>	This applies only to Bristol Water. It will only apply in the event of an interim determination that refers to the Notified Item in respect of the uncertainty associated with charges from the Canal and River Trust (CRT) for abstraction from the Gloucester and Sharpness Canal. Costs associated with these charges come under the Water Resources price control for Bristol Water.

In Chapter 10 of our consultation document, we set out our proposed approach to applying RCV and revenue adjustments for the PR19 reconciliation models during the 2025-30 control period. Table 1.2 summarises the adjustments produced by each of the past performance incentive mechanisms and the price controls we propose to apply them to.

**Table 1.2: Applying past delivery adjustment to price controls**

Type of adjustment	Price control						
	Water resources	Water network plus	Wastewater network plus	Bio-resources	Additional control	Residential retail	Business retail <sup>3</sup>
<b>Revenue adjustments</b>							
RFI	✓	✓	✓		✓		
C-MeX						✓	
D-MeX		✓	✓				
BEA	✓						
Bioresources				✓			

<sup>3</sup> Only relevant for Dŵr Cymru and Hafren Dyfrdwy.

Residential retail						✓	
Business retail							✓
Water trading	✓	✓					
Developer services		✓	✓				
Cost of new debt	✓	✓	✓	✓	✓		
Gearing out-performance		✓	✓				
Green recovery costs	✓	✓	✓	✓			
Tax	✓	✓	✓	✓	✓		
Innovation	✓	✓	✓	✓			
Gloucester and Sharpness canal	✓						
<b>RCV adjustments</b>							
WINEP / NEP	✓	✓	✓	✓			
Land sales	✓	✓	✓		✓		
<b>Revenue and RCV adjustments</b>							
ODIs	✓	✓	✓	✓	✓	✓	✓
Green recovery (TVM)	✓	✓	✓	✓			
Totex costs	✓	✓	✓		✓		
RPI-CPIH wedge	✓	✓	✓	✓	✓		
Strategic regional water resources	✓	✓					
Havant Thicket					✓		

At PR24, we will also make some adjustments for the 2019–20 blind year. Many of the PR14 reconciliation mechanisms in place for 2015–20 needed data for the last year of the price control period, 2019–20, to assess the final benefit for customers or for companies.

When PR19 was completed, the 2019–20 financial year had not finished, so companies made a forecast of 2019–20 performance, which we considered, assessed and included in the PR19 final determination. We then updated our PR14 reconciliation analysis, using the complete information and companies' final audited, actual reported performance for the whole 2015–20 period in 2020. We published our final decisions on the 2019–20 blind year adjustments in 2020 on our [website](#).

Some, but not all, of the required adjustments will be implemented in-period during the 2020-25 period. Table 1.3 summarises which adjustments will have already been made and which will apply at PR24.

**Table 1.3 – When 2019-20 blind year adjustments are applied to price controls**

Type of 2019-20 blind year adjustment	When it applies
ODI revenue adjustments	In 2021-22 via an in-period price control determination
Water revenue forecasting incentive mechanism (WRFIM) revenue adjustments	Across 2021-22, 2022-23, 2023-24 and 2024-25 applied through the Revenue Forecasting Incentive (RFI) formula blind year adjustment
Water trading revenue adjustments	
Totex menu revenue adjustments	
Other revenue adjustments	
Residential retail revenue adjustments	At PR24 captured as an end-of-period blind year adjustment in the Residential Retail model
Totex menu RCV adjustments	At PR24 flowing through the 2025-30 price controls
Land sales RCV adjustments	
ODI RCV adjustments	
Other RCV adjustments	
2019-20 RPI-CPIH wedge RCV adjustments	

### 1.6.1 Feeder models for 2019-20 blind year and PR19 reconciliation models

We propose using two feeder models to take the outputs from the 2019-20 blind year and PR19 reconciliations and convert them for use in the financial model. These are the revenue adjustments model and RCV adjustments model.

The first will profile the revenue adjustments in the 2025-30 price controls and direct the profiled revenue adjustments to the right price control in the financial model. The second will direct the RCV adjustments from the reconciliations into the right price controls.

The business plan tables provide the forecast performance data for each of the PR19 reconciliation models. We expect companies to publish their populated PR19 reconciliation models.

The PR19 reconciliation models use actual expenditure and performance from the APR tables and forecasts from equivalent business plan tables. The APR collects data in outturn (nominal) prices whereas the business plan collects forecasts in 2022-23 base year prices. Where the PR19 reconciliation models require inputs in a different price base to the business plan forecast values, we expect companies to convert the forecasts to the required price base using the inflation details in [business plan table](#) PD1.

Some of the PR19 reconciliation models calculate in 2017-18 prices and others in outturn (nominal) prices. The outputs from these models will be used in the PR24 financial model, which uses 2022-23 prices. We will convert the adjustments output from the reconciliation models to the correct price base for the financial model in the new feeder models.

## 2. Proposed PR24 reconciliation models

This section sets out our current proposals for the PR24 uncertainty and incentive mechanisms to be in place during the 2025–2030 control period. This section does not apply to the PR19 reconciliation models that are required for reconciling performance across 2020–25 for PR24.

