

## Initial reflections

23 July 2025

### Introduction

This week brought the publication of the Independent Water Commission's final recommendations for reforming the England and Wales water sector.<sup>1</sup> The Commission, chaired by Sir Jon Cunliffe, has undertaken a nine-month review of the sector, including extensive stakeholder engagement. Its final report identifies a set of recommendations intended to drive a 'fundamental reset' in the industry and restore public trust.

Headline recommendations include the following.

1 Changing how sector objectives and investment plans are set, with:

- the government providing clearer strategic direction through the development of **National Water Strategies for England and Wales**, as well as a new **Ministerial Statement of Water Industry Priorities**;
- the introduction of independent **regional system planners** based largely around existing River Basin Districts—these bodies will be responsible for turning national priorities/objectives into locally owned plans that reflect local priorities;
- **rationalisation of the strategic planning frameworks**—which set out long-term plans for key areas of company activities and, hence, shape investment requirements—from nine plans to two;
- reviewing and **amending existing water legislation**—with priority on the Urban Wastewater Treatment Regulations and the Water Framework Directive.

2 Merging the functions of the economic regulator (Ofwat), the quality regulator (the Drinking Water Inspectorate) and the environmental regulators (the water functions of the Environment Agency and Natural England) into a **single, integrated regulatory body** for England.<sup>2</sup>

3 Moving towards a **more supervisory approach to regulation**, under which company-specific supervisory teams would both:

- i. inform price reviews and performance target setting; and

- ii. assess financial resilience, with powers to set minimum capital requirements based on their assessment of financial risk.

4 Developing a **formal turnaround regime** to support the turnaround of companies that are performing poorly. This could include greater discretion for the regulator to waive or defer penalties or to revise regulatory allowances/performance targets.

5 Establishing **system-wide infrastructure resilience standards** and strengthened requirements to map/monitor asset health.

6 Providing the merged regulator with **additional powers to block material changes in the ownership** of water companies and to **provide directions to the ultimate controllers** of companies compelling them to take actions specified by the regulator.

The UK government has confirmed that it will fast track five of the Commission's recommendations, including the merging of the four regulators' functions into a single entity.<sup>3</sup> It intends to consult on how to take forward the remaining recommendations in Autumn and, subsequently, to develop a Water Reform Bill.

At over 450 pages, and with 88 recommendations covering a broad range of topics, the report will take time for stakeholders to review and absorb in its entirety. *In this note, we focus on five aspects of the Commission's recommendations that have particular implications for the economic regulation of the water sector, and potentially for other sectors.* This is not intended to be an exhaustive review of the full suite of recommendations made by the Commission, and we intend to cover other recommendations in future publications.

### Providing clearer strategic direction

Water industry stakeholders have raised concerns that successive governments have failed to provide clear direction to the sector, resulting in conflicting and incompatible policy objectives.<sup>4</sup> The Commission also cites concerns around the lack of a clear framework for making trade-offs and a failure to take account of longer-term consequences.

<sup>1</sup> Independent Water Commission (2025), 'Final Report', 21 July.

<sup>2</sup> The report recommends a separate economic regulator for Wales, potentially within Natural Resources Wales.

<sup>3</sup> Department for Environment, Food and Rural Affairs (2025), 'Ofwat to be abolished in biggest overhaul of water since privatisation', press release, 21 July.

<sup>4</sup> Water UK (2025), 'A Reset for Water: Water UK's response to the Independent Water Commission's Call for Evidence', April.

The Commission agrees that clear direction is needed from government on its expectations for the water sector. Its proposed solution is the development of National Water Strategies for England and Wales with a minimum 25-year horizon that sets the direction across all aspects of the water system, and sets out a clear framework for regulators to manage trade-offs between priorities. More detailed guidance to the regulator(s) would be provided through a new Ministerial Statement of Water Industry Priorities. The National Water Strategy and the Ministerial Statement would be updated every five years in line with the price review cycle.

