Water UK's response to Ofwat's 2026 cost change process draft determinations

24 September 2026
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1. Overview

Water UK welcomes the opportunity to respond to Ofwat's draft determinations for the 2026 cost change process for water companies in England and Wales. We respond as the trade association for every water company in England, Wales, Northern Ireland and Scotland.

As Ofwat notes, the cost change process has provisionally unlocked £3.4 billion of new investment during the 2025-30 period that "will allow companies to progress a number of significant statutory schemes, support economic growth and help ensure customers continue to receive safe, reliable water and wastewater services into the future."[1]

We welcome the additional investment approved through the cost change process. The Chancellor of the Exchequer recently reaffirmed the UK Government's commitment to growth.[2] Additional allowances, if financeable, will enable companies to upgrade assets and deliver schemes that unlock investment from developers and businesses – creating local growth and jobs.

The extra investment will include supporting the government's commitment to enable the building of 1.5 million homes by the end of the parliament. However, both the government's economic mission and housing target are at risk because homes are already being blocked and business are already unable to expand for no other reason than a lack of water. It is critical that companies are funded to undertake the enabling network upgrades required to unlock these growth opportunities.

The cost change process has successfully demonstrated that new investment can be flexibly unlocked, rather than after five years at the next price review. Companies have submitted detailed evidence through the cost change process, which has been scrutinised in detail by Ofwat to confirm the need for additional investment before making its draft determination. We support the use of flexible mechanisms to address investment needs across a wider range of assets as they arise, and we encourage Ofwat to identify opportunities to streamline the process for future iterations.

Our response focuses on cross cutting themes from Ofwat's draft determinations for the sector, with individual companies best placed to respond on specific points in their own evidence submissions.

Notwithstanding our support for an in-period mechanism that will unlock much needed investment during the 2025-30 period, we have three overarching concerns with the draft decisions Ofwat has reached during the 2026 cost change process:

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[1] 'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 7.
[2] 'Chancellor John Healey's Growth Speech 2026', *HM Treasury,* 7th September 2026.

(1) **Certain expenditure areas have been ruled out of scope for no good reason:** For example, investment proposals through the asset health reopener have been arbitrarily disallowed for some companies where assets are deemed to have been out of service prior to October 2023 (the initial PR24 Business Plan submission deadline).[3] As a direct result, vital investment proposals in boreholes and water network storage assets have been disallowed. Such a decision would be difficult to understand in normal times. During a time in which England is facing one of the worst droughts on record and near thirty million people are suffering from hosepipe bans, blocking any investment simply because the asset in question was out of service before the drought is impossible to justify. Water UK also raised in September 2025 that the cost change process should be broadened to target the assets with the highest risk.[4] It cannot be overstated how precarious our water supplies are. We urgently need to upgrade and expand our water network and we cannot afford to wait. Ofwat has also ruled out funding for other vital investment which, unless overturned, will create additional pressure against already stretched base cost allowances. Again, Ofwat has done so without engaging with the substance of the evidence submitted by companies.

(2) **Companies must be able to finance the approved investment:** 'In-period' revenue adjustments for growth related expenditure requests have been ruled out, because Ofwat says it has not yet introduced a licence change[5] even though it announced the introduction of the growth category more than a year ago.[6] Water UK raised this concern in our September 2025 response, and no justification has been provided in Ofwat's draft determinations.[7] Delaying bill increases to the future will create bill shocks for customers at the next price control. Ofwat has also maintained the allowed return in line with its final determination position for those companies that did not obtain a PR24 redetermination. This is despite market movements and the Competition and Markets Authority overturning Ofwat's approach to setting the cost of equity.

(3) **Ofwat is weakening incentives for companies to operate efficiently.** Out of the blue, Ofwat is proposing to upend the incentives for companies to operate efficiently with the introduction of a new clawback mechanism on top of existing mechanisms. Any assessment of underspend should not undermine existing efficiency incentives concerning base allowances.

