

August 2014

**Setting price controls for 2015-20**  
**Draft price control determination notice:**  
**company-specific appendix – Bristol Water**



**OFWAT**

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## Overview

This appendix sets out the details of the draft determination of price controls that are specific to Bristol Water. Our draft determination is based on Bristol Water's business plan as submitted by 27 June and its responses to our subsequent queries.

Bristol Water made a number of changes to its plan following the outcome of the risk-based review. We continue to have material concerns surrounding the company's wholesale water costs in the revised business plan. Due to the scale of the difference between the company's view and our view, we published information on our assessment of Bristol Water's special cost claims on 6 August to give the company more time to reconsider its proposals or to supply us with further evidence. In addition, we are making a number of further interventions in Bristol Water's plan designed to safeguard customers' interests. Some of these interventions are around outcomes and the associated delivery incentives which are common to all companies.

It should be noted that in order for the price controls to protect the interests of consumers, we consider that – in accordance with their licence obligations – companies must act in an economic and efficient manner in all circumstances. For the avoidance of doubt, this obligation overrides any individual incentive element.

This draft determination sets out the draft allowed revenues and K factors for Bristol Water, along with what they mean for average customer bills. We have summarised this information in the 'draft determination at a glance section'. The draft determination also sets out:

- the outcomes we expect the company to deliver under each price control;
- the costs we are assuming the company will incur and, where appropriate, the assumptions we have made to arrive at the allowed revenue for each price control;
- the adjustments we are making to the wholesale water and wastewater price controls to reflect the company's performance in 2010-15; and
- our assumptions on risk and reward, including the uncertainty mechanisms that form part of each price control.

As part of this price review, we stated in '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' (our 'final methodology statement') that we would be setting separate price controls for wholesale and retail elements of the appointee business. We explained that these separate controls would be binding, confirmed through the modifications made to the price setting elements of companies' licence conditions.

This means that the companies cannot recover more revenue than allowed under each specific price control. The revenue allowance for each price control is determined by the costs specific to that particular price control. This means that companies cannot cross-subsidise between

controls in terms of costs or revenues, which gives important benefits for providing more effective incentives. It also supports the development of the relevant markets and in particular those provided for by the Water Act 2014.

We have made this draft determination in accordance with our final methodology statement and our statutory duties. We have also had regard to relevant guidance from the UK Government, and where appropriate Welsh Government, and the principles of best regulatory practice to be transparent, accountable, proportionate, consistent and targeted.

This draft determination is structured on an element-by-element basis and is separated into:

- wholesale water;
- wholesale wastewater;
- household retail; and
- non-household retail.

In each area, we have set out the relevant information after our interventions – that is, our draft determination. In those areas in which we have intervened, we discuss the difference between our view and the company view further in the specific annexes where appropriate.

At the appointee level, this draft determination sets out our view of the company's financeability over the period 2015-20.

Annexes 1 to 4 form part of the draft price control determination.

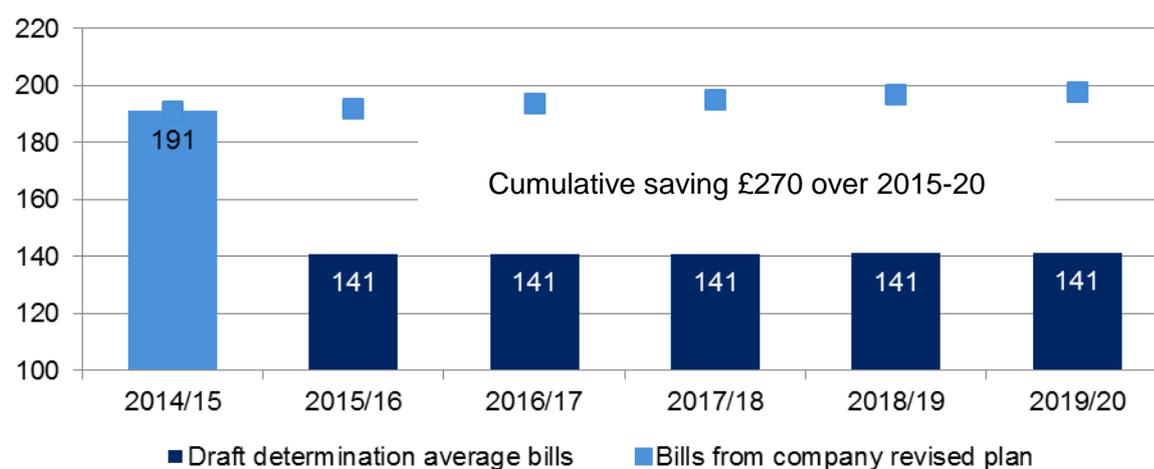
## A1. Draft determination for Bristol Water – at a glance

In this section we set out what the draft determination means:

- for customers, with respect to the average bills they will pay and the outcomes that the company will deliver in return; and
- for the company, with respect to the allowed costs/expenditure, return on regulatory equity (RoRE) range; financial ratios (under the notional structure) and the interventions we made to the company's revised plan.

It should be noted that on 6 August we informed Bristol Water that very material differences remain between the its re-submitted plan and our current assessment of efficient wholesale water costs. We did this to give Bristol (and other affected companies) as much time as possible to reflect on its plan for the coming five-year period and reconsider its proposals or provide further evidence in responding to our draft determinations. Accordingly the information presented below should be considered in the context of this material gap.

### Average household bill (£)



**Note.** The “bills from company revised plan” is based on the data submitted by the company in its business plan but projected using our financial model, thereby ensuring consistency with the draft determination projection. As a consequence the company's proposed bills illustrated above may not necessarily be the same as those described in the revised business plan.

### Outcomes

Wholesale	
Reliable supply	Resilient supply
Sufficient supply	Safe drinking water

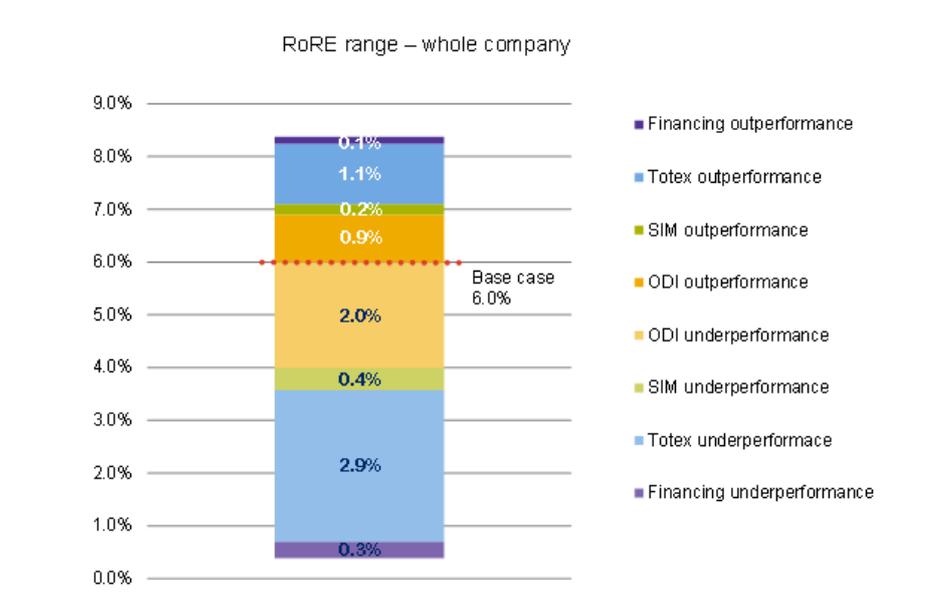
Wholesale	
Water is good to drink	Efficient use of resources by company
Efficient use of water by customers	Sustainable environmental impact
Retail	
Affordable bills	Satisfied customers
Easy to contact	Bills are accurate and easy to understand

### Allowed costs/expenditure<sup>1</sup>

Wholesale	Water	
Totex – 2015-20 total (£m)	383.7	
Allowed weighted average cost of capital (%)	3.70%	
Allowed wholesale revenue in 2015-20 (£m)	415.6	
Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	46.8	
Margin (%)	1.00%	2.5%
Retail allowed revenue (£m)	50.8	7.4
Average bill per household customer – retail component only (£)	21	

<sup>1</sup> Wholesale figures in 2012-13 prices and retail figures in nominal prices: this is consistent throughout this draft determination unless otherwise stated.

## RoRE ranges – appointee



## Ofwat's calculation of notional financeability ratios

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover	3.74
Adjusted cash interest cover ratio (ACICR) – base case (average over five years)	1.85
Funds from operations/debt	13.01%
Retained cash flow/debt	10.30%
Gearing	64.72%
Dividend cover (profit after tax/dividends paid)	2.17
Regulatory equity/regulated earnings for the regulated company	16.66
RCV/EBITDA	8.36

## Summary of interventions

### Outcomes

- **Cap:** We have imposed an overall cap and collar on outcome delivery incentives of +/- 2% of RoRE
- **Horizontal check:** We have made two performance level targets more stretching and changed the penalty for one incentive
- **Bottom-up analysis:** We have made a small number of changes, including amending the penalty rates and changing the range over which penalties apply

### Wholesale costs

- The company's proposed wholesale water totex of £562 million is £203 million (57%) above our draft determination threshold of £359 million.
- We have rejected some of the company's wholesale cost adjustments, or only partially allowed them. We also made some adjustments to our modelling.

<p><b>Retail</b></p> <ul style="list-style-type: none"> <li>• We have rejected the company’s claim for an adjustment to the average cost to serve for input price pressure (IPP).</li> <li>• We have rejected the company’s claim for non-household retail new costs associated with market opening.</li> </ul>	<p><b>Reconciling 2010-15 performance</b></p> <ul style="list-style-type: none"> <li>• We have intervened in the adjustments related to 2010-15 performance (primarily capital expenditure incentive scheme – CIS) to ensure that the adjustments are consistent with our methodology which has reduced the revenue requirement by £3 million.</li> <li>• We have intervened to apply a shortfall on water infrastructure, resulting in an RCV adjustment of £12 million.</li> </ul>
<p><b>Risk and reward</b></p> <ul style="list-style-type: none"> <li>• We have rejected Bristol’s proposed company specific uplift to the weighted average cost of capital (WACC) of 70 basis points.</li> <li>• We have changed the proposed cost sharing rate related to the business rates uncertainty mechanism from 100% to 75%:25% in line with other companies.</li> <li>• We removed the company’s proposed change protocol for costs of non-household competition.</li> </ul>	<p><b>Financeability and affordability</b></p> <ul style="list-style-type: none"> <li>• In the absence of customer preferences for bill profiles, we have reprofiled bills so that there is a reduction in the first year with flat bills for the remainder of the period.</li> </ul>

## A2. Wholesale water

### A2.1 Company outcomes, performance commitments and delivery incentives

#### A2.1.1 Outcomes, performance commitments and incentives

In the [outcomes technical appendix](#), we discuss our approach to outcomes for the wholesale and retail controls.

We summarise the outcomes, performance commitments and outcome delivery incentives for the wholesale water control for Bristol Water in Table A2.1 below.

We are intervening to impose an overall cap and collar on outcome delivery incentives for the 2015-20 period, thereby limiting total rewards and penalties. The maximum rewards for outperformance will be limited to +2% of RoRE and maximum penalties for underperformance are limited to -2% of RoRE. This will help ensure that the overall package of delivery incentives is calibrated to provide meaningful financial incentives and protect customers.

For some performance commitments and incentives types, we have intervened to change the underlying performance level or incentives. These interventions are listed in Table A2.1 below. Full detail of the wholesale water outcomes, performance commitments and incentives is provided in annex 4.

**Table A2.1 Wholesale water outcomes, performance commitments and incentives**

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
A: Reliable supply	A1: Unplanned customer minutes lost	Reward and penalty	No intervention
	A2: Asset reliability – infrastructure	Penalty only	No intervention
	A3: Asset reliability – non-infrastructure	Penalty only	No intervention

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
B: Resilient supply	B1: Population at risk from asset failure	Reward and penalty	<p><b>Bottom-up analysis</b></p> <p>Changed the range over which the penalties in years 3 to 5 apply so that the maximum penalty is equal to half the allowed totex. This ensures that customers are protected in the event of non-delivery.</p>
C: Sufficient supply	C1: Security of supply index	Non-financial	No intervention
	C2: Hose pipe ban frequency	Penalty only	No intervention
	C3: Delivery of Cheddar reservoir stage 2 construction	Penalty only	<p><b>Bottom-up analysis</b></p> <p>Removed performance commitment reflecting the rejection of a special cost claim. However, we recognise that Bristol Water may want to revisit this incentive in its draft determination representations.</p>

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
D: Safe drinking water	D1: Mean zonal compliance	Penalty only	<p><b>Horizontal check</b></p> <p>Changed to a penalty only ODI.</p> <p>Change the committed performance level from 2017-18 onwards to 100%.</p> <p>Set the penalty deadband at 99.96% for all years.</p> <p>Set the penalty collar at 99.95% for all years.</p> <p>Set the penalty incentive rate equal to the average proposed by the water-only companies.</p>
	D2: Construction of Cheddar TW algae removal	Penalty only	<p><b>Bottom-up analysis</b></p> <p>Changed the penalties for late and non-delivery, reflecting a downward adjustment of allowed costs.</p>
E: Water is good to drink	E1: Negative water quality contacts	Reward and penalty	<p><b>Horizontal check</b></p> <p>Reduced (ie, improved) committed performance level in 2017-18 to 2019-20 to be equal to upper quartile performance.</p> <p>Adjusted penalty collars and reward caps to keep the distance between them and the deadbands the same as Bristol Water proposed in its revised business plan.</p> <p>Set penalty deadbands for 2015-16 to 2017-18 at the 2014-15 committed performance level.</p> <p>Set reward deadbands for all</p>

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
			years at upper quartile performance.
F: Efficient use of resources by company	F1: Leakage	Reward and penalty	No intervention
G: Efficient use of water by customers	G1: Meter penetration (households)	Reward and penalty	No intervention
H: Sustainable environmental impact	H1: Total carbon emissions	Non-financial	No intervention
	H2: Raw water quality of sources	Non-financial	No intervention
	H3: Biodiversity Index	Non-financial	No intervention
	H4: Waste disposal compliance	Non-financial	No intervention

### A2.1.2 Outcome delivery and reporting

In the [assurance technical appendix](#), we set out our proposed framework for the form and level of reporting, monitoring and assurance we will seek from companies during the five year regulatory period 2015 -2020 in relation to the delivery of their commitments for the price review. This sets out three levels of assurance and the opportunities available for a company to improve its category status through the finalisation of the price controls and during the regulatory period itself.

We are satisfied with the company's proposals for self-reporting. But consistent with the commentary in our assurance technical annex, we will need to consider the categorisation of the company for assurance purposes at the final determination.

Bristol Water's proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach is summarised in Annex 4.