#### Oxera commentary

- The Commission's calls for a system-wide, long-term National Water Strategy and a revised set of Ministerial Priorities will likely be welcomed by the industry given longstanding concerns around the lack of strategic direction provided by the government. Perhaps the bigger surprise is that such a recommendation is needed in 2025, and onlookers might rightly question why Defra has not already developed a strategy for the sector given its national significance.
- Of particular interest is the Commission's assessment of whether a government and regulatory focus on short-term bill reductions in the run-in to previous price reviews contributed to underinvestment by companies. The Commission 'believes that government and regulator pressure on bills played an important role in what can now be seen as underinvestment over this period [between PR09 and PR24]. Prioritising the objective of low water bills over other objectives is, of course, a strategic decision for government... [However], strategic trade-offs and guidance need to be transparent and consistent, and take into account longer-term consequences.'
- The introduction of regional system planners—with greater local ownership of plans—and a rationalisation of the strategic planning frameworks are in principle welcome changes, which (if implemented as envisaged) could significantly streamline the planning process. Taken together, these changes create the prospect of a clearer line of sight from national water strategy, ministerial priorities, regional system plans, and (finally) company business plans. One area of interest will be how catchment-based planning will fit into the plans set at river basin level, and to company-level operations, particularly if a reduced focus on comparative benchmark regulation facilitates greater sector consolidation.
- While the focus on reflecting regional objectives and voices in planning may be welcome, the introduction of regional system planners will need to be carefully thought through (in terms of their scope, structure and

powers) to avoid creating additional complexity within the system.

- The Commission also recommends that investment planning is carried out under a 5/10/25-year planning model. This could potentially help to provide greater transparency and understanding of long-term implications for capital requirements, returns to investors and charges to customers. This has been a significant issue (as raised by companies during PR24 and the ongoing CMA redeterminations) of Ofwat's regulatory model, and the focus on five-year control periods.

#### Merging the economic, environmental and water quality regulators

A common theme of the Independent Water Commission's recommendations is better coordination and rationalisation across regulatory bodies and planning processes. This is most apparent in the decision to merge the water functions of the existing regulators into an integrated water regulator.

The water sector has had separate economic, environmental and quality regulators with distinct responsibilities and duties since privatisation. Separation between those responsible for shaping company obligations (i.e. DWI and EA), and those responsible for determining the efficient cost of delivering the obligations (i.e. Ofwat) has the potential to create some positive tension in the system.

However, the picture painted by the Commission is that the current institutional arrangements have instead led to a fragmented and overly complex regulatory system, which has obscured accountability. The Commission points to significant duplication in some areas (e.g. regulatory reporting and enforcement activities), gaps in regulatory oversight in other areas (e.g. in relation to asset health), and challenges in managing trade-offs within the regulatory system. While the Commission highlights the Regulators' Alliance for Progressing Infrastructure Development (RAPID) as a good example of cooperation across Ofwat, the EA and the DWI in areas of overlapping responsibility, it also notes that its application is limited to specific water resources projects and does not cover wastewater.

The Commission notes that alternative options (short of a merger) could have been implemented with a view to strengthening coordination across the regulators—such as a strategic committee to coordinate regulatory operations. In the Scottish water sector, for example, the economic regulator (WICS), environmental regulator (SEPA) and the quality regulator (DWQR) have in recent years sought to collaborate more closely as part of the move to a regulatory system based on the principles of ethical business regulation. This included forming a Stakeholder Advisory Group, jointly taking part in the co-creation of the sector

vision, the Strategic Plan and in investment planning and prioritisation, and collaborative research.

However, the Independent Water Commission has ultimately concluded that the water sector is best overseen by a single regulator. Its final report does not include a formal cost–benefit analysis or options appraisal at this stage, despite the government confirming it will take this recommendation forward. It does, however, point to a number of potential benefits of merging, including strengthened oversight, greater accountability, increased investor confidence from a more joined-up approach to regulation, reduced regulatory burdens through removal of duplicative requests and streamlined regulatory interfaces, and better ability to manage trade-offs.