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[3] Ofwat applied two exceptions to this rule: (1) A water network storage claim by Northumbrian Water for a reservoir out of service prior to October 2023. Ofwat did not rule this claim as out of scope as the request had originally been included within the company's PR24 business plan submission as a cost adjustment claim. (2) A water network storage claim by Severn Trent Water for a service reservoir, where two out of five cells were out of service prior to October 2023. As the request included replacing all cells, Ofwat decided to include the cost associated with the two of service cells within its assessment.
[4] 'Water UK's response to the PR24 cost change process consultation', *Water UK,* September 2025.
[5] 'Demand Growth Cost Change Licence Modification Consultation', *Ofwat,* July 2026, page 4. Ofwat stated "[In our November 2025 decision document] …. We said we could only consider growth submissions for adjustments at the end of the 2025-30 period unless there were further licence changes".
[6] 'Supporting economic growth letter to Regulation Directors', *Ofwat,* August 2025.
[7] 'Water UK's response to the PR24 cost change process consultation', *Water UK,* September 2025.

We believe that Ofwat can maximise the benefits of the additional investment unlocked through the cost change process by correcting these instances of poor judgment at final determination, and applying those corrections to future requests that are submitted during the remainder of the 2025-30 period. In our response, we make the following recommendations:

- **Recommendation 1:** Ofwat must change its definition of 'out of scope' cost items, especially for out of service assets. Investment cases should be assessed on the strength of evidence provided by companies, and current need cases, rather than being pre-judged against process-driven cut-off dates or exclusion rules.
- **Recommendation 2:** Ofwat should enable in-period revenue adjustments for growth requests submitted in the 2026 cost change process. Ofwat has the time and powers to change licences, and it should use them.
- **Recommendation 3:** Ofwat should focus on spend against overall total expenditure allowances when assessing a company's delivery performance, rather than a subset of allowances with price control deliverables.
- **Recommendation 4:** Ofwat should satisfy itself that the investment it approves is financeable, including by revising its approach to setting and estimating the allowed return on capital with latest market data and the approach taken by the Competition and Markets Authority in the PR24 redeterminations. Ofwat should revisit its approach to allowed returns and financeability to ensure that it is grounded in the reality of accessing finance efficiently.
- **Recommendation 5:** Ofwat should remove its new clawback mechanism, which retrospectively weakens efficiency incentives against base cost allowances.

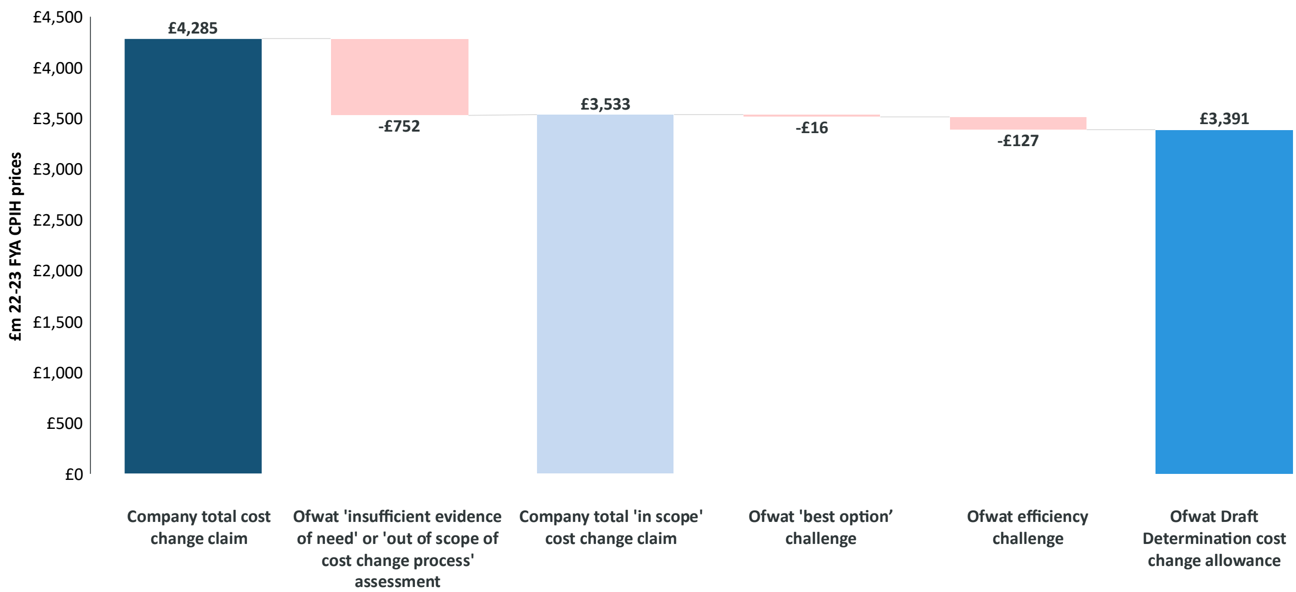
2. Our concerns with Ofwat's 2026 cost change process decisions