## A2.2 Calculating the wholesale water price control

### A2.2.1 Calculating allowed wholesale water expenditure

Our approach to calculating allowed wholesale expenditure is set out in the [wholesale water and wastewater technical appendix](#). In addition, due to the very material differences between Bristol Water's resubmitted plan and our assessment of efficient wholesale costs, we published information regarding our assessment of Bristol Water's special cost claims on 6 August.<sup>2</sup>

In Bristol Water's revised plan the company proposed wholesale water totex of £562 million over 2015-2020 (versus £572 million in its December plan). We calculated the draft determination threshold at £359 million (including an allowance for NEP5), giving rise to a difference of £203 million or 57%. We did consider making a further £152 million in adjustments to our threshold (net of implicit allowances), however the company did not provide sufficient evidence to support these claims. We also note that the company made representations to our cost models following the publication of these in April. The representations made and our response is summarised in the [wholesale water and wastewater technical appendix](#).

It should be noted that the actual gap faced by the company is smaller than what would be implied when looking at the totex gap. This is because the use of menus and our approach to setting baselines<sup>3</sup> reduces the difference faced by the company. In particular, the difference between the company's plan and the amount that it would ultimately recover from customers is 19.8%.

The proposed wholesale water allowed expenditure for Bristol Water is detailed in Table A2.2 below. We provide a further breakdown of some of the calculations in annex 1. Further information about our assessment of each claim is set out in the [populated version of draft determination initial cost threshold models](#).

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<sup>2</sup> See [http://www.ofwat.gov.uk/pricereview/pr14/prs\\_web20140806wholesalecost.pdf](http://www.ofwat.gov.uk/pricereview/pr14/prs_web20140806wholesalecost.pdf)

<sup>3</sup> In calculating an expenditure allowance for a company, we combine our own cost baseline and the company's cost projection with weights of 75% and 25% respectively. This works to reduce any gap in cost baselines

**Table A2.2 Wholesale water allowed expenditure (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	2015-20 total
Draft determination cost threshold						358.9
Costs excluded from menu						6.7
Menu cost baseline <sup>1</sup>	70.2	70.2	70.7	70.4	70.7	352.2
Company's view of menu costs <sup>2</sup>						457.8
Implied menu choice <sup>4</sup>						130.0
Allowed expenditure from menu	75.5	75.5	76.0	75.6	76.0	378.6
Costs excluded from menu	1.4	1.3	1.3	1.3	1.3	6.7
Total allowed expenditure <sup>3</sup>	76.9	76.8	77.4	77.0	77.3	385.3
Less pension deficit repair allowance	0.3	0.3	0.3	0.3	0.3	1.6
<b>Totex for input to PAYG</b>	<b>76.5</b>	<b>76.5</b>	<b>77.0</b>	<b>76.7</b>	<b>77.0</b>	<b>383.7</b>

**Notes:**

1. Menu baseline is equal to the draft determination threshold less pension deficit recovery costs, third party costs and market opening costs related to 2014-15 (see annex 1).
2. Based on company plan totex minus costs for items excluded from the menu.
3. Includes pension deficit repair allowance.
4. The menu choice is capped at 130 consistent with our policy update on April 2014 ([http://www.ofwat.gov.uk/pricereview/pr14/pap\\_pos140404pr14policy.pdf](http://www.ofwat.gov.uk/pricereview/pr14/pap_pos140404pr14policy.pdf)). Further detail is set out in the [wholesale water and wastewater technical appendix](#).

**A2.2.2 Calculation of revenues: pay as you go (PAYG) and regulatory capital value (RCV)-run off**

Table A2.3 shows the company's proposed PAYG ratios and associated totex recovery for wholesale water, which we have used as the basis for this draft determination.

**Table A2.3 Bristol Water wholesale water PAYG ratios**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	76.5	76.5	77.0	76.7	77.0	383.7
PAYG %	53.7%	53.7%	53.7%	53.7%	53.7%	53.7%
Resulting PAYG (£m)	41.1	41.0	41.3	41.1	41.3	205.9

Table A2.4 shows the RCV run-off amounts included within the wholesale water charge. This reflects a run-off rate of 6.00% for the RCV as at 31 March 2015 and 30 years for the totex additions to the RCV over 2015-20.

**Table A2.4 Bristol Water wholesale water RCV run-off (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	23.7	22.3	21.0	19.7	18.5	105.3
RCV run-off of totex additions	0.6	1.8	3.0	4.1	5.3	14.8
Total RCV run-off	24.3	24.1	23.9	23.9	23.9	120.1

### A2.2.3 Return on the RCV

The company has asked for a company specific uplift of 70 basis points to the wholesale WACC of 3.70% set out in the risk and reward guidance. We have considered whether it would be appropriate to allow for this uplift based on the approach we set out in our risk and reward guidance:

**“To justify a company-specific uplift in the WACC, companies will need to demonstrate both that they face a higher cost to raising finance and that there is an offsetting benefit to customers”**

As set out in the [risk and reward technical appendix](#), we consider that Bristol, in common with five other small water only companies, faces higher cost of raising debt, which would be 25 basis points above the cost of debt of 2.75% set out in the risk and reward guidance. This means that the company passed test 1: higher finance costs.

Consistent with our guidance, we have then considered whether there would be offsetting benefits to customers from providing this company specific uplift to Bristol.

For the reasons set out in the [risk and reward technical appendix](#), the company did not pass test 2.

While direct evidence from customers is valuable, it is not a substitute for demonstrating benefits to customers. Bristol presented evidence from its engagement with CCG, which was based on bills increasing due to PAYG by £10 without a company specific uplift whereas bills only rise by £5 with its proposed uplift. However, this evidence appears to be based on maintaining actual rather than notional financeability, as set out in section A5.4, Bristol Water's notional financeability remains comfortable without a company specific uplift or adjustment to PAYG and RCV run off rates.

We have therefore concluded that it would not be efficient for customers to face the incremental costs of finance and therefore have concluded that there should not be an adjustment to the wholesale cost of capital.

We have therefore intervened and used a wholesale water cost of capital of 3.70% in this draft determination. This results in a return on capital of £78.4 million over 2015-20.

Table A2.5 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A2.2.4 below. The average RCV, set out in Table A2.6 for each year, takes into account the proportion of totex additions to the RCV determined by the PAYG ratio and RCV run-off.

**Table A2.5 Bristol Water wholesale water opening RCV (£ million)**

	2015-16
Closing RCV 31 March 2015	391.8
Land sales	0.0
Adjustment for actual expenditure 2009-10	-0.6
Adjustment for actual expenditure 2010-15 <sup>1</sup>	16.3
Net adjustment from logging up, logging down and shortfalls	-11.9
Other adjustments	0.0
Opening RCV 1 April 2015	395.6

**Note:**

1. The adjustment for actual expenditure 2010-15 is explained further in annex 3 as part of the CIS adjustment.

**Table A2.6 Bristol Water wholesale water return on RCV (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	395.6	406.7	418.1	429.9	441.5
RCV additions (from totex)	35.5	35.4	35.7	35.5	35.7
Less RCV run-off	24.3	24.1	23.9	23.9	23.9
Closing RCV	406.7	418.1	429.9	441.5	453.3
Average RCV (year average)	401.2	412.4	424.0	435.7	447.4
Return on capital	14.8	15.2	15.7	16.1	16.5

#### A2.2.4 Reconciling 2010-15 performance

Our approach to reconciling 2010-15 performance is set out in the [wholesale water and wastewater technical appendix](#).

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale water services to reconcile performance in 2010-15. We have intervened and as a result the revenue adjustments for wholesale water have changed from £1.2 million to -£1.2 million. We summarise these interventions in Table A2.7 below, and quantify the resulting adjustments within this draft determination. The impact on the opening RCV of 2010-15 adjustments is shown in Table A2.5. As noted in the table above, we have applied -£11.9m in (net) adjustments arising from logging up, logging down and shortfalls. It should be noted that the company did not propose a shortfall and therefore we have intervened and applied a shortfall of -£11.9m – this relates to (i) unplanned interruption to supply exceeding 12 hours; and (ii) iron mean zonal non-compliance. Further information on our interventions and rationale is set out in annex 3.

**Table A2.7 Bristol Water wholesale water revenue adjustments to reflect 2010-15 performance (£ million)**

Area	Intervention	Why we did it	Total 2010-15
Service incentive mechanism (SIM)	SIM performance reward has increased	To reflect updated industry performance in line with the methodology.	3.0

Area	Intervention	Why we did it	Total 2010-15
Revenue correction mechanism (RCM)	There are changes in inputs and inconsistencies in the calculation, although they cancel each other out in respect of the overall adjustment	We have corrected for inconsistencies between the company's and our view of the FD09 assumptions and corrected for inconsistencies between the business plan tables and the RCM model.	2.6
Opex incentive allowance (OIA)	There are no interventions in this area.	n/a	0.0
Capital expenditure incentive scheme (CIS)	In carrying out our assessment, we have: <ul style="list-style-type: none"> <li>used the Competition Commission's (CC) redetermination values for the bid capex and replicated the CC's CIS ex ante ratio and additional income</li> <li>profiled the revenue adjustment using the same profiling approach as the company</li> <li>used the CC pre-tax WACC as the discount rate (5.97%) in the future value calculation</li> <li>used our assumption of the PR14 cost of capital as the discount rate (3.70%) when profiling the revenue adjustment.</li> </ul>	The company has not reflected the CC redetermination bid capex in its CIS model. This affects the RCV adjustment and the revenue adjustment. The company uses its view of the discount rates (6.10%) in the future value calculation and 5.20% when profiling the revenue adjustment in 2015-20.	-6.7

Area	Intervention	Why we did it	Total 2010-15
Other adjustments	There are no interventions in this area.	n/a	0.0
<b>Total</b>	n/a	n/a	-1.2

### A2.2.5 Calculation of allowed revenue

We set out the calculation of the allowed revenue for Bristol Water's wholesale water control in Table A2.8.

Overall, we consider that the company's wholesale water revenue allowance should be £82.0 million in 2015-16, increasing by 2.6% to £84.1 million in 2019-20.

**Table A2.8 Bristol Water wholesale water allowed revenue (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	76.5	76.5	77.0	76.7	77.0	383.7
PAYG ratio	53.66%	53.66%	53.66%	53.66%	53.66%	-
Totex additions to the RCV	35.5	35.4	35.7	35.5	35.7	177.8
RCV (year average)	401.2	412.4	424.0	435.7	447.4	-
<b>Wholesale allowed revenue build up:</b>						
PAYG <sup>1</sup>	41.4	41.4	41.7	41.4	41.6	207.5
Return on capital	14.8	15.2	15.7	16.1	16.5	78.4
RCV run-off	24.3	24.1	23.9	23.9	23.9	120.1
Tax <sup>2</sup>	1.8	1.8	1.5	1.2	0.9	7.2
Income from other sources	-1.9	-1.9	-1.8	-1.8	-1.7	-9.1
Reconciling 2010-15 performance	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Ex ante additional menu income	-2.9	-2.9	-3.0	-3.0	-3.0	-14.8
<b>Wholesale allowed revenue adjustments</b>						
Profiling adjustments <sup>3</sup>	-0.7	-0.4	-0.2	0.6	0.8	0.0
Capital contributions from connection charges and revenue from infrastructure charges	5.5	5.6	5.5	5.4	5.3	27.4
<b>Final allowed revenues</b>	<b>82.0</b>	<b>82.7</b>	<b>83.1</b>	<b>83.7</b>	<b>84.1</b>	<b>415.6</b>

**Notes:**

1. PAYG includes the PAYG calculated from totex and the pension deficit repair allowance.
2. Including tax on adjustments for reconciling 2010-15 performance and ex-ante additional menu income. Bristol Water
3. Our bill profiling adjustments are discussed in section A5.5

## A2.3 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in the [risk and reward technical appendix](#). In Table A2.9 below, we set out Bristol Water's proposed wholesale water uncertainty mechanisms and our assessment of these proposals.

**Table A2.9 Bristol Water’s proposals for wholesale water uncertainty mechanisms**

Bristol Water proposals	Our assessment
<p>Bristol proposed an uncertainty mechanism for water business rates in which customers would absorb of 100% of increases in rates.</p>	<p>We consider that the materiality, comparability and control over risk criteria for water business rates are met. We have included a 75%:25% uncertainty mechanism for all companies consistent with our prior guidance and earlier draft determinations. While Bristol has separately proposed a gain sharing mechanism, we do not consider this is fully aligned with incentive based regulation or justifies a 100%:0% uncertainty mechanism for business rates.</p> <p>The specific text of this Notified Item and the rationale for its inclusion in the draft determination is set out in the <a href="#">risk and reward technical appendix</a>.</p>

## A3. Household retail

### A3.1 Company outcomes, performance commitments and delivery incentives

In the [outcomes technical appendix](#), we discuss our approach to outcomes for the wholesale and retail controls.

We summarise the outcomes, performance commitments and outcome delivery incentives for the household retail control for Bristol Water in Table A3.1 below.

For some performance commitments and incentives types, we have intervened to change the underlying performance level or incentives. These interventions are listed in Table A3.1 below. Full detail of the wholesale water outcomes, performance commitments and incentives is provided in annex 4.

**Table A3.1 Household retail outcomes, performance commitments and incentives**

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
G: Efficient use of water by customers	G2: Per Capita Consumption	Non-financial	No intervention
I: Affordable bills	I1: Percentage of customers in water poverty	Non-financial	No intervention
J: Satisfied customers	J1: SIM	Reward and penalty	No intervention
	J2: General satisfaction from surveys	Non-financial	No intervention
	J3: Value for money	Non-financial	No intervention
K: Easy to contact	K1: Ease of contacts from surveys	Non-financial	No intervention
L: Bills are accurate and easy to understand	L1: Negative Billing Contacts	Non-financial	No intervention

### A3.1.1 Outcome delivery and reporting

In the [assurance technical appendix](#), we set out our proposed framework for the form and level of reporting, monitoring and assurance we will seek from companies during the five year regulatory period 2015-2020 in relation to the delivery of their commitments for the price review. This sets out three levels of assurance and the opportunities available for a company to improve its category status through the finalisation of the price controls and during the regulatory period itself.

We are satisfied with the company's proposals for self-reporting. But consistent with the commentary in our assurance technical annex, we will need to consider the categorisation of the company for assurance purposes at the final determination.

Bristol Water's proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach is summarised in Annex 4.

## A3.2 Costs

Our approach to the household retail control is set out in the [household retail technical appendix](#).

### A3.2.1 Allocation of costs

In Table A3.2 below, we summarise our assessment of Bristol Water's cost allocation methodology.

**Table A3.2 Our assessment of Bristol Water's cost allocation methodology**

Area assessed	Assessment
No potential material misallocations	Pass
Adequate assurance provided	Fail
Reconciliation to Regulatory accounts and December business plan provided	Pass
Correct price base used	Pass

The company has submitted information to suggest that it has allocated its costs in line with our guidance. In our draft determination, we have used the company's cost allocations between retail and wholesale and between household and non-household.

However, we note that while the company states that it has obtained external assurance over its business plan cost allocations from PwC, it has not provided us with a copy of this report. Therefore we cannot place any reliance on this assurance.

We also note that the company has undertaken sampling to allocate its network customer enquiries and complaints between household and non-household and that it states that it has obtained external assurance over this sample. But again the company has not provided us with a copy of the assurance report so we cannot place any reliance on this assurance.

We will be expecting the company to provide us with a copy of the external assurance report covering their cost allocations (including assurance over their network customer enquiries and complaints sample) with its draft determination representations on 3 October.