#### Oxera commentary

- The 'abolition' of Ofwat and proposed merging of regulators is one of the more eye-catching recommendations made by the Commission. Government communications around the final report indicate the economic regulator has been assigned much of the blame for industry failures, with Defra stating that 'Ofwat has failed customers'.
- In isolation, such a merger will not provide a 'silver bullet' for the myriad challenges and problems facing the sector. However, the sector's long-term challenges (of climate adaptation, water scarcity, and infrastructure resilience) call for greater coordination between stakeholders, which an integrated regulator has the potential to facilitate.
- A key question is whether the integration of Ofwat, the EA and DWI into a single body will indeed change the way in which the regulator is able to trade-off different considerations/externalities. By bringing the determination of obligations and prices together within a single entity, an integrated regulator might be able to set environmental standards and define investment programmes in a way that better accounts for the cost to the consumer. However, there may remain a fundamental challenge that environmental and quality regulators have limited room for compromise when tasked with securing compliance with legislation. This highlights the importance of getting the underlying legislation and the strategic direction provided by the government right.
- Within the new body, there will inevitably remain distinct economic, environmental and water quality functions. The way in which the priorities of the organisation are shaped, and trade-offs are made, will be dependent on governance structures, personnel and the functioning of the entity. Regulatory decision-making may be enhanced through better governance and structures,

but this will require no small amount of optimising in what is likely to be a large regulatory body. How these different disciplines come together will be key.

- Relatedly, there is a question of how large the new regulator will need to be. Combining Ofwat, DWI and the EA water team could mean a body in excess of 1,000 staff.
- The establishment of a new organisation does provide an opportunity to reshape culture and capabilities if this is considered at the design and implementation stages. The Commission has highlighted the gaps in existing regulators' engineering and financial capabilities in particular, which the new regulator will need to address. It suggests that the new regulator should operate outside of public sector pay scales to attract appropriately skilled staff. This will increase the cost of regulation, which is ultimately picked up by consumers, but appears to be a necessity given the role envisaged for the new regulator.
- A final concern (recognised by the Commission) is the impact that the transition to the new regulatory arrangements might have. There is a risk of a vacuum at a time when significant regulatory design choices need to be made, and risk of delay to PR29 and other ongoing processes. Time will be needed for a considered establishment of the new regulator, but a slower transition would also mean a longer time period where existing arrangements are continued. This may have implications for price control arrangements for the current (2025-30) period—e.g. the industry's ongoing work on asset health understanding.

#### A supervisory approach to regulation

The Commission is also recommending the introduction of a 'supervisory approach' to regulating individual companies. It suggests this approach may help to overcome a number of issues with the current approach to economic regulation, including:

- excessive reliance on evidence from econometric benchmarking;
- insufficient consideration of company-specific conditions and challenges;
- reliance on aggregate metrics and limited understanding of companies' operations resulting in ineffective oversight and interventions.

Supervisory teams would be structured around understanding and engaging with individual companies, drawing on central specialist expertise as required. The evidence gathered from this engagement would be used to inform price reviews and target setting. The Commission states that:

The regulator should aim to give broadly equal weight in its judgments to the evidence and information it has gained through the supervisory engagement with firms and from objective econometric modelling.<sup>5</sup>

In addition to playing a key role in target setting and price reviews, supervisors would also be expected to use the information available to them to decide what—if any—remedial actions a company should take to manage risks and address performance issues. For example:

- if a company were acting in a manner which presented a risk of public harm, supervisors could intervene to signal the need to strengthen the company's governance, appoint new expertise, or get a third-party specialist to examine, report, or provide assurance on asset quality;
- if financing arrangements were either unclear or presented unacceptable risks, the supervisor could seek information from the ultimate controller about the financial arrangements where these are not transparent and (provided this was consistent with legal safeguards), could direct the company and the ultimate controller to take steps to de-risk the company, such as moving their financing arrangements to a more sustainable footing.

**Supervisors would have oversight of each company's financial risk profile, as well as its infrastructure resilience and asset health.** A financial supervision framework would be established, with an agreed set of risk factors used to inform the supervisors' judgement of the company's financial risk profile. The supervisory approach would give the regulator overall oversight of infrastructure and operational resilience, which would also be strengthened by the appointment of a Chief Engineer within the regulator.

**Supervisors would also play an important role in overseeing a new turnaround regime for poorly performing companies.**

This new regime would combine enhanced powers of direction as well as regulatory forbearance to help companies improve their performance.<sup>6</sup> Supervisors would engage on the feasibility of the company's turnaround plan and take action to facilitate recovery, for instance by giving directions to seek new equity or providing 'regulatory space' for the company to recover.