Water UK supports the additional investment that will be unlocked as a result of the cost change process. However, we have concerns that important investment proposals have been arbitrarily ruled out of scope and some investment may not be financeable. Ofwat's overall approach continues to create unnecessary burdens and regulatory costs.

2.1. Ofwat must reconsider the cost claims it has ruled out of scope

It is misleading for Ofwat to promote that its draft determinations allow 96% of proposed in scope expenditure. Ofwat decides what is in scope, then it decides whether to allow the proposed expenditure within the scope it has created. Once again, Ofwat is acting as 'judge and jury' concerning vital investment. It would be more accurate to say that Ofwat has allowed 79% of expenditure sought. Although Ofwat has not published a granular breakdown of proposals rejected after ruling them to be 'out of scope', Water UK analysis of company draft determinations confirms this is worth at least £200 million. Along with proposals rejected on its view of "insufficient evidence of need", Figure 1 below shows it is this is the largest intervention made by Ofwat in its draft determinations.

Figure 1: Breakdown of Ofwat adjustments to company cost claims (£m 22-23 FYA CPIH prices)[8]



[8] Water UK analysis of company specific draft determination documents.

Ofwat has applied an October 2023 cut off to certain out of service assets

Ofwat has ruled expenditure proposals out of scope where assets have been out of service prior to October 2023, the original deadline for submitting PR24 business plans. Eight out of thirteen companies draft determinations included exclusions for this reason.[9] Ofwat argues that the primary driver for returning sites to service that are not currently in use is primarily associated with increased resilience to supply and not asset health. Ofwat states "if an asset has already failed, then there is limited likelihood of further direct consequence of deterioration on supply. This is because, if an asset has already failed, then there is limited likelihood of further direct consequence of deterioration of supply".[10] In excluding these assets, Ofwat says that water companies should have included requests relating to assets out of service prior to this point in their PR24 business plans.

We have two concerns with Ofwat's approach to out of service assets:

- **This cut-off date is not evidence based and excludes legitimate cost pressures simply because of their timing relative to an administrative deadline in the price control process**. As a result of this rule, water storage and borehole assets have been rejected as out of scope for some companies – at a time of heighted pressure on water supplies. An investment need is an investment need, regardless of when it has been requested. Ofwat's approach also fails to acknowledge that new evidence available since October 2023 by companies may now justify an investment compared to when PR24 business plans were submitted. For example, England has experienced its second consecutive drought. The Environment Agency describes it as, "…an exceptionally serious situation and one that will have long-lasting impacts on our environment, wildlife, and the economy."[11] More than thirty million people are suffering from a hose pipe ban. Some parts of the country have been in drought and required temporary use bans in both 2025 and 2026, whilst companies develop plans assuming such measures would be used once in ten years. We have also experienced the provisionally hottest summer on record in the UK[12] and driest July[13], creating rapidly changing pressures on water demand and supply that companies must be able to respond to. Given such circumstances, it is very difficult to understand Ofwat's rationale for blocking attempts to increase the nation's water supplies.
- **Companies have been working with Ofwat through its asset health workstream since business plans were submitted**. That workstream has required[14] companies to undertake inspection activity across a sample of assets (determined by Ofwat) within the scope of the asset health reopener, and to submit evidence on asset condition scores. This is new evidence that has been gathered after PR24

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[9] Water UK analysis of company specific draft determination documents.