In Table A3.3 below, we outline Bristol Water's proposed average cost to serve (ACTS) adjustments and our assessment of these proposals. The adjustments proposed by Bristol Water and Ofwat are quantified in Table A3.4. Our approach to assessing adjustment claims is set out in the [household retail technical appendix](#).

**Table A3.3 Bristol Water proposals for ACTS adjustments**

		Adjustment assessment criteria			
Adjustment	Value (£m over 2015-20)	Materiality	Beyond efficient management control	Impact company in materially different way	Value of adjustment appropriate
Input price pressure	5.8	Pass	Fail	Efficiency benchmarking evidence: Fail	Fail
				Upper quartile: Pass	

Bristol Water proposed an adjustment for input price pressure (IPP) of £5.8 million across 2015-20. We reject Bristol Water's proposal because the company has not demonstrated that these costs are outside of efficient management control or that it

is affected in a materially different way to other companies. We set out our assessment against each criteria below.

The value of the adjustment is material, at 10.4% of household retail operating expenditure plus depreciation over 2015-20.

We do not consider that the evidence provided on management practices is sufficient and convincing that the company manages its costs to the extent that future cost increases are outside of efficient management control.

The evidence provided on the relative efficiency of Bristol Water, including benchmarking is limited to whole company (not retail specific) benchmarking against the water industry only. We do not consider this to be sufficient evidence to demonstrate that Bristol Water is an efficient retailer compared to companies outside of the water industry.

Our assessment for ACTS does suggest that Bristol Water are upper quartile efficient for unmetered retail costs but not for metered costs. This assessment is subject to change up to final determination, for example, subject to cost allocation changes being made by companies that could affect the ACTS.

Although our ACTS assessment does suggest that Bristol Water is relatively efficient within the sector for some of its retail activities, because of the lack of convincing benchmarking evidence, the company has not demonstrated that it is efficient compared to companies outside of the water industry. Bristol Water has therefore not demonstrated that it is affected in a materially different way to other companies.

Although we do not consider that an adjustment for input price pressure is appropriate for Bristol Water, for completeness we have assessed the evidence provided on the size of an adjustment. We do not think that the evidence provided to support the size of the adjustment is sufficient. In particular, the measure of wage inflation is not targeted sufficiently at the type of labour employed by a water retailer and the Total Factor Productivity growth estimate is low compared to estimates provided by other companies.

**Table A3.4 Household retail adjustments (£ million, nominal prices)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
<b>Adjustments proposed in Bristol Water's business plan</b>						
Input price pressure	0.617	0.873	1.148	1.444	1.758	5.839
Pension deficit repair costs	0.069	0.069	0.068	0.068	0.068	0.342
<b>Adjustments included in business plan</b>	<b>0.685</b>	<b>0.941</b>	<b>1.217</b>	<b>1.512</b>	<b>1.826</b>	<b>6.182</b>
<b>Adjustments included in draft determination</b>						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.068	0.068	0.068	0.068	0.068	0.339
<b>Adjustments included in draft determination</b>	<b>0.068</b>	<b>0.068</b>	<b>0.068</b>	<b>0.068</b>	<b>0.068</b>	<b>0.339</b>

There will be no indexation for retail price controls.

### A3.2.3 New costs

Bristol Water did not propose material household retail new costs.

The modification for immaterial new costs included in this draft determination are quantified in Table A3.5.

**Table A3.5 New household retail costs (£/customer)**

	Value
Modification made to 2013-14 CTS for ACTS calculation	0.37

**Note:**

There will be no indexation for retail price controls from this 2012-13 price base.

### A3.3 Calculating the allowed revenues

Using the average industry allowances per customer, and the projected customer numbers in the company's revised business plan, we have calculated the total allowed household retail revenues, including the efficiency challenge and the household retail net margin.

### A3.3.1 Net margins

The table below shows the household retail net margin over 2015-20.

**Table A3.6 Household retail net margins (%)**

	2015-16	2016-17	2017-18	2018-19	2019-20
Household retail net margin	1.00%	1.00%	1.00%	1.00%	1.00%

Table A3.7 below sets out the components of the allowed household retail revenue.

**Table A3.7 Components of the allowed household retail revenue (nominal prices)**

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
<b>Company cost to serve (£/customer)</b>						
Unmetered single service customers	16.04					
Metered water only customers	23.40					
<b>Industry average cost to serve (£/customer)</b>						
Unmetered single service customers			20.73			
Metered water only customers			26.78			
<b>Allowed cost to serve<sup>1</sup> (£/customer)</b>						
Unmetered single service customers		14.74	15.01	15.28	15.57	15.87
Metered water only customers		21.77	21.71	21.66	21.62	21.92
<b>Total allowed (£ million)</b>						
Cost to serve (excluding net margin)		8.8	9.1	9.4	9.6	10.0
Forecast household wholesale charge		83.8	87.3	91.0	94.7	98.4

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
(including forecast RPI <sup>2</sup> ) <sup>3</sup>						
Household retail revenue (including an allowance for the net margin) <sup>4</sup>		9.5	9.8	10.2	10.5	10.8

**Notes:**

There will be no indexation for retail price controls.

1. Allowed cost to serve includes pension deficit repair costs.
2. The household wholesale charge includes forecast RPI so that the total household retail revenue can be displayed on the same price base as other retail costs.
3. The allocation of allowed wholesale revenue to different wholesale charges will be at the company's discretion, subject to charging rules and licence conditions.
4. This number is indicative as allowed revenue will depend upon actual customer numbers.

### A3.4 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in the [risk and reward technical appendix](#). In Table A3.8 below, we set out Bristol Water's proposed household retail uncertainty mechanisms and our assessment of these proposals.

**Table A3.8 Bristol Water proposals for household retail uncertainty mechanisms**

Bristol Water proposals	Our assessment
Bristol Water did not propose any uncertainty mechanisms related to household retail beyond those that will already form part of the regulatory framework for 2015-20.	n/a

## A4. Non-household retail

In the [non-household retail technical appendix](#), we outline our overall approach to the non-household retail price control. Further information regarding our observations on companies' proposals for their non-household retail price controls is set out in

In this chapter, we provide details of Bristol Water's non-household retail draft determination.

### A4.1 Indicative non-household retail total revenue

Table A4.1 below shows the indicative total of non-household allowed revenue. The table is indicative, as it does not assume any gains or losses from competition or impacts from the company charging customers at levels different to the relevant default tariffs for the projected customers in each customer type.

**Table A4.1 Indicative non-household retail total revenue price control including net margins (£ million, nominal prices)**

	2015-16	2016-17	2017-18	2018-19	2019-20
Indicative non-household retail total revenue price control including net margins	1.4	1.5	1.5	1.5	1.5

**Note:**

There will be no indexation for retail price controls from this price base. The non-household wholesale charge includes forecast RPI so that the total non-household retail revenue can be displayed on the same price base as other retail costs. Figures exclude retail services to developers and revenues associated with miscellaneous charges.

### A4.2 Net margins

The company proposed net margins that summated in aggregate to 2.5%. This is in line with our risk and reward guidance. We have therefore accepted the company's proposals.

### A4.3 Cost proposals

Below we set out our interventions on the company's costs, including for:

- Consistency with existing policy, including for example ensuring that companies cost information is presented in a consistent price base and pension deficit costs are presented as per our stated policy; and
- Cost escalation, including for example material new investments or increases in costs or requests for input cost allowances.

In ['IN 13/17: Treatment of companies' pension deficit repair costs at the 2014 price review'](#) we explained how we would treat the costs associated with water companies reducing the deficits in their defined benefit pension schemes at the 2014 price review. Where companies' proposals have differed from our calculations we have over-written their proposals in line with our overall approach.

This resulted in the company's proposals being adjusted from £0.060 million over the control period, to £0.054 million.

The company included an allowance for input price pressures. This was not supported by sufficient evidence. We therefore adjusted the company's proposals by £0.756 million over the control period to reflect this.

Overall the company's proposed costs increase by more than our non-household retail materiality threshold of 5.3% between 2015 and 2020. We therefore assessed the evidence presented in the company's plan.

The largest proposed new cost is for £2.25 million capex (pre efficiency) relates to company-specific 'market opening' costs. It is not clear from the company's submission what these costs will be used for, apart from new IT expenditure. The company has not provided sufficient evidence to justify the need, costs and benefits.

In total (including the pension deficit repair cost adjustment), this resulted in the company's proposed costs being adjusted from £7.328 million over the control period to £4.562 million.

We outline our approach to uncertainty mechanisms in the [risk and reward technical appendix](#). In Table A4.2 below, we set out Bristol’s proposed non-household retail uncertainty mechanisms and our assessment of these proposals.

**Table A4.2 Bristol Water proposals for non-household retail uncertainty mechanisms**

Bristol Water proposals	Our assessment
<p>Bristol proposed an uncertainty mechanism to protect against the unknown costs associated with establishing competition for non-household customers.</p>	<p>We do not accept this proposed uncertainty mechanism. This is based on the following:</p> <p><b>Materiality:</b> The totex impacts associated with the introduction of competition are not material.</p> <p><b>Controllability:</b> These costs will be incurred by Bristol Water and so it has some control over the level of the cost</p> <p><b>Comparability:</b> This risk is common to all companies and Bristol has not provided evidence demonstrating that why it requires specific protection from these risks when other companies do not. If Bristol is protected from this risk then there is a risk that this distorts competition which would not be in the interests of competition.</p> <p><b>Interests of customers:</b> Bristol have not proposed a sharing mechanism of the costs associated with the introduction of competition in this uncertainty mechanism and so it is unclear why it will operate in the interests of customers.</p>

## A5. Appointee

In this section we discuss at an appointee level:

- bills and K factors;
- uncertainty mechanisms
- return on regulated equity
- financeability; and
- affordability

### A5.1 Bills and K factors

Table A5.1 below sets out the allowed revenues we have assumed in our draft determination for Bristol Water to deliver its:

- statutory duties;
- outcomes; and
- associated performance commitments.

It also sets out the average customer bills on the basis of the draft determination.

We note that on 6 August we informed Bristol that very material differences remain between the its re-submitted plan and our assessment of efficient wholesale costs. This was done to give Bristol (and other affected companies) as much time as possible to reflect on its plan for the coming five-year period and reconsider their proposals or to provide further compelling evidence in responding to our draft determinations. The information presented below should be considered in context of this material gap.

#### **Table A5.1 Bristol Water's draft determination – K factors, allowed revenues and customer bills (in 2012-13 average prices)<sup>4</sup>**

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1. Wholesale figures in 2012-13 prices and retail figures in nominal prices.

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (£m) <sup>1</sup>	82.0	82.7	83.1	83.7	84.1	415.6
Wholesale water – K (%) <sup>2</sup>	0.00%	0.79%	0.68%	0.43%	0.38%	-
Retail household allowed revenue (£m)	9.5	9.8	10.2	10.5	10.8	50.8
Retail non-household expected revenue (£m)	1.4	1.5	1.5	1.5	1.5	7.4
Average household bill – water (£) <sup>3</sup>	141	141	141	141	141	-

**Notes:**

1. The allowed revenue for our draft determination is based on an implied menu choice. The company will have the opportunity to make its own menu choice, which will impact on its allowed revenues and customers' bills.
2. As discussed in the [wholesale water and wastewater technical appendix](#), K is set to zero for 2015-16 for wholesale water because there are no directly equivalent wholesale revenues for 2014-15 (on account of the new price review structure). As such, there is no reference point against which to express a change in K.
3. It should be noted the average household bill illustrated above reflects a notional allocation (by Ofwat but based on the company's split of household and non-household customers) of the overall wholesale revenue requirement across Bristol Water's household and non-household customer base. In practice, this will depend upon the structure of wholesale charges implemented by Bristol Water.

We note that customer bills in the regulatory period from 2020 will be affected by Bristol Water's performance in the forthcoming regulatory period in relation to costs and the regulatory incentives in place for performance delivery and revenue projection performance.

## A5.2 Uncertainty and gain share mechanisms

We outline our approach to uncertainty mechanisms and gain share in the [risk and reward technical appendix](#). In Table A5.2 below, we set out Bristol's proposed appointee level uncertainty mechanisms and our assessment of these proposals.

**Table A5.2 Bristol Water proposals for appointee level uncertainty and gain share mechanisms**

Bristol Water proposals	Our assessment
<p>Bristol Water has proposed a gain share mechanism for sharing returns on regulated equity (RoRE) in excess of 11% with a sharing rate of 50% customer and 50% company.</p> <p>Bristol explained that the purpose of this gain sharing mechanism is to provide symmetry to its ability to seek an IDoK in the event of extreme downside risks. The 11% threshold is modelled to be exactly symmetrical to the opposite downside risk that would trigger an IDoK. Bristol notes that although it has not historically achieved a RoRE of 11%, it is not unprecedented in the industry.</p>	<p>Bristol can elect to pass on a reduction in bills in 2015-20 or future periods without Ofwat's agreement and therefore we do not propose any intervention.</p> <p>However, we note that such a mechanism may not be consistent with incentive based regulation as it may reduce the incentive for Bristol to seek cost efficiencies and outperform to a level greater than the proposed 11% threshold.</p> <p>Bristol Water assumes that PR19 reconciliation of totex would take account of any cost sharing already provided through the gain sharing mechanism, although Bristol has not stated how this would operate. We do not propose PR19 totex reconciliation should take account of gain sharing undertaken by the company.</p>

## A5.3 Return on regulated equity range

We set out our approach to calculating the expected range in RoRE in the [risk and reward technical appendix](#). The whole company RoRE range, based on RoRE information provided by Bristol Water, and reflecting our interventions on ODIs, is shown in Table A5.3 below

**Table A5.3 Whole company RoRE range**

	Lower bound (%) (appointee)	Upper bound (%) (appointee)
Overall	-5.6%	+2.4%
ODIs	-2.0%	+0.9%
Totex	-2.9%	+1.1%
Financing	-0.3%	+0.1%
SIM	-0.4%	+0.2%

**Commentary:**

The whole company RoRE range is from 0.4% to 8.4% with a base case of 6.0%, and therefore overall impacts from -5.6% to +2.4%. This excludes any small company uplifts to the cost of debt or cost of equity that were proposed by Bristol.

The totex performance range from -2.9% to +1.1% has been modelled by Bristol Water with reference to economic and rainfall scenarios published with Ofwat's PR14, capex risks and downside-only specific cost risks. Bristol Water's methodology has been appropriately evidenced and is consistent with other companies on the downside, although towards the lower end on the upside. The evidence and narrative in Bristol's business plan demonstrates that it has considered a range of cost risks facing the business and that the cost impacts have been analysed on a P10/P90 basis. As set out in the [risk and reward technical appendix](#), this analysis does not take account of our interventions on wholesale totex for the draft determination.

The ODI range from -2.0% to +0.9% is based on Bristol's ODI submissions and the calculated impact of our interventions (see Annex 4).