### Introduction and background policy

Our regulatory framework assigns risk between customers, companies and their investors, with a view to allocating risk to the entity that is best placed to manage it. This has led us over time to develop our existing framework of uncertainty mechanisms, which cover:

- **reconciliations:** which protect companies and customers against the risk of forecasting uncertainties;
- **ODI protections:** such as caps, collars and sharing thresholds which limit ODI performance share risks between companies and customers beyond certain thresholds;
- **totex sharing rates:** which apportion totex performance risk to companies and customers; and
- **interim determinations:** which allow for the re-opening of price controls to protect companies from material changes in defined circumstances.

Uncertainty mechanisms play a key role in reducing the amount of risk borne by companies that might otherwise leave them exposed to uncertain costs or revenues. Uncertainty mechanisms also reduce the need for more complex reopeners that would otherwise be more common.

Over successive price reviews, we have increased the number of uncertainty mechanisms. Such mechanisms can provide significant additional protections and regulatory certainty, but there can be a risk that they increase complexity and blunt or distort incentives. It is therefore important to ensure that the mechanisms we use remain beneficial by allocating risk appropriately and supporting the right incentives.

### 2.1 Our emerging thinking and stakeholder responses

#### Responses to our discussion paper and our view

In our December discussion paper,<sup>4</sup> we addressed concerns from companies that there are too many uncertainty mechanisms and reconciliations now. We said that, in exploring

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<sup>4</sup> Ofwat, '[PR24 and beyond: discussion paper on risk and return](#)' December 2021

whether we could reduce the number of mechanisms, we would consider the following criteria:

- **Materiality:** Persistently small reconciliations or those whose net impact is broadly neutral across control periods may indicate that the reconciliation is unimportant and that its complexity outweighs its benefit.
- **Efficiency of risk allocation:** We intend to place significant weight on the principle that risk should be held by the party best placed to manage it.
- **Cost-benefit:** Reconciliations tend to improve precision in allowance-setting and can achieve policy objectives. Against these benefits should be weighed costs – for instance through increased complexity.

Respondents broadly welcomed our approach and were supportive of the ambition to reduce the number of reconciliation mechanisms. Respondents also broadly supported our proposed assessment framework described above. However, respondents did raise additional considerations to improve our assessment criteria.

Both Yorkshire Water and South West Water felt that the criteria should be considered at the company level, as the outcome of the assessment might be significantly different depending on the perspective. We understand that our assessment criteria will yield different views between companies depending on their specific circumstances. We agree that this is an important consideration and is something we will consider within our criteria.

Anglian Water and Affinity Water felt that financeability should play a role in the assessment criteria. Thames Water suggested that we need to have a cross check to the potential increase in risk to equity from any removal of mechanisms. We consider that both concerns are met by the materiality and risk allocation criteria.

Wessex Water added that our current framework misses any reference to ensuring that the incentive properties for good performance remain. We agree that it is important to ensure that uncertainty mechanisms do not dampen a company's incentive to deliver better performance. Our assessment of our current suite of mechanisms will consider the impact of the mechanisms on incentives.

### **Our assessment and proposed PR24 uncertainty and incentive mechanisms.**

Overall, we consider that our criteria cover the key factors required to assess current uncertainty and incentive mechanisms as well as any potential new mechanisms. The following tables outline our current proposals on the mechanisms at PR24.

## 2.1.1 Proposed continued uncertainty and incentive mechanisms

This section sets out the PR19 reconciliation mechanisms that we are proposing we will still apply to the PR24 period (2025-2030). Table 2.1 sets out each of these reconciliations and gives a brief explanation as to why we consider it is still required at PR24.

**Table 2.1: List of PR19 uncertainty and incentive mechanisms we propose to retain**

Uncertainty or incentive mechanism	Reason for keeping the mechanism
<b>Outcome delivery incentives (including C-MeX, D-MeX and the newly proposed BR-MeX)</b>	This mechanism holds water companies to account for the outcomes that companies need to deliver for their customers, society and the environment.
<b>Revenue forecasting incentive mechanism</b>	This mechanism mitigates against a material revenue risk between actual and forecasted revenues. It also incentivises timely revenue collection.
<b>Bioresources revenue</b>	This mechanism mitigates against a material revenue risk between actual and allowed revenues for the bioresources control.
<b>Residential retail revenue</b>	This mechanism mitigates against a material revenue risk from factors such as changing customer numbers and corrections between allowed and actual revenues.
<b>Water trading incentive</b>	This mechanism implements our policy of providing a financial incentive to companies to make efficient water trades, which we wish to promote to help customers.
<b>Cost of new debt reconciliation</b>	This mechanism improves the accuracy of the cost of new debt allowance by passing through outturn movements in economy-wide interest rates through to customer bills.
<b>Cost reconciliations</b>	This mechanism includes a number of adjustments that share expenditure risks between companies and customers. This enables us to rely less on other uncertainty mechanisms, such as interim determinations, helping to improve regulatory certainty and reduce overall regulatory burdens. In addition, the cost sharing mechanism also strongly incentivises cost efficiency as well as sharing of cost risks.
<b>Tax reconciliations</b>	This mechanism mitigates a material risk of significant movements in tax that are beyond a company's control.
<b>Land sales</b>	The mechanism shares a portion of the net proceeds from the sale of land for customer, consistent with companies' licence requirements to split net proceeds for any land sale equally between shareholders and customers.
<b>Strategic regional water resources reconciliation</b>	This mechanism reconciles any cost variations from a small number of strategic resource options during 2025-30 and shares them between the company and customers. These started development activities in the 2020-25 period and will continue to receive funding at PR24. It is also possible that emerging options identified as part of an adaptive best value water resources management plan as clear alternatives to progressing schemes may receive development allowances similar to the approach at PR19.