[10] 'PR24 cost change process - Asset health cross cutting issues appendix', *Ofwat,* August 2026, page 26.

[11] 'Press Release: Drought declared in half of England', *Department for Environment, Food & Rural Affairs*, 29th July 2026.

[12] 'Summer 2026 provisionally hottest on record for the UK', *Met Office*, September 2026.

[13] 'Historic July sees record dryness, unprecedented sunshine and exceptional warmth', *Met Office*, September 2026.

[14] 'PR24 cost change process - Asset health cross cutting issues appendix', *Ofwat*, August 2026, page 5.

business plan were submitted, and in response to Ofwat's requests. Companies should not be penalised for developing investment cases in response to new information.

Ofwat has ruled out important asset health focused claims as 'out of scope'

Ofwat has reaffirmed its artificial and highly restricted number of assets for which it will entertain cost change applications. The Competition and Markets Authority, in its redetermination of PR19, observed that "Ofwat's cost assessment is backward looking" and suggested that Ofwat "considers developing indicators to track this issue and to enable it to enhance its analysis with a forward-looking element that will assist in triangulating results from its econometric modelling of historic costs."[15] Over the subsequent five years, throughout all of PR19, Ofwat did not provide any additional means for companies to improve asset health. It was only at a late stage in the PR24 process that Ofwat set minor adjustments for mains renewals and meter replacements, neither of which are forward-looking in nature.

The issue of asset health is urgent, with Sir Jon Cunliffe similarly critiquing Ofwat's historic approach and recommending that, "…the regulators should ensure metrics for asset health are sufficiently forward-looking."[16] Yet Ofwat has only allowed the possibility of funding for just six assets in the first year (which will not reflect every company's mix of assets and risk). Ofwat's guidance for just one type of asset is 30 pages long and includes, by our estimate, twenty-three evidential criteria and twelve additional requirements relating to sampling.[17] A far better approach would be to allow water companies to set out their investment cases and for Ofwat to consider them on their merits.

We are concerned that in its draft determinations, Ofwat thinks it is reasonable to decide that there should be a further five reasons for activities to be considered out of scope of the asset health reopener:[18]

- **(1) Decommissioning of assets, where not in association with recent wider site works.** This applies to one company.[19] Ofwat argues such activities are unlikely to pose a risk to loss of service that would need to be addressed outside the standard price control cycle. This blanket approach fails to consider the merits of individual cases proposed by companies and the asset risks that they have identified in their claims.
- **(2) Strategic reviews / Pre 2030-35 investigatory work and (3) asset inspections.** This applies to two companies.[13] Ofwat argues that these are normal operational activities and should be funded through existing base allowances. This would require companies to deliver more within base allowances that are already proving to be insufficient: Water UK's analysis of company 2025-26

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[15] '[Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations: Final report]', *Competition and Markets Authority,* pg. 185, March 2021.

[16] Sir Jon Cunliffe GBE, CB; Recommendation 67 of '[Final report]', *Independent Water Commission*, July 2025.

[17] '[PR24 Cost change process: Gravity sewers investment assessment guidance]', *Ofwat*, February 2026.

[18] '[PR24 cost change process - Asset health cross cutting issues appendix]', *Ofwat,* August 2026, page 25.

[19] Water UK analysis of company specific draft determination documents.