The supervisory approach would be forward-looking, judgement-based and proportionate, based on company circumstances and risks. This, the Commission argues, should avoid adding unnecessary burdens to companies, since the level and intensity of engagement and information flow with individual companies would be adjusted according to risk.

The Commission argues that the work of the supervisors should be facilitated by greater use of 'SupTech' (i.e. technology to support supervision).

#### Oxera commentary

- The move to a supervisory model is arguably one of the Commission's most radical recommendations, as it would represent a substantial departure from the current approach to economic regulation in England and Wales water. This would have significant implications for 'ex ante' price setting (e.g. how costs would be assessed and performance targets set at price reviews), 'ex post' regulatory reporting and monitoring, the approach to assessing (risks to) financial resilience and decisions over companies' capital structures.
- In terms of price reviews, the approach envisaged by the Commission would provide a more focused role for econometric benchmarking, while enabling the regulator to develop a deeper understanding of the challenges facing each company. Stakeholders have consistently argued that there has been an over-reliance on econometric benchmarking in Ofwat's price review toolkit.<sup>7</sup> Information gleaned from supervisory activities has the potential to provide a counterpoint to econometric evidence. The respective weights that are placed on different types of evidence will need to be assessed appropriately in future price reviews.
- Under the proposals, companies could be required to hold minimum levels of capital/equity on their balance sheet and the regulator would be able to direct companies to inject new equity. This would be a departure from the historical approach of allowing companies to determine their own capital structures. Such an approach does exist in other sectors (e.g. the gearing cap within NERL's licence in the air traffic control sector) but has to date been resisted in the water sector (including during the PR24 review when Ofwat consulted on forms of gearing cap). The Commission leaves it open as to whether the capital requirements should involve an industry-wide floor, company-specific capital requirements, or some combination of the two.
- European regulators, particularly in the energy sector, have recognised that backwards looking, metrics-based regulation is insufficient in high-investment, high-uncertainty environments such as the energy transition.<sup>8</sup> Some of them have moved toward a supervisory-style

<sup>5</sup> Independent Water Commission (2025), 'Final Report', 21 July, p. 194.

<sup>6</sup> The Commission makes clear however that the SAR should remain a credible option of last resort for companies in distress.

<sup>7</sup> This was highlighted in our work for Water UK on performance and supervision. Oxera (2025), '[A new approach to performance and supervision in the England and Wales water sector](#)', 25 April, pp. 30–33.

<sup>8</sup> See, for example, Oxera (2025), 'Review of ACM's new regulatory framework proposal', February.



regulation, characterised by real-time engagement, forward-looking assessment of firms' capabilities, and operational visibility. They are considering advanced supervisory tools such as, process mining to trace operational workflows and inefficiencies, process maturity assessments to gauge internal capability, KPI dashboards for real-time performance tracking, process-product matrices to link operations with outcomes, and data assurance audits to improve trust in self-reported information. Cunliffe's report is very much aligned with this shift, particularly in moving away from ex post econometrics, adopting a whole-firm view, and improving data confidence and culture.

- A supervisory model, implemented successfully, could provide considerable benefits in the context of differing regional challenges and asset bases, and changing investment requirements. It would allow the regulatory system to better account for differing local objectives and challenges, in a way that is unlikely to be feasible under the existing approach.
- While the approach brings potential benefits, there are risks from supervisory regulation that would need to be carefully managed (and which were raised in Oxera's report for Water UK on this subject). These include:
  - the risk of an inconsistent approach to regulation across companies;
  - the risk that supervision leads to micromanagement of the regulated businesses;
  - the risk of supervisory teams being 'captured' by the companies they supervise.
- Many of these risks are acknowledged by the Commission, which outlines initial suggestions for how these could be managed. For example, it suggests that the risk of inconsistent regulation across companies could be mitigated via guidance on how supervisory teams should be expected to operate, and by giving the regulator flexibility to recruit and retain the high-calibre engineering and financial expertise needed to successfully scrutinise each company's operations.
- Nevertheless, many questions regarding how the supervisory approach will be implemented remain unanswered. This includes how the supervisory teams will be structured, the scope of their mandate, and how evidence obtained from supervisors will be balanced alongside evidence from comparative benchmarking when setting price reviews (particularly where this evidence is highly divergent). Naturally, with the design

of a new supervisory framework, the devil will be in the detail and much remains to be worked out.