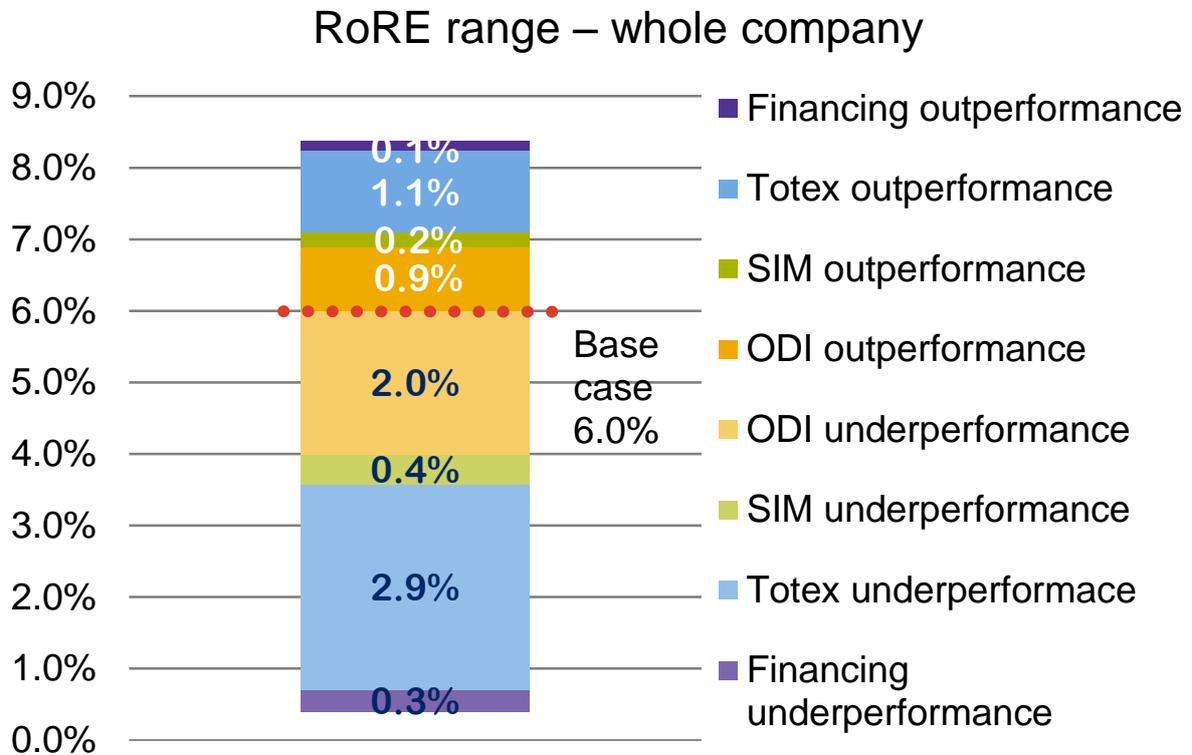
Bristol has assessed financing impacts on a notional basis. It has calculated differing impacts for the upside and downside based on a high level view of likely movements in interest rates during 2015-20. The resulting RoRE impacts of -0.3% to +0.1% are acceptable.

Bristol has estimated SIM impacts using an assumption of maximum rewards and penalties (+6% to -12% of 2019-20 household revenue). Bristol has performed at the lower end of the top quartile of companies against the SIM. We, therefore, consider the full range of SIM impacts and resulting RoRE impact of approximately -0.4% to +0.2% to be acceptable.

The composition of the RoRE range for Bristol Water at an appointee level is shown in

Figure A5.1 below.

Figure A5.1 Bristol Water RoRE range – appointee



### A5.4 Financeability

We have compared the financial ratios provided by Bristol Water and our calculation of its financial ratios implied by the company’s business plan proposals submitted on 27 June, when both are prepared on a notional basis. We illustrate these in the table below.

**Table A5.4 Company and Ofwat financial ratio calculations based on the company business plan and financial ratios based on our draft determination**

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on our draft determination (average 2015-20)
	Company calculation	Ofwat calculation	
Cash interest cover (ICR)	3.57	3.76	3.74
Adjusted cash interest cover ratio (ACICR) – base case (average over five years)	1.96	2.07	1.85
Funds from operations(FFO)/debt	14.02%	14.36%	13.01%
Retained cash flow/debt	10.99%	11.12%	10.30%
Gearing	61.30%	64.65%	64.72%
Dividend cover (profit after tax/dividends paid)	2.12	2.47	2.17
Regulatory equity/regulated earnings for the regulated company	15.07	13.67	16.66
RCV/EBITDA	7.81	7.59	8.36

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on our draft determination (average 2015-20)
	Company calculation	Ofwat calculation	

**Commentary:**

**Financial Ratios:** On a notional basis the company's and our ratios are broadly consistent. The company's reported notional level of gearing is materially lower than ours. The company has assumed a low dividend yield to help prevent rising gearing and consequential deterioration of ratios. Our modelling adheres to the notional dividend assumption. The underlying trend shows some deterioration in our calculated ratios although ratios are still reasonable by the end of the period. Consequently, we consider the company to be financeable at draft determination.

**PAYG changes:** Bristol Water increased its PAYG rates from its December plan for Water from 52% to 54%. The PAYG rate is 93% of opex plus IRE. PAYG is 119% of opex plus IRE expensed, which reflects Bristol Water expensing only 25% of IRE.

**Pass through of WACC Reduction:** Bristol reduced its view on WACC by 0.2% between December and June. Bristol Water does not pass through any of this reduction to customer bills in 2015-20.

**Customer Support:** We are concerned at the quality of the company engagement with its CCG on a company specific uplift to the WACC. It has asserted that failure to provide an uplift will result in bills increasing due to PAYG by £10 whereas bills only rise by £5 with its proposed uplift. The CCG has stated that they support the uplift, if the statement about bills is correct

**Conclusion on intervention:** We are proposing no intervention to PAYG rates on the basis of financeability. We do not propose to intervene on PAYG as the reduction in the WACC from the removal of company specific uplift for Bristol Water will benefit customers in 2015-20. Bristol Water should engage and obtain customer support if it subsequently proposes to change PAYG levers in response to the draft determinations. Any engagement on financeability should be undertaken on the basis of notional financeability.

Table A5.5 sets out the PAYG and RCV run-off rates which show whether revenue has been brought forward compared to the December plan and the impact that this has on RCV growth and longer term affordability and financeability. Bristol Water has increased PAYG rate, but RCV growth remains strong, even after allowing for Ofwat interventions on totex.

**Table A5.5 Impact on the longer term**

	PAYG rate	RCV run-off	RCV growth % 1 April 2015 to 31 March 2020
Company December plan	52.1%	6.00%	43.3%
Company June plan	53.7%	6.00%	29.6%
Draft determination	53.7%	6.00%	14.6%

## A5.5 Affordability

Table A5.6 sets out the change in household bill profile between the company's December and June business plans and the draft determinations.

**Table A5.6 Household bill profile**

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	195	193	193	193	193	193
Company June plan	195	193	193	193	193	193
Ofwat calculation for June plan	191	192	194	195	197	198
Ofwat calculation for draft determinations – pre-reprofiling	191	142	142	141	140	140
Ofwat calculation for draft determinations	191	141	141	141	141	141

Companies have not necessarily used the same method of calculating household bills as Ofwat – for example, we have included economies of scope for household retail when calculating combined water and sewerage bills. So the Ofwat calculations (lines 3 and 4 of Table A5.6) are not directly comparable to the company plans (lines 1 and 2 of Table A5.6). Our interventions have reduced revenue and bill requirements over 2015-20. In the absence of customer preferences for bill profiles at this level we have reprofiled bills so that there is a reduction in the first year with

flat bills for the remainder of the period. This equalises the customer benefits across the period. We invite Bristol Water to engage with its customers on their priorities for bills as part of its response to the draft determinations.

Table A5.7 sets out the reasons why this draft determination is assessed as affordable. It describes key changes in relation to Bristol Water's December business plan that we assessed as affordable between 2015-20.

**Table A5.7 Business plan affordability assessment**

	Commentary
<b>Acceptability</b>	Bristol Water conducted customer research to support its original December 2013 business plan submission. Its research found 90% of household customers supported a plan that proposed decreasing real term bills. It is reasonable to assume that the further reduction in bills resulting from our interventions in the this draft determination will remain acceptable to the majority of the company's customers.
<b>Identification of affordability issues and appropriate support measures</b>	There is no new evidence that the company is planning to alter its original submission's proposals to provide measures to ensure the affordability of its bills in 2015-20 such as its social tariff, restart schemes and more joint working with third parties to promote assistance schemes and tariffs (that we assessed as acceptable in the RBR).
<b>Longer-term affordability – cost recovery tools</b>	<p>Bristol failed to provide sufficient and convincing evidence of long-term affordability in its December submission and failed this aspect of the RBR affordability test. The company failed to demonstrate that customers actively support its use of the PAYG ratio to reduce bills in 2015-20 by £2 and increase bills by £5 at the start of the price control period 2020-25.</p> <p>After conducting new research the company concluded that customers favoured stable bills over the longer term (to 2025). In response to our challenge on the use of the PAYG levers to delay bill increases the company has now adopted a PAYG ratio that leaves bills flat throughout 2015 to 2025.</p> <p>We also note that Bristol has linked its research on the company specific uplift with the use of PAYG levers. In particular the company asserted that failure to provide an uplift will result in bills increasing due to PAYG by £10 whereas bills only rise by £5 with its proposed uplift. We consider the information provided to customers is likely to be misleading, as</p>

	Commentary
	<p>set out in section A2.2.3.</p> <p>However, the engagement with CCG on PAYG in regard to company specific uplift does not raise concerns about use of PAYG/RCV run off rates between price control periods.</p>
<b>Longer-term affordability – ODIs</b>	<p>The company's new research into ODIs tested a maximum positive bill impact of around £4 and this was considered not onerous by participants. Given the 90% acceptance level of the proposed bill profile across 2015-20 it is reasonable to conclude that such an impact would still see a plan that is acceptable to the majority of customers. The company's CCG is satisfied that the company has created a package of revisions to its ODIs that matches customers' views by increasing the size of the penalties to more than the size of the rewards (which the CCG supports).</p>

## Annex 1 Wholesale costs

### Establishing draft determination thresholds

Our approach to establishing draft determination thresholds is outlined in the [wholesale water and wastewater technical appendix](#).

In the tables below, we provide some information on the company-specific numbers that support these calculations.

Further information about our assessment of each claim is set out in the [populated version of draft determination initial cost threshold models](#).

**Table AA1.1 Movement from basic cost threshold to draft determination menu threshold for wholesale water totex (£ million)**

Basic cost threshold	Policy additions <sup>1</sup>	Unmodelled costs adjustment	Deep dive <sup>2</sup>	Draft determination threshold	Deep dives fully or partially not added <sup>3</sup>
315.3	29.5	14.0	0.0	358.9	152

**Note:**

1. We did make a number of adjustments as set out below, however these are reflected in policy additions and unmodelled cost adjustments
2. Deep dives are net of implicit allowances. A value of zero means deep dives are wholly covered by IAs or unmodelled adjustments.
3. See Table AA1.4 below.

**Table AA1.2 Policy additions to the wholesale water basic cost threshold (£ million)**

Business rates	Pension deficit payments	Third party costs	Open market costs <sup>1</sup>	Net v gross adjustments	Total
22.4	1.6	5.1	0.5	0.0	29.5

**Note:**

1. Of this amount, £0.062m relates to 2014-15 open market costs.

**Table AA1.3 Comparison of company wholesale water totex with the draft determination threshold and 2010-15 totex (£ million)**

Plan	DD threshold	Gap <sup>1</sup>	Plan v 2010-15
562.0	358.9	203.1	61.0

**Note:**

1. This gap will not equal the deep dives fully or partially not added in Table AA1.1 if the company's claims for special treatment in the costs thresholds are not equal to the gap.

In the table below we have summarised our assessment of the special cost claims made by the company and the amount allowed – this is consistent with the cost claims that were published on 6 August.

**Table AA1.4 Summary of wholesale water cost assessment**

Company proposal		Assessment				DD allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
<b>Cheddar Two Reservoir</b>	43.7	0	Fail	Partial pass	Fail	Reject	0
<b>Replacement of Bedminster Reservoir</b>	6.5	1.4	Fail	Fail	Partial pass	Reject	0
<b>Opex part 1: Water treatment modelling</b>	13.1	2.9	Fail	n/a	Fail	Reject	0
<b>Opex part 2: Canal water</b>	14.7	3.2	Fail	n/a	Fail	Reject	0
<b>Opex part 3: Canal and River Trust payments</b>	8.1	1.8	Fail	n/a	n/a	Reject	0
<b>Opex part 4: Bristol traffic</b>	6.0	1.3	Fail	Partial pass	Fail	Reject	0

Company proposal		Assessment				DD allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
<b>congestion</b>							
<b>Asset reliability – unplanned customer minutes lost<sup>1</sup></b>	3.5	0.8	n/a	n/a	n/a	Reject	0
<b>National Environment Programme</b>	11.9	0	Pass	Pass	Partial pass	Partially accept	3.2
<b>Capital maintenance costs</b>	81.1	17.9	Fail	n/a	Fail	Reject	0
<b>Southern Resilience Scheme</b>	30.8	8.4	Pass	Pass	Partial pass	Partially accept	3.2
<b>Asset Reliability – discoloured water contacts</b>	12.3	4.8	Pass	Pass	Partial pass	Partially accept	2.0

Company proposal		Assessment				DD allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
<b>Cheddar Treatment Works raw water deterioration</b>	23.0	10.1	Pass	Pass	Partial pass	Partially accept	5.6
<b>Growth expenditure</b>	14.4	10.1	Fail	Fail	n/a	Reject	0

**Note:**

1. Not assessed due to not passing materiality threshold.
2. The company also made representations on the totex models. Our analysis and conclusions on this claim have been set out in annex 1 to the wholesale cost technical appendix.

## Annex 2 Household retail revenue modification

We outline our approach to revenue modification in the household retail price control in the [household retail technical appendix](#).

Table AA2.1 sets out the amount per customer, by customer type, that allowed revenues will be modified by if outturn customer numbers differ from forecast customer numbers and Table AA2.2 sets out the baseline number of customers.

**Table AA2.1 Household retail allowed revenue modification factors by class of customer (£/customer)**

Revenue modification per:	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only customer	15.98	16.27	16.58	16.91	17.24
Metered water only customer	23.60	23.54	23.51	23.49	23.81

**Note:**

There will be no indexation for retail price controls.

**Table AA2.2 Assumed number of customers for household retail total revenues (000s)**

Number of customers	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only	245.7	226.3	208.3	191.5	175.8
Metered water only	237.0	261.8	285.3	307.4	328.4

## Annex 3 Reconciling 2010-15 performance

We set out our methodology for calculating the adjustments to 2015-20 wholesale price controls resulting from the company's actual performance during the 2010-15 period in the [wholesale water and wastewater technical appendix](#).

In this annex, we set out the draft determination adjustments to 2015-20 price controls for Bristol Water resulting from the company's actual performance during the 2010-15 period.

As part of the draft determination of the 2010-15 adjustments we have undertaken detailed calculations within our models for the RCM, OIA, CIS and serviceability shortfalls. While we have covered an explanation of our interventions within this annex, each model covers the detail of the specific calculation. Similarly, our detailed calculations behind the midnight adjustments such as land sales (but excluding those relating to the Change protocol) are contained within the RCV midnight adjustment model. A copy of any of these models is available on request.

Table AA3.1 below compares the company's view of the required revenue adjustments included in its revised business plan for each of the incentive tools for water services, with our own view. Our view reflects our understanding of the company's performance using these incentives, based on information provided in its revised business plan and subsequent query responses. The table also shows other adjustments, such as those relating to tax resulting from the company's actual performance during the 2010-15 period.