Annual Performance Reports shows water companies are already overspending their base expenditure allowances by 12% at the sector level.[20]

- **(4) Adjacent and ancillary asset components (such as inlet works and storm tanks) and (5) control and monitoring.** This applies to three companies.[13] Ofwat argues that investment proposals should be related to the six priority assets within the scope of the asset health reopener. As set out in our response to Ofwat's initial consultation on the cost change process[21], water companies should have the opportunity to provide evidence of which assets in their regions and networks are most at risk and therefore require investment to improve resilience. Company submissions for these activities should be reviewed on their merits, instead of being automatically rejected for not perfectly aligning with Ofwat's narrow list of priority assets.

Recommendation 1: Ofwat must change its definition of 'out of scope' cost items, especially for out of service assets. Investment cases should be assessed on the strength of evidence provided by companies, and current need cases, rather than being pre-judged against process-driven cut-off dates or other exclusion rules.

2.2. Ofwat should ensure approved investment can be financed

Companies can only deploy investment approved through the cost change process if that investment can be financed. As we set out below, we are concerned by Ofwat's approach to:

- excluding growth investment from in-period revenue adjustments;
- limiting delivery assessments to a subset of company expenditure allowances; and
- using outdated allowed return on capital assumptions.

Excluding growth investment from in-period revenue adjustments

Ofwat has excluded growth expenditure from in-period revenue adjustments. This exclusion seems to go directly against Ofwat's growth duty,[22] and the UK Government's policy to prioritise economic growth, recently reaffirmed by the Chancellor of the Exchequer.[23]

In justifying its decision to exclude growth claims from in-period adjustments, Ofwat says "the licence does not allow in-period funding to be provided for this item this year".[24] However, Ofwat is *currently* consulting on a licence modification that would allow growth related in-period adjustments for submissions made for

[20] Overspend calculated as the percentage difference in wholesale totex allowances and actual expenditure using company reported values as per Annual Performance Reports 2025-26 table 4C. Base expenditure values constructed using the following cost categories: Standard Base, Business Rates, Abstraction Charges and Discharge Consents, Totex not subject to cost sharing.

[21] 'Water UK's response to the PR24 cost change process consultation', *Water UK,* September 2025.

[22] The duty is formally set out in section 108 of the Deregulation Act 2015.

[23] 'Chancellor John Healey's Growth Speech 2026', *HM Treasury,* 7th September 2026.

[24] 'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 10.

the 2027 cost change process.[25] We see no reason why expenditure requests that are approved by Ofwat in the 2026 process, which will affect revenues from 1 April 2027, should be excluded from consideration of in-period adjustments.

Indeed, not providing in-period adjustments for growth expenditure that is approved through the 2026 process will have three negative effects:

- **Investment will not happen**. Without an ability for water companies to finance the new investment approved through the cost change process, it will not happen. New investment requires new capital and that requires a return to be paid – either as debt interest payments or equity returns. Without in-period revenue adjustments, companies that lack sufficient headroom will not be able to make those payments.
- **Customers will be treated differently based on where they live**. It is not fair that people who happen to live in parts of the country where a water company has sufficient financial resource to pay upfront for investment with no prospect of any repayment for several years, are able to receive extra investment that allows housing developers and businesses to create positive economic growth and employment benefits in their region. Those who live in other parts of the country will miss out as a direct result of Ofwat's decision to rule out in-period revenue adjustments for growth investment.
- **Bill increases will be delayed to 2030, creating bill shock for customers.** Bill increases are never welcome, but the money is needed to fund vital upgrades to improve asset health and support economic growth. Any decision to delay bill increases through RCV adjustments must consider customer preferences around bill profiling. Simply delaying bill increases to 2030 will create bill shock for customers at that point in time.