### The Commission recommends a number of changes to price reviews to better balance investability and accountability

In addition to recommending the establishment of a supervisory function within the new regulator, the Commission has also made a number of recommendations that relate to specific 'building blocks' and incentive mechanisms within Ofwat's regulatory model.

In this context, the Commission's recommendations appear to seek to balance providing a more investable framework—based on a more balanced risk/return profile and greater regulatory stability—with ensuring that companies are held accountable for delivery.

It is notable that the Commission recognises the distinction between (debt) financeability and investability, in a way that Ofwat did not in reaching its PR24 determinations. The Commission recommends that, in order to promote investability, the government should set the new regulator a target relating to the stability and predictability of the regulatory model (and that this could also be reflected in revised statutory duties). This aligns with a recommendation made by Oxera in our work for Water UK.<sup>9</sup>

The general view presented by the Commission appears to be that the regulatory package should be de-risked to provide a 'low-risk/low-return' profile for investors. Specific recommendations in this area include the following.

- Removing the quality and ambition assessment, which provided companies with (financial, procedural and reputational) incentives to align their business plans to Ofwat's view of efficient allowances and performance targets.
- Reviewing the outcome delivery incentives framework, with a view to reducing the reliance on cross-company benchmarking and reducing the level of return at risk. The Commission calls for a reduced number of performance commitments, all of which would be common across the industry. Companies would, however, be set company-specific targets ('performance commitment levels') reflecting their individual circumstances and historical performance.
- Reconsidering how levels of customer service are measured and incentivised through the C-MeX metric.

<sup>9</sup> 'We recommend that the government should recognise the investability challenge and promote investment that is in the long-term consumer interest through...setting firm and measurable regulatory requirements around promoting investment. For example, [the regulator] could be required to set out a pathway to re-securing its previous AAA/Aaa score for regulatory stability and predictability, and to report on its progress on an ongoing basis.' Oxera (2025), 'A sustainable and investable regulatory framework for the England and Wales water sector', 23 April.

- Reviewing the current price control deliverables framework to provide companies with greater flexibility at programme level, while extending the coverage of the PCDs to encompass a greater proportion of base activities.
- Enforcing accountability in capital maintenance activities by recommending the reintroduction of separate base CAPEX allowances. While the Commission recognises that this represents a significant shift from the current TOTEX regime introduced by Ofwat in PR14, it considers the change necessary to ensure that capital maintenance requirements are met and that companies are not able to reallocate underspending on base expenditure to other areas or distribute unused allowances as dividends.

The Commission acknowledges that bills will need to increase to fund future investment and that additional measures will be needed to support low-income customers and prevent water poverty.<sup>10</sup> It recommends that the government consult on national social tariffs to provide fair, consistent support for customers who are unable to pay their bills.

#### Oxera commentary

- The recommendations made by the Commission in this area are a clear indication that it believes Ofwat's PR24 methodology has got the balance between investability and consumer protection wrong. It will be interesting to see the extent to which these recommendations influence—or are aligned with—the position of the Competition and Markets Authority (CMA) when it produces its redeterminations for the appellant companies later this year.
- The Commission's position that the water sector should be low risk/low return, which implies reduced levels of return variation, may need to be considered further, in light of the large contribution of incentive rewards to companies' overall returns, particularly for the listed sector.
- In any case, if the recommendations of the Commission are taken forward by the new regulator, the regulatory framework at the next price review could look materially different to PR24. A clear steer from the Commission is that the incentives—particularly performance incentives—have become too high-powered, exposing companies to higher levels of risk that have not been reflected in allowed returns. A simplified regulatory framework with less risk exposure could result.

The Commission's recommendations also extend to the role of the CMA. Specifically, it proposes that the CMA could be tasked with producing a common cost of capital (WACC) methodology, with the majority of parameters being set at the same level across multiple regulated sectors. This would mean that the water regulator would only have responsibility for setting parameters that are sector-specific (i.e. beta and cost of embedded debt).