**Table AA3.1 Revenue adjustments 2015-20 (£ million)**

	Company view	Ofwat view
Service incentive mechanism (SIM)	2.435	3.023

	Company view	Ofwat view
Revenue correction mechanism (RCM)	2.560	2.560
Opex incentive allowance – post-tax (OIA)	0.000	0.000
Capital expenditure incentive scheme (CIS)	-3.845	-6.743
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000
Total wholesale legacy adjustments	1.150	-1.161

**Notes:**

Totals may not add up due to rounding.

For the CIS mechanism, there is a corresponding adjustment to the RCV made at 1 April 2015 (part of the ‘midnight’ adjustments’). The impact on the RCV for water can be seen in Table AA3.15. This adjustment is net of any logging up, logging down or shortfalls. A full reconciliation showing all of the midnight adjustments to the RCV, including the impact of logging up, logging down and shortfalls, can be seen in Table A2.5.

**Service incentive mechanism (SIM)**

We provide our view of each company’s SIM reward/penalty in the [wholesale water and wastewater technical appendix](#).

Table AA3.2 provides the annualised rewards from the company’s SIM performance. The difference in views reflects that the reward calculation has used updated industry performance statistics and company turnover.

**Table AA3.2 SIM annualised rewards (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.487	0.487	0.487	0.487	0.487	2.435
Ofwat view	0.605	0.605	0.605	0.605	0.605	3.023

**Revenue correction mechanism (RCM)**

This draft determination includes our view of the company's RCM annualised adjustment amounts as detailed in Table AA3.3 below. Table AA3.4 summarises our interventions in relation to Bristol Water's proposed 2010-15 RCM adjustments.

**Table AA3.3 RCM annualised adjustments for 2015-20 (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.512	0.512	0.512	0.512	0.512	2.560
Ofwat view	0.512	0.512	0.512	0.512	0.512	2.560

**Table AA3.4 Interventions on proposed 2010-15 RCM adjustments**

Area of intervention	What we did	Why we did it
FD09 assumptions	Our assumptions at the draft determination includes our view of the FD09 assumptions taking into account the CC determination.	There are inconsistencies between the company's and our view of the FD09/CC assumptions used in the company's populated RCM model.
Number of households billed	Our assumptions for the draft determination uses the data the company submitted in business plan table R3 to calculate our view of the RCM adjustment.	There were inconsistencies with the number of households billed between business plan table R3 and the company's populated RCM model.
Outturn financial year average RPI	Our assumptions for the draft determination uses the data that the company submitted in business plan table A9 to calculate our view of the RCM adjustment.	There are inconsistencies with the outturn financial year average RPI between table A9 and the company's populated RCM model.
PR14 discount rate	Our assumption for the PR14 discount rate at draft determination is 3.7% (applied for all companies).	The company proposed a PR14 discount rate of 5.2%. Our assumptions for the PR14 discount rate at DD is 3.7%.
Corporation tax rate	Our assumptions for the corporation tax rate applied in the RCM model at the draft determination is the same as HMRC's published tax rates for each year.	The company has applied a corporation tax rate of 22% in 2014-15 in its populated RCM model. Our assumption for the corporation tax rate applied in the RCM model at the draft determination is set at 21%.

Table AA3.5 below summarises the company's view and our view of the incentive allowances for 2015-20. Table AA3.4 summarises our interventions in relation to Bristol Water's proposed 2010-15 OIA adjustments.

**Table AA3.5 Operating expenditure incentive allowances for 2015-20 (£ million)**

Water service		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Incentive allowance (post-tax)	Company view – no adjustment was proposed by the company	0.000	0.000	0.000	0.000	0.000	0.000
	Ofwat view	0.000	0.000	0.000	0.000	0.000	0.000

**Table AA3.6 Interventions on proposed 2010-15 OIA adjustments**

Area of intervention	What we did	Why we did it
There are no interventions in this area.	n/a	n/a

### Change protocol (logging up, logging down and shortfalls)

Table AA3.7 and Table AA3.8 below summarise Bristol Water's view and our baseline view of total adjustments to:

- capex included in the CIS reconciliation; and

- the FD09 opex assumptions used in the calculation of the opex incentive revenue allowances.

Table AA3.9 summarises our interventions in relation to Bristol Water’s proposed change protocol adjustments.

**Table AA3.7 Summary of post-efficiency capex for logging up, logging down and shortfalls included in the CIS reconciliation (£ million)**

2009-10 to 2014-15 – post-efficiency capex	Company view	Ofwat view
Logging up (two sided)	0.000	0.000
Logging down (two sided)	0.000	0.000
Shortfalls (one sided)	0.000	0.000

**Notes:**

1. Includes two-sided adjustments from the PR09 agreed overlap programme as set out in Table AA3.13.
2. We exclude shortfalls for serviceability from the CIS reconciliation, but instead make direct adjustments to the RCV in 2015-16. We do this to allow the actual capex the company incurred in seeking to maintain serviceability, to be reflected in the rewards or penalties earned through the scheme. But to also ensure customers are not required to pay for the regulatory output the company has failed to deliver.

**Table AA3.8 Summary of post-efficiency opex for logging up, logging down and shortfalls included in the opex incentive allowance calculation (£ million)**

2009-10 to 2014-15 – post-efficiency opex	Company view	Ofwat view
Logging up	0.000	0.000
Logging down	0.000	0.000

2009-10 to 2014-15 – post-efficiency opex	Company view	Ofwat view
Shortfalls	0.000	0.000

**Table AA3.9 Interventions on proposed 2010-15 change protocol adjustments**

Area of intervention	What we did	Why we did it
There are no interventions in this area	NA	NA

## Service standard outputs

The final determination supplementary reports in 2009 contained defined project(s) where the primary output was the service standard specified.<sup>5</sup> These outputs were set out to recognise that companies may decide to prioritise investment differently in order to achieve the service output in a more innovative and efficient manner, while still holding the company to account for the benefits to customers and the environment.

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<sup>5</sup> In the final determination supplementary reports we said: “Both the project activity (as proposed in your final business plan) and the service standard are the defined output. You must demonstrate delivery of the stated service standard output through the June return. The service standard output is the primary output. We recognise that companies may decide to prioritise activity differently in order to achieve the service output in a more efficient manner. All material changes to the project activity must be reported and explained through your June return.”

Where companies have not reported progress on these service standards, we would have expected them to demonstrate achievement of the service standards to both customers and Ofwat as part of the price review process.

We have considered applying shortfalls equal to the cost of the FD09 project(s) with defined service standards. However, in many cases there is some evidence that the projects and activities have been delivered, but there is a lack of compelling evidence that the service standards specified have been achieved.

**For the purposes of these draft determinations, we will not applying shortfalls on this issue conditional upon this information being provided as part of companies’ draft determination representations.** We would expect companies to respond to this issue in their representations. If they do not provide adequate evidence to demonstrate achievement of the service standards set out, then they should assume that we will apply a shortfall equal to the costs assumed for the project(s) at FD09 within our final determinations in December 2014.

## Serviceability performance

Table AA3.10 below summarises our serviceability assessments for Bristol Water and Table AA3.11 quantifies the value and impact of any serviceability shortfall on the RCV. Table AA3.12 summarises our interventions in relation to Bristol Water’s proposed adjustments for serviceability.

**Table AA3.10 Serviceability assessments for 2010-15<sup>1</sup>**

		2010-11	2011-12	2012-13	2013-14	2014-15 <sup>2</sup>
Water infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Stable	Stable	Marginal	Deteriorating	Deteriorating
Water non	Company view	Stable	Stable	Stable	Stable	Stable

		2010-11	2011-12	2012-13	2013-14	2014-15 <sup>2</sup>
infrastructure	Ofwat view	Stable	Stable	Stable	Stable	Stable

**Notes:**

1. Assessments are based on actual and forecast performance submitted in the company's revised business plans.
2. Assessments for 2014-15 are based on forecast data and are subject to review once actual performance data becomes available.

**Table AA3.11 Impact of serviceability shortfalls on the RCV (£ million)**

2009-10 to 2014-15		Water service
RCV adjustment	Company view	0.0
	Ofwat view	-11.9

**Table AA3.12 Interventions on proposed 2010-15 serviceability adjustments**

Area of intervention	What we did	Why we did it
Unplanned interruption to supply exceeding 12 hours	<p>We have applied a shortfall adjustment of £6.3m (£6.2m post efficiency) for deteriorating performance in this indicator. In accordance with our shortfall calculation methodology the shortfall is calculated based on performance in 2011-12 and 2013-14. We have applied a cap at 2 standard deviations to the shortfall in 2013-14, to limit the impact of specific measures and scaling factors<sup>6</sup>. The overall scale of the shortfall does not exceed 50% of the sub-service capital expenditure and therefore no further cap has been applied.</p> <p>We would expect the company to demonstrate its latest performance as part of its representations and in advance of the final determination.</p>	<p>The company has had two breaches of the upper control limit in 2011-12 and 2013-14 and was very close to the upper control limit in 2012-13. The company has provided some evidence to show that single incidents can affect a large number of properties and that these events should be excluded. However, we do not consider these events should be excluded from the analysis, as they were within the company's control and were events which could have been mitigated. Therefore, we have applied a shortfall adjustment for deteriorating performance in this indicator.</p>

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<sup>6</sup> The shortfall calculation methodology is detailed within the [wholesale water and wastewater technical appendix](#)

Area of intervention	What we did	Why we did it
Iron mean zonal non-compliance	<p>We have applied a shortfall adjustment of £5.7m (£5.6m post efficiency) for marginal performance in this indicator. In accordance with our shortfall calculation methodology the shortfall is calculated based on performance in 2011-12 and 2013-14. We have applied a cap at 2 standard deviations to the shortfall in 2011-12, to limit the impact of specific measures and scaling factors<sup>7</sup>. The overall scale of the shortfall does not exceed 50% of the sub-service capital expenditure and therefore no further cap has been applied.</p> <p>We would expect the company to demonstrate its latest performance as part of its representations and in advance of the final determination.</p>	<p>The company has had two breaches of the upper control limit in 2011-12 and 2013-14 and has forecast 2014-15 performance to be near the upper control limit. The company has not provided sufficient evidence to explain the failures. The company has also not provided sufficient evidence that they will achieve the enhanced service level target. Therefore we have applied a shortfall adjustment for the marginal performance of this indicator.</p>

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<sup>7</sup> Shortfall calculation methodology is detailed in the [wholesale water and wastewater technical appendix](#).

## The 2009 agreed overlap programme

As the company did not propose an overlap programme at PR09, our FD09 did not contain any agreed projects that would need to be reviewed in this price review. Therefore, we have not assessed any scheme progress or costs under this mechanism. Table AA3.14 confirms this position and Table AA3.13 below confirms the zero assumptions included in this draft determination.

**Table AA3.13 PR09 agreed overlap programme adjustments and assumptions (£ million)**

	2010-15		2015-20	
	Two-sided adjustment for inclusion in the CIS		Expenditure forecasts to complete the projects	
	Capex	Opex	Capex	Opex
Company view	0.000	0.000	0.000	0.000
Ofwat view	0.000	0.000	0.000	0.000

**Table AA3.14 Interventions on proposed 2010-15 PR09 agreed overlap programme adjustments**

Area of intervention	What we did	Why we did it
The company did not propose an overlap programme at PR09.	n/a	n/a

## Capital expenditure incentive scheme (CIS)

Table AA3.15 provides details of the CIS ratios and performance incentive. It also gives the:

- monetary amounts of the CIS performance reward or penalty;
- true-up adjustment to 2015-20 allowed revenues; and
- midnight adjustment to the closing 2014-15 RCV.

Table AA3.16 then sets out the profiled values of the revenue adjustments in each year 2015-20.

**Table AA3.15 Legacy true-up adjustments**

		Water service
<b>Restated FD09 CIS bid ratio</b>	Company view	112.466
	Ofwat view	127.920
<b>Outturn CIS ratio</b>	Company view	113.908
	Ofwat view	113.935
<b>Incentive reward/penalty (%)</b>	Company view	-3.694
	Ofwat view	-4.184
<b>Reward/penalty (£m)</b>	Company view	-9.226
	Ofwat view	-10.447

		Water service
<b>Adjustments to 2015-20 revenue (£m)</b>	Company view	-3.485
	Ofwat view	-6.279
<b>CIS adjustment to RCV (£m)</b>	Company view	26.006
	Ofwat view	16.275

**Commentary:**

The company has not reflected the CC redetermination bid capex in its CIS model. This affects the RCV adjustment and the revenue adjustment.

The company uses its view of the discount rates (6.10%) in the future value calculation and 5.20% when profiling the revenue adjustment in 2015-20.

In carrying out our assessment, we have:

- used the Competition Commission's (CC) redetermination values for the bid capex and replicate the CC's CIS ex ante ratio and additional income;
- used the CC pre-tax WACC as the discount rate (5.97%) in the future value calculation;
- profiled the revenue adjustment using the same profiling approach as the company; and
- used our assumption of the PR14 cost of capital as the discount rate (3.70%) when profiling the revenue adjustment.

**Notes:**

The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol (Table AA3.7) and the 2009 agreed overlap programme (Table AA3.13).

The reward/(penalty) is adjusted for the additional income included in the 2010-15 determination and the financing cost on the difference between actual spend and capital expenditure assumed in the 2010-15 determination to derive the value of the adjustment to 2015-20 revenue.

The adjustment to 2015-20 revenue values shown in this table assume a single year adjustment in the first year, and do not include the NPV profiling used for the draft determination.

**Table AA3.16 Profiled revenue adjustments from the CIS reconciliation (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.769	-0.769	-0.769	-0.769	-0.769	-3.847
Ofwat view	-1.349	-1.349	-1.349	-1.349	-1.349	-6.743

## Other adjustments

Table AA3.17 below confirms the assumptions included in this draft determination with respect to the following adjustments:

- tax refinancing benefit clawback;
- other tax adjustments;
- equity injection clawback; and
- other adjustments.

**Table AA3.17 Other adjustments 2015-20 (£ million)**

	Company view	Ofwat view	Commentary
Tax refinancing benefit clawback	0.000	0.000	n/a
Other tax adjustments	0.000	0.000	n/a
Equity injection clawback	0.000	0.000	n/a
Other adjustments	0.000	0.000	n/a

## **Annex 4 Outcomes, performance commitments and outcome delivery incentives**

This chapter sets out in detail the performance commitments and outcome delivery incentives (ODIs) we are proposing for the company's wholesale water and household retail outcomes, presented in that order.