Ofwat should act now to change water company licences. There are no legal barriers to Ofwat changing licences in the time available, as it is currently doing for cost change requests that will be made in 2027. For English companies, Ofwat need only consult for 42 days on a change, and to wait a further 56 days for the change to take effect (with the waiting period able to be waived by Ofwat).[26] For Welsh companies, provided the water company agrees, 28 days need to pass before a change takes effect. As such, in line with the typical timescales for price control decisions where revenue allowance decisions are communicated by 31 December so they can be incorporated in the coming year's charges, the latest possible point for Ofwat to consult on a change would likely be 20 November 2026 for English companies and 4 December 2026 for Welsh companies.

Recommendation 2: Ofwat should enable in-period revenue adjustments for growth requests submitted in the 2026 cost change process. Ofwat has the time and powers to change licences, and it should use them.

[25] 'Demand Growth Cost Change Licence Modification Consultation', *Ofwat,* July 2026.

[26] See Sections 12A and 12B of the Water Industry Act 1991.

Limiting delivery assessments to a subset of company expenditure allowances

Ofwat also consider how companies are delivering in PR24 when determining whether to allow in-period adjustments, and states for "we do not provide in-period funding for allowed asset health expenditure for these companies, taking into account a number of factors, such as progress on delivery and financial constraints, in the round".[27] Ofwat's assessment only considers delivery against allowances with price control deliverables, which Ofwat note only cover around 40% of expenditure allowances in PR24.[28]

Recommendation 3: Ofwat should focus on spend against overall total expenditure allowances when assessing a company's delivery performance, rather than a subset of allowances with price control deliverables.

Weighted Average Cost of Capital (WACC) applied to approved investments

Where it has applied an in-period adjustment, Ofwat has applied a different allowed return on capital across water companies. For those companies that received a redetermination from the Competition and Markets Authority at PR24, Ofwat has used the allowed return set by the Competition and Markets Authority. For every other company, Ofwat has used the allowed return that it set in December 2024.

Ofwat's decision has two principal issues:

- **It fails to reflect recent market movements, which reflect a higher cost of capital compared to Ofwat's estimate from nearly two years ago.** At the time of Ofwat's PR24 final determinations, the one-month average of the 20-year RPI-linked gilts rate was 1.19%,[29] which set the basis for Ofwat's risk free rate assumption. This estimate increased to 2.18% at the time of the Competition and Market Authority's final determinations in March 2026.[30] As shown in the chart below, the equivalent figure has risen even further to 2.47% as at the end of August 2026, based on our analysis of Bank of England data.[31] Continuing to apply an outdated cost of capital assumption to allowances approved in period risks creating a financing challenge and undermining the case for investment that the cost change process is intended to unlock.

[27] 'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 10.

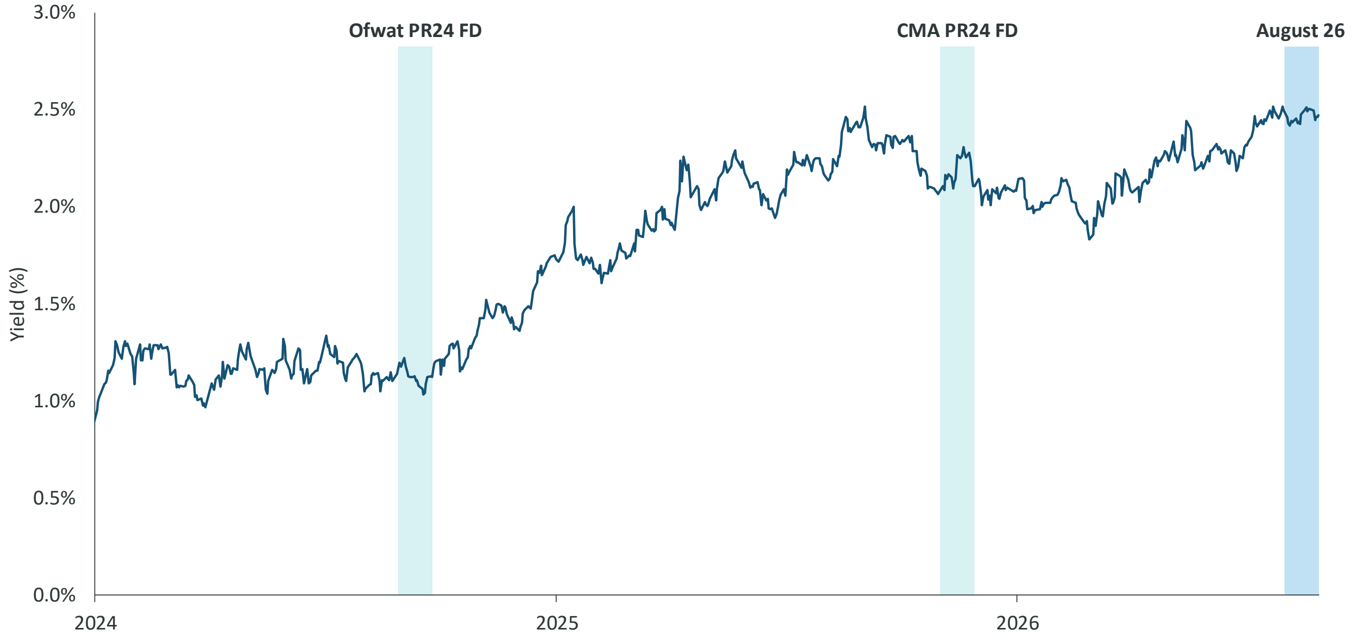
[28] 'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 33.