It further advocates for indexation of several parameters (the risk-free rate and the cost of new debt) such that these would be updated annually to reflect the latest market conditions during the control period. There is no discussion of alternatives to the capital asset pricing model (CAPM) to estimate the WACC, despite earlier references to this in the call for evidence.

A further change in role for the CMA is proposed, in the form of a recommendation that disputes around price control settlements move to an appeals framework rather than redetermination. The adoption of an appeals model would allow for appeals on single issues (as opposed to the entire settlement), while also opening up the possibility of customer-led appeals of Ofwat's decisions.

#### Oxera commentary

- The appeals framework is now the prevailing model in the vast majority of UK-regulated sectors—including air traffic control, airports and energy—and it seems inevitable that the PR24 redetermination will be the last of its kind. (Incidentally, the CMA's own submission to the Commission had suggested that price control appeals should be heard by the Competition Appeals Tribunal, rather than CMA panels.)
- The suggestion that the majority of WACC components should be set centrally by the CMA is more radical. Efforts have already been taken to establish common WACC methodologies and enhance consistency through the UK Regulators' Network (UKRN). Assigning WACC determinations to the CMA would represent an additional step towards cross-sector uniformity. Sector-specific betas and cost of embedded debt allowances would still allow for variation in returns between sectors to reflect genuine differences in risk and debt costs. It is not clear from the report whether CMA decisions on the WACC would be appealable—with a lack of appeal route likely to be a matter of concern to investors in the sector.

<sup>10</sup> Independent Water Commission (2025), 'Final Report', 21 July, paras 658–59.

## Asset health and resilience

Drawing from work by the National Infrastructure Commission as well as its own research and stakeholder engagement process, the Commission is **highly critical of the prevailing approach to regulating asset health**, highlighting the following concerns.

- Responsibility for asset health and infrastructure resilience is spread across regulators and there is limited integrated oversight. While noting that the EA and DWI set implicit standards in places, the Commission is critical of Ofwat's failure to lead or coordinate regulatory assurance of companies' infrastructure or consider overall system resilience given its [Ofwat's] resilience objective/duty.<sup>11</sup>
- The reliance by Ofwat on a handful of backward-looking, short-term, 'failure-based' metrics to assess companies' resilience.<sup>12</sup> The Commission highlights that the incomplete picture these metrics create can be overly affected by external factors (such as weather)—giving an overly optimistic view of asset condition.<sup>13</sup> The Commission highlights Ofwat's failure to respond to the CMA's call for Ofwat to develop a forward-looking approach to assessing asset health after PR19.
- Limited engineering capability at Ofwat.<sup>14</sup>
- A lack of transparency over the extent to which base cost allowances are, or should be, used to effectively maintain assets rather than to support other activities or objectives.<sup>15</sup>
- The general duties on companies to provide drinking water and treat waste lack minimum system resilience standards to provide a high level of confidence that they will deliver a resilient system in the context of forward-looking risk.<sup>16</sup>
- Cyber security resilience is lacking, in part as there are gaps in the legislation of cyber standards for wastewater activities and projects carried out by third parties (such as DPC and SIPR). The Commission has also identified gaps in how security legislation is enforced—as the Water Industry Act does not provide for powers of entry and the power to issue penalties has been retained by the Secretary of State, rather than being delegated to relevant regulators.

The Commission recommends **that statutory resilience standards (covering both system infrastructure and supply chains) should be developed** for the water industry. These would 'ensure all companies make forward-looking, long-term assessment of their systems and assets and of their ability to recover from disruption'.<sup>17</sup> This should be done at pace, so that the resulting priorities can be reflected within the PR29 settlement. This goes hand in hand with another recommendation that companies should be required to collect data on, map and assess the health of their assets.

The Commission proposes that this be operationalised through **strengthened oversight by the new consolidated regulator**. This would include the appointment of a Chief Engineer to the board of the regulator—for the first time since 2005. The Commission envisages that the new approach to supervision will play a key part in how the new regulator is able to scrutinise companies' activities. Taken with the other changes, this effectively amounts to a rollback of the Gray Review recommendations to move to a lighter-touch, outcomes-based approach first implemented at PR14. This is consistent with the recommendations Oxera made in the report we prepared on behalf of Water UK.<sup>18</sup>

With respect to cyber security, the Commission recommends that the existing gaps in legislation be remediated by the UK and Welsh governments, and enforcement powers delegated to the new consolidated regulator.