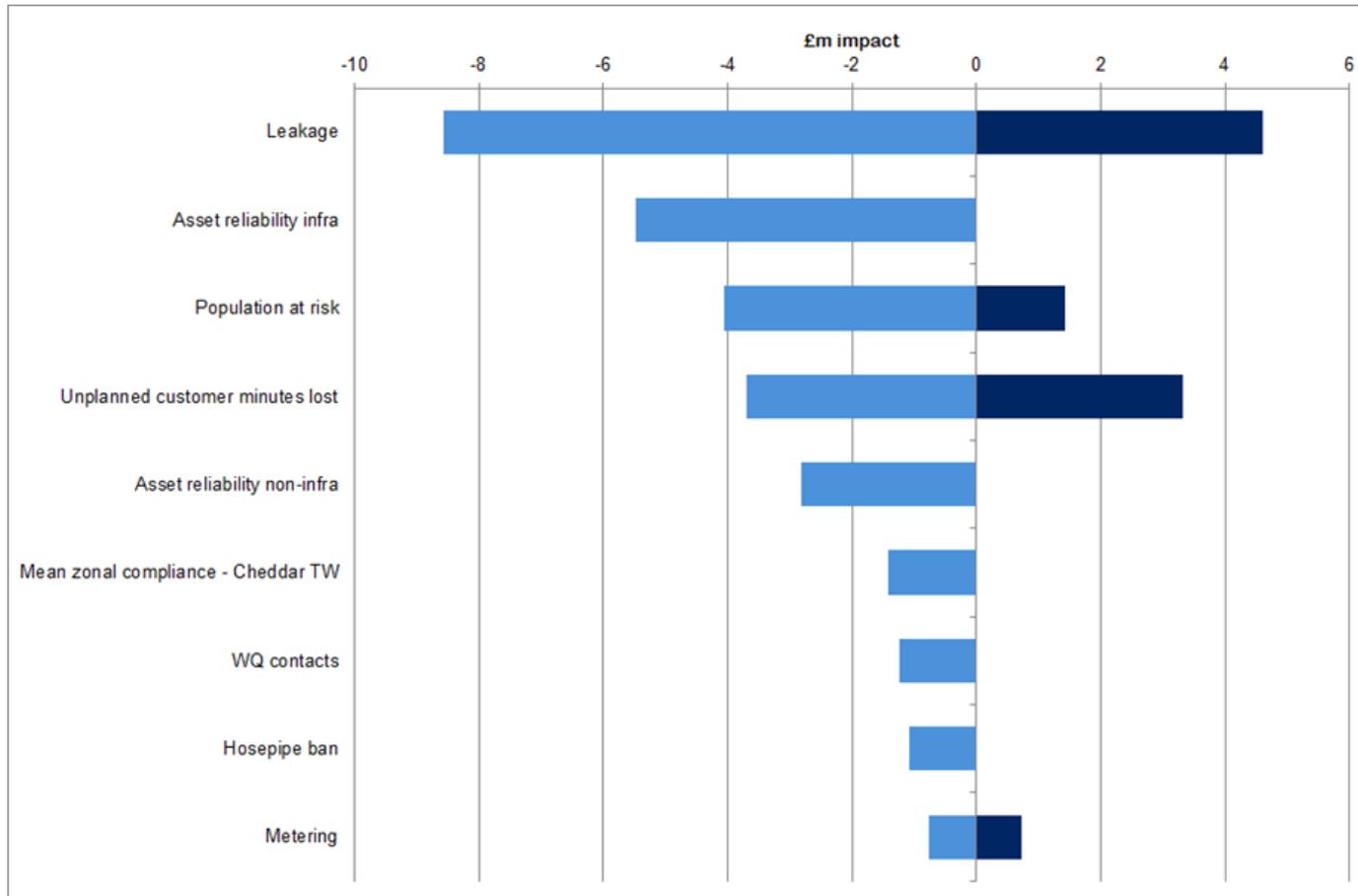
The two figures below first provide an overview of these proposed performance commitments and ODIs. Table AA4.1 shows the balance between reward and penalty, penalty only and reputational incentives in the package of proposed incentives for the company and

Figure AA4.1 shows the potential financial impact of each of the financial incentives proposed.

**Table AA4.1 The composition of the proposed package of ODIs**

	Reward and penalty	Penalty only	Non-financial incentives
Wholesale water	5	5	5
Household retail	1		6
Number of PCs	6	5	11

Figure AA4.1 Overview of financial ODIs



Note: This figure does not include the SIM

As explained in the [outcomes technical appendix](#), we are proposing the introduction of an aggregate cap on rewards and collar on penalties from the outcome delivery incentives. Details of how the cap/collar will operate are set out in section A5 of the Outcomes Technical Appendix. There are a small number of specific exclusions from the cap/collar. For Bristol Water, the exclusions are Cheddar raw water deterioration and Southern resilience.

Tables AA4.2 and AA4.3 set out a more detailed explanation of our interventions in the company’s wholesale water and household retail outcomes.

**Table AA4.2 Summary of interventions on wholesale water outcomes, performance commitments and incentives**

PC/ODI affected	What we did	Why we did it
E1: Negative water quality contacts	<p>Reduced committed performance level in 2017-18 to 2019-20 to be equal to upper quartile performance.</p> <p>Adjusted penalty collars and reward caps to keep the distance between them the same as Bristol Water proposed in its revised business plan.</p> <p>Set penalty deadbands for 2015-16 and 2016-17-at the 2014-15 committed performance level.</p> <p>Set reward deadbands for all years at upper quartile performance.</p>	<p>We have intervened following a review of negative water quality contacts across all companies to ensure that the companies are incentivised to achieve upper quartile performance. See the <a href="#">outcomes technical appendix</a> for further details.</p>

PC/ODI affected	What we did	Why we did it
<p>D1: Mean zonal compliance</p>	<p>Intervened to make this a penalty only ODI.</p> <p>Changed the committed performance level from 2017-18 onwards to 100%.</p> <p>Set the penalty deadband at 99.96% for all years.</p> <p>Set the penalty collar at 99.95% for all years.</p> <p>Set the penalty incentive rate equal to the average proposed by the water-only companies.</p>	<p>We have intervened following a review of mean zonal compliance across all companies to ensure that the companies are incentivised to achieve upper quartile performance. See the <a href="#">outcomes technical appendix</a> for further details.</p> <p>The company has defined outcome delivery incentives for drinking water quality compliance with a penalty at less than 100%. This penalty represents an incentive to the company to not reduce its compliance with water quality measures. This threshold represents the point at which financial incentives will be applied to the company through the price setting process. All companies are subject to drinking water quality obligations regulated by the DWI, which are the overriding statutory obligations that a water company must comply with as part of their Section 37 obligations. The company's Board has confirmed as part of its business plan submission that it will comply with all relevant statutory obligations.</p>

PC/ODI affected	What we did	Why we did it
D2: Construction of Cheddar TW algae removal	Changed the penalties for late and non-delivery.	The allowed costs are less than the amount which Bristol Water asked for in its business plan. Therefore we have adjusted the penalties for late and non-delivery accordingly.
B1: Population at risk from asset failure	Changed the range over which the penalty in years 3 to 5 apply.	The maximum penalty needs to be sufficient to protect customers in the event that Bristol Water does not spend the money and does not deliver the resilience scheme.

**Table AA4.3 Summary of interventions on household retail outcomes, performance commitments and incentives**

PC/ODI affected	What we did	Why we did it
We have not made any interventions		

## Outcome delivery and reporting

In the [outcomes technical appendix](#), we outline a framework against which we have assessed Bristol Water's proposals in relation to outcome delivery and reporting.

The table below summarises Bristol Water's proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach.

**Table AA4.4 Bristol Water's proposals for outcome delivery and reporting**

Bristol Water proposals	Our assessment
<p><b>(Taken from page 185 onwards of Bristol Water's June submission business plan)</b></p> <p><b>Performance Commitment Reporting:</b></p> <p>We will publish details of our performance against our Performance Commitments (PC) 6-monthly on our website.</p> <p>Annually reported data will be subject to our existing governance process for quality assurance of Annual Return and Ofwat KPIs.</p> <p>We will employ an appropriate assurance process prior to 6-monthly data being published on our website. This will include internal and external review. The published data will be subject to scrutiny and challenge from our local stakeholder representative group.</p> <p>Each PC has a designated owner, who is responsible for reporting performance data and providing appropriate commentary on performance.</p> <p>The definition of each PC is as set out in the relevant outcome section for each measure.</p> <p>Methodologies for calculation and</p>	<p>We are satisfied with the company's proposals for self reporting. But consistent with the commentary in our assurance technical annex, we will need to consider the categorisation of the company for assurance purposes at the final determination. In time, we may develop further information requirements with regard to outcomes, as we review and change current requirements relating to performance indicators and each company's annual risk and compliance statement.</p>

production of data for each measure are produced and maintained by the PC owner.

Our overall governance and reporting process is subject to Internal Audit within the triennial audit cycle to assess the adequacy and effectiveness of the controls in place. These reports are reported to the Audit and Risk Assurance Committee.

### **Annual Reporting**

We produce an Annual Data Return each year detailing our performance against key regulatory performance metrics. This report succeeded the June Return that we were required to submit to Ofwat until 2011.

Performance Commitment data is included within the Annual Return. The Annual Return also includes the KPIs that all companies are required by Ofwat to publish each year, along with the annual Risk and Compliance Statement.

Data included in our Annual Report is subject to internal peer review, and external assurance. Until 2011 companies were required to use Reporters to verify reported data to Ofwat. Since 2012 we have continued to employ an external assurance consultancy, Mott MacDonald, in a similar role, with a duty of care to the Bristol Water Board rather than to Ofwat. Key financial data is audited by our statutory Auditor, currently Price Waterhouse Coopers.

All data owners are required to sign a quality assurance form to accompany data submissions, to confirm that data has been compiled in accordance with the stated methodology, and that the data is a true representation of the facts.

Key data is subject to detailed review by executive directors, and the overall report is approved by the Board before publication

### ***Monthly KPI Reporting***

We produce a KPI report each month for use by Directors, Senior Managers, the Board and Shareholders to monitor company performance.

Performance data on all PCs is internally monitored through our monthly KPI report. The performance measures are reported within the established methodology for monthly KPIs.

Each KPI is assigned to a line owner who is responsible for providing the data. Each KPI has a reviewer assigned to review reported performance data before submission for the monthly report. The KPIs are signed off by a Director prior to final circulation to the Senior Management team for review.

A meeting is held each month for Senior Managers and Directors to review performance. KPIs are reported to our shareholders each month and to the Board ahead of each Board meeting.

- The type of incentive
- The performance commitment level
- For financial incentives:
  - the limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable<sup>8</sup>; and

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<sup>8</sup> In general, the cap or collar is the level of service at which the maximum penalty or reward occurs and a deadband is the level of service at which the incentive first applies. However, where a greater

- the incentive rates.
- Additional details on the measure
- Where Ofwat has not accepted the company’s proposals, the nature of the intervention made is also explained.

Appendix 1 of our final methodology statement contains a number of worked examples that illustrate how the different incentive types will operate.

We have intervened in relation to a number of performance commitments proposed by the company. Where our intervention is to remove the performance commitment in question, details and reasoning are provided in Table AA4.5 at the end of this annex. Where we have amended the company’s proposed incentive but retained the performance commitment, we have intentionally set out our interventions below using a ~~strike through~~. What this means is that we have rejected the proposal that has been struck through and instead we have either used a different value or not included a value at all (for example, in the case of some rewards).

Bristol Water will be able to finalise its proposed menu choice and affected ODI calibrations following our consideration of responses to these proposals.

**Table AA4.5 Performance commitments proposed by the company that we have removed from this draft determination**

Performance commitment	Reason for its removal
<b>Wholesale water</b>	
C3 Delivery of Cheddar Reservoir Two – stage 2 construction	Following a detailed review of Bristol Water’s evidence for this scheme we disallowed the costs associated with it. A performance commitment is therefore no longer appropriate.
<b>Household retail</b>	
None	

than or less than symbol precedes the figure this denotes that the maximum or initial incentive only occurs if service is greater than or less than this level.

## Wholesale water outcome A: reliable supply

### Performance commitment A1: Unplanned customer minutes lost

**Detailed definition of performance measure:** Total number of minutes that customers have been without a supply of water through unplanned interruptions to their properties in a year divided by the total of number of properties served by the company in the year.

**Incentive type:** Financial – rewards and penalties.

#### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Mins/ prop/ year	13.7	13.4	13.1	12.8	12.5	12.2
Penalty collar	Mins/ prop/ year		15.4	15.1	14.8	14.5	14.2
Penalty deadband	Mins/ prop/ year		14.4	14.1	13.8	13.5	13.2
Reward deadband	Mins/ prop/ year		12.4	12.1	11.8	11.5	11.2
Reward cap	Mins/ prop/ year		11.1	10.8	10.5	10.2	9.9

## Incentive rates

Incentive type	Performance levels (mins/prop/year)		Incentive rate (£/min/year)
	Lower	Upper	
Penalty	14.8	13.8	£0.739m
Reward	11.8	10.5	£0.510m

## Additional details

Necessary detail on measurement units	The measure is calculated using the total duration of all unplanned water supply interruptions by the number of properties the company supply to give an average interruption time in minutes per year.
Frequency of PC measurement and any use of averaging	Performance to be calculated and reported annually, in addition to six-monthly publication of performance data. The incentive is to be calculated based on average performance over the 5-year period.
Timing and frequency of rewards/penalties	Rewards and penalties to be implemented as adjustments to revenue between 2020-21 and 2024-25.
Form of reward/penalty	Revenue Adjustment
Any other information or clarifications relevant to correct application of incentive	<p>Bristol Water's business plan commitment is to deliver an outcome for customers of Reliable Supply. To achieve this, the company has proposed a performance target of reducing average unplanned Customer Minutes lost by 1.5 minutes. Bristol Water believes that if it does not deliver this level of performance for customers, it should incur a penalty.</p> <p>Bristol Water's cost benefit assessment has shown that this proposal is aligned with the economic level of service and is the top equal priority for customers. As such it is proposing a penalty and reward incentive in line with the Ofwat guidance that states that a reward is appropriate in this situation.</p> <p>As performance for this incentive is strongly influenced by external factors such as the weather and also by significant one off events such as a trunk main failure, Bristol Water is proposing an incentive that is based on average performance over the price control period, 2015-20.</p>

Bristol Water has applied a deadband of 1 property minute to both the penalty and the reward to allow for this variance affecting average performance. The size of this deadband has been designed to ensure that the incentive remains strong and effective ensuring protection for customers but at the same time limits 'chance' determining the reward and penalty. It is based on the impact that a bad winter can have on the performance measure. The company has compared data from the recent past for consecutive years to understand the variance between a good year and a year with a bad winter. These data demonstrate that the weather can cause an average variance of around 16 minutes. On average the company would expect one bad winter in a 5 year period but this could be either zero or 2 events. If only one event occurred in the 5 year period this would cause a variance of 3 minutes to the 5 year average. The company has used this information to set a deadband for both the penalty and the reward that is symmetrical around the performance commitment. This accounts for some but not all of the variability due to weather but still provides an incentive to manage performance during bad winters.

The assessment of performance for this incentive overlaps to some extent with some of the company's other measures of success that also have a financial incentive applied. These are population at risk from asset failure and its measure that relate to its Water Resource Management Plan. As such, two exclusions are proposed to this measure to remove any double counting:

- Population at risk from asset failure: The benefits for this incentive are based on mitigating the risk to long duration interruptions. This means that, if Bristol Water has not delivered the improvement in line with its proposals and an event occurs, it will be penalised twice – once due to not delivering the population at risk from asset failure and once through the impact on the unplanned customer minutes lost measure. The company's proposal is that any long duration interruptions (greater than 12 hours) after its

proposed delivery date of 2016-17 in the Southern Resilience Scheme area should be excluded from the assessment if it has not delivered this scheme in line with its proposals

- Water resources plan: Bristol Water also proposes to exclude interruptions due to extreme drought as the value for these has been included and used to calculate the incentives for hosepipe bans, leakage and metering.