**Table 2.2: List of company specific PR19 uncertainty and incentive mechanisms we propose to retain.**

Uncertainty or incentive mechanism	Companies affected	Reason for keeping the mechanism
<b>Havant Thicket</b>	Portsmouth Water	We have committed to mid-period review which is likely to include adjustments following the procurement and planning processes for Havant Thicket in PR24.
<b>Business retail controls</b>	Dŵr Cymru and Hafren Dyfrdwy	The mechanism is required to protect the customers of the companies operating in Wales, where there is limited competition.
<b>Green Economic Recovery reconciliations</b>	Companies that have green recovery investment that stretches into the 2025-30 period eg South West Water and United Utilities have planned delivery in 2025-26.	We will consider if each impacted scheme should transfer into a new price control deliverables (PCD). This PCD will protect customers against potential non- or partial delivery in the 2025-30 period. <sup>5</sup>

## 2.1.2 Uncertainty and incentive mechanisms under review

This section sets out uncertainty and incentive mechanisms that depend on policy that we are still developing. Table lists these mechanisms and why further consideration is needed.

**Table 6: List of uncertainty and incentive mechanisms under review**

Uncertainty or incentive mechanism	Reason for further consideration
<b>Developer services revenue adjustment (DSRA) mechanism</b>	This mechanism depends on our final policy for regulating developer services at PR24. We set out our proposals in Chapter 3 of our consultation document. If site-specific developer services are removed from the price control, the DSRA could potentially be removed or amended in scope.
<b>Water Industry National Environment Programme</b>	We are not convinced that a WINEP enhancement uncertainty mechanism, similar to the PR19 mechanism included for amber WINEP schemes, is required for PR24. Due to the timings for WINEP/NEP for PR24, the majority of the uncertainty around the programmes have reduced with residual uncertainty managed through our totex and outcomes framework. We are considering the scope for accelerating environmental improvements at PR24, although we propose that is handled through bespoke outcome delivery incentives in the first instance.
<b>Gearing outperformance sharing mechanism</b>	We consider that the proposals to strengthen the regulatory ring-fence and to enhance monitoring and reporting could serve to increase levels of financial headroom and better protect the interests of customers with respect to companies' financial structures. We will consult on these issues further over the summer and this may remove the need for specific incentives at PR24 to encourage companies to adopt more resilient financial structures. However, we may apply an incentive-based mechanism within the price review if we are not satisfied with progress achieved through other means. We will return to this in the final methodology taking account of responses to our separate consultation.

<sup>5</sup> For further detail on PCDs see Appendix 9 – Setting expenditure allowances.

## 2.1.3 Proposed uncertainty and incentive mechanisms to discontinue for PR24

This section sets out the PR19 mechanisms that we consider are no longer required for the 2025–30 period. Table 2.3 lists out each of these mechanisms and provides our high-level reasoning as to why we consider they will not be needed at PR24.

**Table 2.3: Proposed uncertainty and incentives mechanisms to remove for PR24**

Uncertainty or incentive mechanism	Reason for dropping the mechanism
<b>Bilateral market entry mechanism</b>	We do not anticipate that bilateral markets will open in the 2025–30 period. Therefore, we consider that this mechanism is not needed at PR24. We intend to reinstate it in future if bilateral markets open.
<b>RPI-CPIH Wedge reconciliation</b>	With a full transition to indexing the RCV by CPIH (see Chapter 7 of our consultation document), we consider that the wedge reconciliation mechanism is not needed.
<b>Gloucester and Sharpness canal</b>	This is a specific mechanism relating to a notified Item. It is intended to deal with uncertainty up to 2025 and is therefore not required afterwards at PR24.

## 2.1.4 Proposed new uncertainty and incentive mechanisms

This section contains a list of new mechanisms that we are proposing to introduce for PR24.

**Table 2.4: List of the proposed new uncertainty and incentive mechanisms**

Uncertainty or incentive mechanism	What the mechanism does	Reason for introducing a new mechanism
<b>BR-MeX</b>	Determines how we will reconcile outperformance and underperformance payments for BR-MeX.	We are proposing BR-MeX to incentivise incumbent water companies (wholesalers) to take a more customer-orientated approach to help resolve frictions around data quality, wholesaler-retailer interactions and wholesaler performance. Our monitoring and review of incumbent support for the business retail market indicates that this needs to improve.

Q1. Do you agree with our proposed approach to mechanisms at PR24?

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