[29] 'Aligning risk and return – allowed return appendix', *Ofwat,* March 2025, page 21. Ofwat's assumption based on the September 2024 average of 20-year RPI-linked gilt yield.

[30] 'Water PR24 references. Final Determinations Volume 4: Allowed return – chapter 7', *Competition and Markets Authority,* March 2026, para 7.172.

[31] Water UK analysis of Daily government liability curve (real) up to August 2026, published by the Bank of England.

Figure 2: 20-year UK index linked gilts yield



- **It perpetuates a methodology that has been overturned by the Competition and Markets Authority.** Unlike Ofwat in its PR24 final determinations, the Competition and Markets Authority included Pennon as a beta comparator, concluding the "additional information value provided by using Pennon as a comparator outweighs any drawbacks of having a more limited data set compared to Severn Trent and United Utilities".[32] The Competition and Markets Authority also selected a point estimate 30bps above the midpoint of its cost of equity range, given concerns that the difference between its unlevered cost of equity and cost of new debt may be too narrow to incentivise equity investment.

We acknowledge that there is no recent precedent for updating the allowed return compared to that used in the last five-year price control determination when carrying out an in-period decision for a water company in England and Wales.[33] However, we think doing so now would be justified for three reasons:

- **The cost change process is itself unprecedented.** More than £4 billion of investment has been requested in a single year, intended to enable economic growth and improve services levels for customers. That level of investment has never been requested before between price control periods.

[32] 'Water PR24 references. Final Determinations Volume 4: Allowed return – chapter 7', *Competition and Markets Authority,* March 2026, para 7.491.

[33] Although in its review of a substantial adverse effects claim by SES Water in 2008, the Competition Commission deliberately looked at an updated cost of capital when assessing what a reasonable rate of return would need to be to comply with Ofwat's financing duty – though it did not ultimately apply that figure in its final determination. See paragraph 4.61 of 'Sutton and East Surrey Water plc Interim Price Determination', *Competition Commission*, (August 2009), pages 43-44.

- **Other regulators recognise that market movements may require some in-period adjustments to financing costs.** Ofgem, for example, indexes the cost of equity annually as part of RIIO-3 and those changes are applied every year of the price control period, not at the end of the period.[34]
- **Ofwat's duties create an expectation among stakeholders that it should act if there is a risk that approved investment cannot be financed**. Ofwat is required to act "in the manner… in which it considers is best calculated… to further the consumer objective" and "to secure that [water companies] are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of [their] functions".[35] In our view, neither objective is met if water companies are unable to finance investment should Ofwat's allowances be inadequate compared to the prevailing cost of capital.