## Performance commitment A2: asset reliability – Infrastructure

**Detailed definition of performance measure:** Basket of indicators of infrastructure reliability, based on previous serviceability measures:

- Total bursts (nr)
- Trunk Mains bursts (nr)
- Iron non-compliance (as 100 minus Mean Zonal Compliance) (%)
- DG2 Low pressure (nr of properties)
- Customer contacts – discolouration (nr/1000 population)
- Distribution Index TIM (as 100 minus Mean Zonal Compliance) (%)
- Unplanned Customer Minutes Lost

**Incentive type:** Financial penalty.

### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	assessment	Stable	stable	stable	stable	stable	stable
Penalty collar	assessment		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Penalty deadband	assessment		Marginal	Marginal	Marginal	Marginal	Marginal

## Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Penalty rate 1 – deteriorating assessment	n/a	n/a	£8.215m
Penalty rate 2 – marginal assessment	n/a	n/a	£2.738m
Reward	n/a	n/a	n/a

## Additional details

Necessary detail on measurement units	<p>Basket of indicators of infrastructure reliability, based on previous serviceability measure assessing the capability of a system of infrastructure assets to deliver an expected level of service to consumers and to the environment now and into the future.</p> <p>Full details of this measure are provided in Bristol Water's Wholesale Plan, pages 132 – 158.</p>
Frequency of PC measurement and any use of averaging	<p>Annual assessment to be made with performance allocated to one of the following categories.</p> <ul style="list-style-type: none"> <li>• Improving</li> <li>• Stable</li> <li>• Marginal</li> <li>• Deteriorating</li> </ul>
Timing and frequency of rewards/penalties	Any penalty will apply as an adjustment to RCV with effect from 2020-21
Form of reward/penalty	RCV adjustment
Any other information or clarifications relevant to correct application of incentive	<p>Bristol Water proposes to return to customers up to 25% of the total maintenance spend attributable to those assets depending on the level of non-delivery. The rationale for setting a maximum penalty of 25% is as follows.</p> <ul style="list-style-type: none"> <li>• For a menu incentive rate of 50%, the benefit that the company would retain if it only spent</li> </ul>

half its allocation on maintenance is 25%

- Bristol Water considers that only spending 50% of its allocation on maintenance would result in a deteriorating assessment at the end of 2015-20
- Spending less than 50% of its proposed expenditure would result in unacceptable poor performance potentially leading to enforcement action. Given this, the company believes that greater incentives are not required.

To allocate the penalty Bristol Water has applied the following performance score.

- Stable or improving – 0 points
- Marginal – 1 point
- Deteriorating – 3 points

The maximum score that aligns with a penalty of 50% of relevant totex will be eight. The company has proposed to include a deadband of one marginal assessment over 2015-20. This means that a penalty will apply for the second marginal assessment and the value of the penalty will be based on an increment of seven. The penalty will apply to the second consecutive year that service is marginal or deteriorating.

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## Performance commitment A3: Asset Reliability – Non-Infrastructure

**Detailed definition of performance measure:** Basket of indicators of non-infrastructure reliability, based on previous serviceability measures:

- Water treatment works coliforms non-compliance (%)
- Service reservoir coliforms non-compliance (%)
- Turbidity performance at treatment works (nr)
- Enforcement orders from DWI (nr incidents)
- Unplanned maintenance events (nr)

**Incentive type:** Financial – penalty only

## Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	assessment	stable	stable	stable	stable	stable	stable
Penalty collar	assessment		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Penalty deadband	assessment		Marginal	Marginal	Marginal	Marginal	Marginal

## Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Penalty rate 1 – deteriorating assessment	n/a	n/a	£8.474m
Penalty rate 2 – marginal assessment	n/a	n/a	£2.825m
Reward	n/a	n/a	n/a

## Additional details

Necessary detail on measurement units	<p>Basket of indicators of infrastructure reliability, based on previous serviceability measure assessing the capability of a system of non- infrastructure assets to deliver an expected level of service to consumers and to the environment now and into the future.</p> <p>Full details of this measure are provided in Bristol Water's Wholesale Plan, pages 132 – 158.</p>
Frequency of PC measurement	Annual assessment to be made with performance

<p>and any use of averaging</p>	<p>allocated to one of the following categories:</p> <ul style="list-style-type: none"> <li>• Improving</li> <li>• Stable</li> <li>• Marginal</li> <li>• Deteriorating</li> </ul>
<p>Timing and frequency of rewards/penalties</p>	<p>Any penalty will apply as an adjustment to RCV with effect from 2020-21</p>
<p>Form of reward/penalty</p>	<p>RCV adjustment</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>Bristol Water proposes to return to customers up to 25% of the total maintenance spend attributable to those assets depending on the level of non-delivery. The rationale for setting a maximum penalty of 25% is as follows.</p> <ul style="list-style-type: none"> <li>• For a menu incentive rate of 50%, the benefit that the company would retain if it only spent half its allocation on maintenance is 25%</li> <li>• Bristol Water considers that only spending 50% of its allocation on maintenance would result in a deteriorating assessment at the end of 2015-20</li> <li>• Spending less than 50% of its proposed expenditure would result in unacceptable poor performance potentially leading to enforcement action. Given this, the company believes that greater incentives are not required.</li> </ul> <p>To allocate the penalty Bristol Water has applied the following performance score:</p> <ul style="list-style-type: none"> <li>• Stable or improving – 0 points</li> <li>• Marginal – 1 point</li> <li>• Deteriorating – 3 points</li> </ul> <p>The maximum score that aligns with a penalty of 50% of relevant totex will be eight. The company has proposed to include a deadband of one marginal assessment over 2015-20. This means that a penalty will apply for the second marginal assessment and the value of the penalty will be based on an increment of seven. The penalty will apply to the second consecutive year that service is marginal or</p>

deteriorating.

## Wholesale Water Outcome B – Resilient Supply

### Performance commitment B1: Population in centres >25,000 at risk from asset failure

**Detailed definition of performance measure:** Populations in centres of greater than 25,000 who are at risk of failure of the single supply source serving them. The risk relates to water supply interruptions in the event that a critical asset such as a treatment works is unable to operate or a source is contaminated.

**Incentive type:** Financial – reward and penalty

#### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Population	288,589	288,589	288,589	9,063	9,063	9,063
Penalty collar	Population		308,589	308,589	<del>29,063</del> 69,063	<del>29,063</del> 69,063	<del>29,063</del> 69,063
Penalty deadband	Population		288,589	288,589	9,063	9,063	9,063
Reward deadband	Population		288,589	288,589	9,063	9,063	9,063
Reward cap	Population		268,589	268,589	0	0	0

#### Incentive rates

Incentive type	Performance levels (assessment)*		Incentive rate (£/population)
	Lower	Upper	
Penalty	<del>440,873</del> 308,589	<del>420,873</del> 9,063	£40.60
Reward	<del>420,873</del> 268,589	<del>407,436</del> 0	£21.21

\*Performance levels are shown for the average range over the 5 years

### Additional details

<p><b>Necessary detail on measurement units</b></p>	<p>The total number of consumers in supply areas of more than 25,000 who are at risk of failure of the single source they are served by in extreme circumstances</p>
<p><b>Frequency of PC measurement and any use of averaging</b></p>	<p>The PC is to be measured annually.</p>
<p><b>Timing and frequency of rewards/penalties</b></p>	<p>Any penalty will apply as an adjustment to revenue between 2020-21 and 2024-25</p>
<p><b>Form of reward/penalty</b></p>	<p>Revenue adjustment</p>
<p><b>Any other information or clarifications relevant to correct application of incentive</b></p>	<p>Bristol Water believes that if it does not deliver the proposed level of performance for customers, it should incur a penalty. As this measure relates to a specific scheme the company has proposed a 2 stage incentive that changes before and after the scheme is expected to be delivered. The proposed reward aims to incentivise early delivery in 2015-16 and 2016-17 and delivering additional benefits by removing the remainder of the population at risk from 2017-18 onwards.</p>

## Wholesale Water Outcome C – Sufficient Supply

### Performance commitment C1: Security of Supply Index (SOSI)

**Detailed definition of performance measure:** The Ofwat measure used to assess the security of companies' supplies. It takes into account the supply of water that the company has available and demand from customers. Security of supply index is calculated as the proportion of dry weather demand that can be met by the water available for use.

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Index	100	100	100	100	100	100
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

#### Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate (£/population)
	Lower	Upper	
Penalty	n/a	n/a	n/a
Reward	n/a	n/a	n/a

**Additional details**

Necessary detail on measurement units	Security of supply index determined according to the Ofwat KPI definition. There are no specific units for this measure which derives an index value with a maximum score of 100.
Frequency of PC measurement and any use of averaging	The PC is to be measured and reported annually.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a – Reputational incentive
Any other information or clarifications relevant to correct application of incentive	Bristol Water is proposing that SOSI is a reputational incentive. For the 'Sufficient Supply' outcome, the company has customer WTP to reduce the length of hosepipe/temporary use bans and 2-3 week stoppages. It has included this WTP within a penalties only financial incentive for the performance measure 'Hosepipe ban frequency' and has retained the performance measure 'Security of Supply Index' as a reputational incentive only. This approach avoids the company being penalised twice in the event of a shortage of water resources.

**Performance commitment C2: Hosepipe Ban Frequency**

**Detailed definition of performance measure:** The statistical probability that restrictions to customer use will be required, expressed as a return period in years for a defined severity of event.

**Incentive type:** Financial – Penalty Only

**Performance commitments**

	Starting level	Committed performance levels (no. days of restrictions per year)					
Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	

		Starting level	Committed performance levels (no. days of restrictions per year)				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Days	0	10.2	10.2	10.2	10.2	10.2
Penalty collar			15.2	15.2	15.2	15.2	15.2
Penalty deadband			10.2	10.2	10.2	10.2	10.2
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

### Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate £m per expected day of restrictions
	Lower	Upper	
Penalty	15.2	10.2	£0.043m
Reward	n/a	n/a	n/a

### Additional details

Necessary detail on measurement units	The number of expected days in the report year that water restrictions are placed based on the likelihood in any one year that restrictions on the use of hosepipes will be implemented. Usually expressed as 1 in X years.
Frequency of PC measurement and any use of averaging	The PC is to be measured and reported annually.
Timing and frequency of rewards/penalties	Any penalty will apply as an adjustment to revenue between 2020-21 and 2024-25
Form of reward/penalty	Revenue adjustment

**Any other information or clarifications relevant to correct application of incentive**

Maintaining a 1 in 15 year hosepipe ban frequency is delivered by a range of measures including leakage and metering. As Bristol Water has separate incentives for these impacts it has allocated the relevant benefit to these measures. Just under 95% of the increased yield delivered by its Water Resources Plan is allocated to metering and leakage. The remainder has been allocated to this incentive. This means that the WTP value the company proposes to use for this incentive is £42,504 per day of restriction. The remaining investment is delivered by water efficiency measures and the costs for these are allocated to the retail plan. As a result the company has not included any incremental costs for this measure.

The incentive for hosepipe bans will be assessed each year based on the observed deficit. The penalty is based on expected days of hosepipe bans, not actual days.

**Performance commitment C3: Delivery of Cheddar Reservoir Two Stage 2 construction**

~~Detailed definition of performance measure: This incentive is specific to the investment at Cheddar Reservoir Two, which is planned to be completed in 2026. The penalty will occur if phase 2 of the scheme does not commence. Delivery is defined as consistent with expenditure profile to within +/- 25%~~

~~Incentive type: Financial – Penalty Only~~

**Performance commitments**

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC		0	n/a	n/a	n/a	n/a	Phase 2 commenced

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty collar			n/a	n/a	n/a	n/a	Phase 2 not commenced
Penalty deadband			n/a	n/a	n/a	n/a	Phase 2 not commenced
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

### Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate £m
	Lower	Upper	
Penalty	Phase 2 not commenced	Phase 2 not commenced	£4.984m
Reward	n/a	n/a	n/a

### Additional details

Necessary detail on measurement units	There are no specific units for measurement as this measure relates to a milestone of the commencement of phase 2 of the Cheddar Reservoir Two scheme.
Frequency of PC measurement and any use of averaging	The PC is to be measured at the end of the period.
Timing and frequency of rewards/penalties	Any penalty would apply as an adjustment to revenue between 2020-21 and 2024-25

Form of reward/penalty	Revenue adjustment
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>As part of its long run Water Resources Management Plan, Bristol Water is proposing to construct Cheddar Reservoir Two. Design, construction and commissioning of this asset will take 11 years. Due to the required construction times this investment will not impact on customer service or the supply demand deficit in 2015-20. As this investment will not impact on the service that customers receive during 2015-20, the company does not consider that an outcome delivery incentive based on observable service and customer willingness to pay is appropriate. As such the company is proposing an incentive that is milestone focused to ensure that customers are protected should the company not undertaken the investment. This penalty is set at 50% of the proposed totex for phase two of the construction to remove the double count with the totex menu incentive.</p>

## Outcome D: Safe Drinking Water

### Performance commitment D1: Mean Zonal Compliance

Detailed definition of performance measure: Statutory indicator used by DWI to assess overall water quality compliance across all water companies in England and Wales.

Incentive type: ~~Reputational~~ Penalty only

#### Performance commitments

		Starting level	Committed performance levels (% Compliance)				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	99.96%	99.96%	99.96%	100.00% <del>99.96%</del>	100.00% <del>99.96%</del>	100.00% <del>99.96%</del>
Penalty collar			99.95% <del>n/a</del>	99.95% <del>n/a</del>	99.95% <del>n/a</del>	99.95% <del>n/a</del>	99.95% <del>n/a</del>
Penalty deadband			99.96% <del>n/a</del>	99.96% <del>n/a</del>	99.96% <del>n/a</del>	99.96% <del>n/a</del>	99.96% <del>n/a</del>
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

#### Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate £m
	Lower	Upper	
Penalty	99.95% <del>n/a</del>	99.96% <del>n/a</del>	0.284 <del>n/a</del>
Reward	n/a	n/a	n/a

## Additional details

<p>Necessary detail on measurement units</p>	<p>This measure is based on up to 39 parameters which are determined by the DWI. Samples are collected from defined supply points and customers' taps situated in Water Quality Zones. The percentage compliance score is calculated (to three decimal places) from the number of determinants taken versus the number of determinants that failed the relevant drinking water standard in each Water Quality Zone. It is calculated by averaging the mean zonal percentage compliance from the regulatory sampling programme. Each parameter is weighted equally. The measure of success is based on current regulation and standards (including the tightening of the lead standard in 2013).</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>This PC will be measured annually (calendar year) and reported to the DWI. Performance will also be published six-monthly on the company website.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>n/a Annually</p>
<p>Form of reward/penalty</p>	<p>n/a Revenue adjustment</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p><del>Bristol Water is not proposing that mean zonal compliance is subject to a financial incentive. Drinking Water Compliance is a statutory obligation that is enforced by the Drinking Water Inspectorate (DWI). The parameters that the DWI assesses fall into two categories: those that could have an adverse impact on human health and those that affect the appearance, taste or smell of the water. The performance measure and associated financial penalty for negative water quality contacts will capture the vast majority of these issues.</del></p>

## Performance commitment D2: Construction of Cheddar TW Algae Removal

**Detailed definition of performance measure:** This incentive is specific to the investment at Cheddar Treatment works which is planned to be completed in March

2020. The penalty will occur if the scheme is not implemented. The performance is based on whether the company provides a solution to substantially mitigate the risk of failure of the works due to be legally blinding by 31 March 2020.