### Oxera commentary

The report leaves no question that there is a significant asset health deficit to be redressed. While the Commission's recommendations are clear, and consistent with a move towards a more sustainable and long-term approach to asset health, they are far from a clear roadmap to achieving this goal. A large amount of work will need to underpin how future legislation is defined, how the new regulator is set up and how the new regulatory regime delivers the required change. It is essential that companies are at the heart of designing these changes—if nothing else the last decades have shown that a top-down imposed model cannot deliver the right outcomes for a sector with such a large, complex and dispersed asset base.

Two of the key issues facing the new regulatory regime will be:

<sup>11</sup> Independent Water Commission (2025), 'Final Report', 21 July, para. 874.

<sup>12</sup> Independent Water Commission (2025), 'Final Report', 21 July, para. 868, para. 871.

<sup>13</sup> Para. 871.

<sup>14</sup> Para. 875.

<sup>15</sup> Paras. 453–455. Recommendation 19.

<sup>16</sup> Para. 869.

<sup>17</sup> Para. 882. Recommendation 66.

<sup>18</sup> Oxera (2025), '[A new approach to performance and supervision in the England and Wales water sector](#)', 25 April, accessed on 22 July 2025.

- 1 deciding how much work needs to be done—which assets should be replaced and how should refurbishment programmes be designed;
- 2 assessing the cost effectiveness of companies' programmes to replace and refurbish their assets.

Addressing the former will likely draw extensively on the regulator's new supervisory functions and engineering capabilities. However, the industry has a crucial role to play in coordinating how companies collect data and assess asset condition, as well as proactively taking ownership of the business planning process. As day-to-day operators of their networks, companies have a unique insight into what needs to be done that needs to be central to future planning.

With respect to cost and performance assessment, while the emphasis on econometric modelling as the 'final word' on the efficiency of costs looks set to change, such models are likely to remain an important part of the regulatory regime. Importantly, the econometric models of the future should avoid perpetuating the negative incentives that prevailed in the past.

In this regard, European sector regulators offer valuable lessons in complementing top-down econometric benchmarking with advanced supervisory tools for proactive assessment and targeted intervention.

As well as developing independent sources of evidence to validate the outputs of any top-down analysis, the future regulator should consider how it can capture workload in its modelling. Workload variables (e.g. measures or renewal or replacement activities) are used by Ofgem to assess replacement and capital expenditure requirements. This way, companies are not penalised for doing more and there is reduced incentive to 'outperform' through under-delivery.

A final question mark hanging over the future approach to regulating asset health is whether customers will fund the costs of redressing the full deficit, or whether investors will be expected to fund (as well as finance) the shortfall. The Commission sets out that the water industry is best served by investors that take a long-term, low-return, low-risk approach. Such investors are unlikely to be attracted if they perceive a risk of ex post penalties—particularly if historical underinvestment was considered to be 'within the rules of the game' under the previous regime or has happened under the stewardship of previous owners. The industry reset envisaged by Sir Jon Cunliffe may be the time for amnesty for past mistakes, so that the asset health deficit can now be addressed for future generations.

## Next steps

Led by Sir Jon Cunliffe, the Commission has provided a detailed report with wide-ranging and, in some cases, radical recommendations.

It is clear that there is a lot to reflect on, and that key issues will include (1) balancing time to get the enduring regime right and managing the transition under Ofwat and (2) how the still broad concepts in Cunliffe's report will be implemented in practice.

There remains a huge amount still to work out and a key clear implementation plan will be needed to give stakeholders confidence in next steps. A robust economic appraisal, with a comprehensive analysis of the costs and benefits of the Commission's proposals will also be needed.

With primary legislation needed to implement a high proportion of the changes, it is likely to be some time before there is certainty over what is taken forward, and how.

The extent to which the new arrangements can be implemented in time for PR29 remains to be seen.