For these reasons, we recommend that Ofwat reviews the prevailing cost of finance in the wider economy, to ensure that those water companies that receive an in-period adjustment are able to attract the finance that they need to enable investment. That could include a fresh review of the cost of capital for recent market movements, and at the very least align with the cost of capital methodology adopted by the Competition and Markets Authority.

It is also important that Ofwat ensures that companies can practically finance any additional investment requirements. Ofwat's approach to assessing financeability for the cost change draft determinations assumes equity injections in-period to maintain a notional gearing assumption of 55%.[36] This approach does not reflect the feasibility of raising incremental new equity during a price control. It is unlikely to be cost-effective for water companies to continually raise new equity at every stage of the cost change process, which would entail issuance and legal costs at every turn. Ofwat should therefore revisit its financeability assumptions, including reassessing its equity injection assumptions, to ensure that the approach is grounded in the reality of accessing finance efficiently.

Recommendation 4: Ofwat should satisfy itself that the investment it approves is financeable, including by revising its approach to setting and estimating the allowed return on capital with latest market data and the approach taken by the Competition and Markets Authority in the PR24 redeterminations. Ofwat should revisit its approach to allowed returns and financeability to ensure that it is grounded in the reality of accessing finance efficiently.

2.3. Ofwat should remove its proposed clawback mechanism

While we welcome the cost change process as a mechanism to unlock new investment between price reviews, we want to ensure that it is proportionate.

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[34] 'RIIO-3 Final Determinations – Finance Annex', *Ofgem*, (December 2025), page 45.

[35] 'Water Act 2003 – Explanatory Notes', *UK Government.*

[36] 'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 36.

The introduction of a new clawback mechanism at draft determination creates complex interactions with new and existing price control deliverables. It would add to regulatory burdens, which are ultimately paid for by customers, and directly contradicts the government's commitment, reaffirmed by the Chancellor as recently as the 7th of September, to reduce the cost of business regulation by 25% this Parliament.[37]

Unless altered, three separate mechanisms would be in operation under Ofwat's draft determinations:

(1) Price control deliverables applied on specific investments relating to asset health, growth, PFAS and large gated schemes.

(2) An additional price control deliverable specific to 'what base buys', ringfencing funding to the specific priority assets where allowances have been provided.

(3) An overarching clawback mechanism applied across PR24 base allowances, and any additional asset health allowances approved through the cost change process, up to the value of additional cost change allowances provided.

As a package, these mechanisms return any unspent cost change allowances, whilst restricting opportunities for base expenditure outperformance up to the value of the asset health cost change allowances that have been provided. This approach removes potential upside opportunities for companies, whilst retaining downside cost risk exposure. The problem it creates is illustrated by the example below:[38]

- A company receives a base allowance of £1,000m and an asset health cost change allowance of £250m.
- The company achieves a £100m efficiency against its base allowance and spends and delivers in line with its asset health cost change allowance.
- In this scenario, the full £100m efficiency achieved would be clawed back (rather than 50% of it, as would normally), as the efficiency is less than the value of the asset health cost change allowance, removing any incentive to deliver those base cost savings in the first place.

If the clawback mechanism is confirmed, this will retrospectively adjust incentives put in place by the final determinations issued in December 2024 (or in March 2026 for those companies that received a redetermination by the Competition and Markets Authority). It would not only weaken the incentives to achieve base efficiencies, but it would also keep companies exposed to overrun risk. Thus, another asymmetry would be introduced. It would also negatively affect company decisions that have already happened (based on existing cost efficiency incentives for base expenditure) and cannot be undone.

Recommendation 5: Ofwat should remove its new clawback mechanism which retrospectively weakens efficiency incentives against base cost allowances.

[37] 'Chancellor John Healey's Growth Speech 2026', *HM Treasury,* 7th September 2026.

[38] Scenario 2 as presented in'PR24 cost change process - Sector Overview', *Ofwat,* August 2026, page 42.