**Incentive type:** Financial – Penalty Only

#### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC		n/a	n/a	n/a	n/a	n/a	Solution delivered
Penalty collar			n/a	n/a	n/a	n/a	Solution not delivered
Penalty deadband			n/a	n/a	n/a	n/a	Solution delayed
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

#### Incentive rates

Incentive type	Performance levels (assessment)		Incentive rate £m
	Lower	Upper	
Penalty rate 1 – solution not delivered	Solution not delivered	Solution delivered	<del>£11.446m</del> –£9.975m
Penalty rate 2 – solution delayed	Solution delayed	Solution delayed	<del>£0.960m</del> –£0.837m
<b>Additional details Necessary detail on measurement units</b>		There are no specific units for measurement as this measure relates to the delivery of an appropriate mitigation for algae contamination at Cheddar Treatment Works.	

Incentive type	Performance levels (assessment)		Incentive rate £m
	Lower	Upper	
Frequency of PC measurement and any use of averaging	This PC will be measured at the end of the five year period in 2020.		
Timing and frequency of rewards/penalties	Any penalties will be paid through an adjustment to revenue between 2020-21 and 2024-25		
Form of reward/penalty	Revenue Adjustment		
Any other information or clarifications relevant to correct application of incentive	<p>As this investment will not impact on the service that customers receive during 2015-20, Bristol Water does not believe that an outcome delivery incentive based on observable service and customers' willingness to pay is appropriate. As such, the company is proposing a two stage incentive that is milestone focused to ensure that customers are protected should Bristol Water not undertake the investment. The first stage is a penalty for not implementing the scheme which is set at 50% of the proposed totex to remove the double count with the totex menu incentive. This performance is based on whether the company provides a solution to substantially mitigate the risk of failure of the works due to algal blinding by 31st March 2020. The second stage is a penalty for delaying the delivery of the scheme and this is 50% of the annualised cost for one year.</p> <p>Ofwat has changed the penalties for late and non-delivery, reflecting a 13% downward adjustment of allowed costs.</p>		



## Outcome E: Water is Good to Drink

### Performance commitment E1: Negative Water Quality Contacts

**Detailed definition of performance measure:** This measure relates to the number of customer contacts Bristol Water receive each calendar year about taste, odour and appearance and is consistent with the company's reporting to the DWI that is, excludes reportable events.

**Incentive type:** Financial – Rewards and Penalties

#### Performance commitments

		Starting level	Committed performance levels – number of contacts per year				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	No.	2,450	<del>2,422</del> 2,113	<del>2,409</del> 1,776	<del>2,322</del> 1,439	<del>2,275</del> 1,439	<del>2,221</del> 1,439
Penalty collar			<del>2,477</del> 2,505	<del>2,464</del> 2,505	<del>2,377</del> 1,494	<del>2,330</del> 1,494	<del>2,276</del> 1,494
Penalty deadband			<del>2,422</del> 2,450	<del>2,409</del> 2,450	<del>2,322</del> 1,439	<del>2,275</del> 1,439	<del>2,221</del> 1,439
Reward deadband			<del>2,422</del> 1,439	<del>2,409</del> 1,439	<del>2,322</del> 1,439	<del>2,275</del> 1,439	<del>2,221</del> 1,439
Reward cap			<del>2,259</del> 1,276	<del>2,246</del> 1,276	<del>2,159</del> 1,276	<del>2,112</del> 1,276	<del>2,058</del> 1,276
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per contact				
	Lower	Upper					
Penalty	<del>2,385</del> -2,505	<del>2,330</del> -1,439	£0.006m				
Reward	<del>2,330</del> -1,439	<del>2,167</del> -1,276	£0.001m				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per contact
	Lower	Upper	
<b>Additional details Necessary detail on measurement units</b>	<p>All 'unwanted' telephone and written contacts in the SIM relating to taste, hardness, chlorine and discoloured water</p> <p>'Unwanted' defined by Ofwat within SIM</p> <p>Details of this performance measure are included in the company's Wholesale Plan, pages 309 – 322</p>		
<b>Frequency of PC measurement and any use of averaging</b>	<p>This PC will be measured annually. The incentive will be based on average performance over the 5-year period.</p>		
<b>Timing and frequency of rewards/penalties</b>	<p>Any rewards or penalties will apply as an adjustment to revenue between 2020-21 and 2024-25</p>		
<b>Form of reward/penalty</b>	<p>Revenue Adjustment</p>		
<b>Any other information or clarifications relevant to correct application of incentive</b>	<p>As Bristol Water is below the economic level of service but in line with average industry performance it has constrained its proposed reward based on the incremental cost. Using the incremental cost resets the economic level of service so Bristol Water must reduce its costs to avoid being penalised by improving service.</p>		



## Outcome F: Efficient use of resources by company

### Performance commitment F1: Leakage

**Detailed definition of performance measure:** The leakage performance measure is defined as the amount of water that enters the distribution system but is not delivered to customers because it is lost from either the company's or customers' pipes. Leakage is measured in megalitres per day (MI/d).

**Incentive type:** Financial – Rewards and Penalties

#### Performance commitments

		Starting level	Committed performance levels – MI/d				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	MI/d	48	48	47	45	44	43
Penalty collar	MI/d		50	49	47	46	45
Penalty deadband	MI/d		48	47	45	44	43
Reward deadband	MI/d		44	44	44	44	43
Reward cap	MI/d		42	42	42	42	41
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per MI/d				
	Lower	Upper					
Penalty	47.3	45.4	£0.902m				
Reward	43.8	41.4	£0.486m				
Additional details Necessary detail on measurement units			The measure is based on the volume of water leaking from the company's water supply assets. The annual average is applied to give a figure for megalitres per day (MI/d). It includes any uncontrolled losses between water treatment works and customers' internal stop taps. It does not include customers' internal plumbing losses.				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per MI/d
	Lower	Upper	
Frequency of PC measurement and any use of averaging	This PC will be measured annually. The incentive will be based on average performance over the 5-year period.		
Timing and frequency of rewards/penalties	Any rewards or penalties will apply as an adjustment to revenue between 2020-21 and 2024-25		
Form of reward/penalty	Revenue Adjustment		

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per MI/d
	Lower	Upper	
Any other information or clarifications relevant to correct application of incentive	<p>Bristol Water has proposed a performance target of reducing leakage by 6MI/d (2% of Distribution Input) from a target of 49MI/d in 2014-2015 to 43MI/d by 2020. This investment is aligned with the company's long run economic level of leakage that was assessed as part of the Water Resources Management Plan.</p> <p>Bristol Water believes that if it does not deliver this level of performance for customers, it should incur a penalty. It has also proposed a reward for outperformance of the proposed target since reducing leakage is the third priority area for customers.</p> <p>The company has included a deadband for the reward. This is to take account of the fact that its leakage performance in 2013-14 was 44MI/d. The company has applied this deadband for years 1 to 4 until its targeted performance is forecast to exceed this level in year 5. In this way it will only receive a reward for stretching performance that exceeds its observed performance levels in line with customers' views.</p> <p>As part of our assessment we have undertaken a horizontal consistency check of leakage incentives. This has focused on the degree of underperformance that is subject to a financial penalty. Where a company has proposed a penalty range that is less than the company average we have considered whether it is appropriate to increase the penalty collar to a level in line with the industry average. One key consideration in this decision is the incentive rate proposed for the penalty. While Bristol Water have a below average range at which their penalty applies, the incentive rate is sufficient to ensure customers are adequately protected. Therefore, no intervention has been made.</p>		

## Outcome G: Efficient Use of Resources by Customers (Wholesale)

### Performance commitment G1: Meter Penetration

**Detailed definition of performance measure:** Defined as the proportion of total properties of billed household customers that are charged for water on a measured basis.

**Incentive type:** Financial – Rewards and Penalties

#### Performance commitments

		Starting level	Committed performance levels – % Meter Penetration				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	45.6%	50.4%	54.8%	58.8%	62.5%	65.9%
Penalty collar	%		46.4%	50.8%	54.8%	58.5%	61.9%
Penalty deadband	%		50.4%	54.8%	58.8%	62.5%	65.9%
Reward deadband	%		50.4%	54.8%	58.8%	62.5%	65.9%
Reward cap	%		54.4%	58.8%	62.8%	66.5%	69.9%
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per %				
	Lower	Upper					
Penalty	54.5%	58.5%	£0.038m				
Reward	58.5%	62.5%	£0.036m				
<b>Additional details Necessary detail on measurement units</b>			The percentage of water service billed on a measured basis of charging as a percentage of billed household customers (at the end of each financial year).				
<b>Frequency of PC measurement and any use of averaging</b>			This PC will be measured annually. The incentive is assessed based on performance each year over the period 2015 to 2020.				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate £m per %
	Lower	Upper	
Timing and frequency of rewards/penalties	Any rewards or penalties will apply as an adjustment to revenue between 2020-21 and 2024-25		
Form of reward/penalty	Revenue Adjustment		
Any other information or clarifications relevant to correct application of incentive	<p>Bristol Water’s proposed investment is based on a forecast of the number of customers requesting a meter and the level of property turnover. In reality the actual numbers could deviate from this forecast due to external factors such as the weather and the housing market. The company has included a penalty and a reward to allow for this potential deviation.</p> <p>Bristol Water has not included any deadbands for this incentive, the penalty collar and reward cap are set at <math>\pm 4\%</math> of properties.</p>		

## Outcome H: Sustainable Environmental Impact

### Performance commitment H1: Total Carbon Emissions

**Detailed definition of performance measure:** The company's total carbon emission figure, divided by the population supplied. Measured as kgCO<sub>2</sub>e/person.

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – kgCO <sub>2</sub> e/person				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	kgCO <sub>2</sub> e/person	40	32	25	23	22	20
Penalty collar	kgCO <sub>2</sub> e/person		n/a	n/a	n/a	n/a	n/a
Penalty deadband	kgCO <sub>2</sub> e/person		n/a	n/a	n/a	n/a	n/a
Reward deadband	kgCO <sub>2</sub> e/person		n/a	n/a	n/a	n/a	n/a
Reward cap	kgCO <sub>2</sub> e/person		n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				
<b>Additional details Necessary detail on measurement units</b>			The measurement is the annual operational greenhouse gas emissions based on the Carbon				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
			Accounting Workbook and is expressed in kilotonnes of CO <sub>2</sub> (carbon dioxide) equivalent divided by the population supplied.
Frequency of PC measurement and any use of averaging			This PC will be measured and reported annually.
Timing and frequency of rewards/penalties			n/a – reputational incentive
Form of reward/penalty			n/a – reputational incentive
Any other information or clarifications relevant to correct application of incentive			Bristol Water is proposing that total carbon emissions is a reputational incentive due to the overlap with statutory incentives within the period 2015 to 2020. This measure focuses on operational carbon emissions that are primarily due to electricity consumption. These emissions and other fuel based emissions are incentivised through a range of mechanism and taxes, including the EU Emissions Trading Scheme costs and the Climate Change Levy costs that are passed on in energy costs and the Carbon Reduction Commitment tax. For the 2015-20 period these costs exceed the carbon values published by DECC. This means that operational carbon reduction is incentivised through the regulatory cost incentives and including an additional outcome delivery incentive would double count.

## Performance commitment H2: Raw Water Quality of Sources

**Detailed definition of performance measure:** This is an assessment of the quality of the company's raw water sources. The current trend shows deterioration in key surface water sources. As the Mendip lakes have a large sediment burden, Bristol Water anticipates that they will respond slowly to changes in incoming water quality due to improvements in land management in the company's catchment area. In order to provide more precise measurement of the impact of catchment actions, the company will further develop this measure in 2015-20 to consider changes in the quality of water entering these sites via tributaries in the catchment area.

**Incentive type:** Reputational

### Performance commitments

		Starting level	Committed performance levels – Assessment				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Assessment	Deteriorating	Deteriorating	Deteriorating	Marginal	Marginal	Stable
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				
Additional details Necessary detail on measurement units			The water quality of some of Bristol Water's sources is at risk of deterioration due to potential ingress of nutrients and/or pesticides from their catchments. Measured as improving, stable, marginal or deteriorating				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Frequency of PC measurement and any use of averaging	This PC will be measured and reported annually.		
Timing and frequency of rewards/penalties	n/a – Reputational incentive		
Form of reward/penalty	n/a – Reputational incentive		
Any other information or clarifications relevant to correct application of incentive	Bristol Water is proposing that raw water quality of sources is a reputational only incentive. The consequences of deteriorating raw water quality include reduced availability of water that directly impacts on its Supply Demand Balance. As such the financial incentives on hosepipe ban frequency and unplanned customer minutes lost will capture the impacts on customers if the company does not perform against this measure.		

## Performance commitment H3: Biodiversity Index

**Detailed definition of performance measure:** Bristol Water will carry out regular surveys at its sites to assess the level of biodiversity. This will involve quantifying the area of specific habitats available, together with their quality, importance and presence of significant species. The company will combine these measurements to create a quantitative "Biodiversity Index" for each of its sites and an aggregate Biodiversity Index for its overall landholdings.

Biodiversity Index Calculation is [Hectares of priority habitat or metres of linear habitat] \* [status grade of this habitat]. This measure will be developed fully in the first year of 2015-20, following surveys the company has carried out since December 2013 and research it is now carrying out on the best way to quantify the Index

**Incentive type:** Reputational

### Performance commitments

		Starting level	Committed performance levels – Assessment				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Assessment	Under development	Improving	Improving	Improving	Improving	Improving
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Additional details Necessary detail on measurement units	Bristol Water will carry out regular surveys at its sites to assess the level of biodiversity.  Biodiversity Index Calculation is [Hectares of priority habitat or metres of linear habitat] * [status grade of this habitat].		
Frequency of PC measurement and any use of averaging	This PC will be measured and reported annually.		
Timing and frequency of rewards/penalties	n/a – Reputational incentive		
Form of reward/penalty	n/a – Reputational incentive		
Any other information or clarifications relevant to correct application of incentive	Bristol Water is proposing that its biodiversity index is a reputational only incentive. As this measure is new the company does not have a baseline against which to measure its performance. Bristol Water is proposing to develop this baseline over the 2015 to 2020 period, and therefore it does not currently have sufficient data to introduce a financial incentive for this measure during 2015-20.		

## Performance commitment H4: Waste Disposal Compliance

**Detailed definition of performance measure:** The Environmental Permitting Regulations (2010) created a new framework for the management of discharges from the company's sites to ensure that they are consistent with a sustainable environmental impact. Compliance is calculated based on the results of Bristol Water's operational sampling programme, which is more extensive than that required by the Environment Agency.

**Incentive type:** Reputational

## Performance commitments

		Starting level	Committed performance levels – Assessment				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Assessment	97%	97%	97%	98%	98%	98%
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				
Additional details Necessary detail on measurement units		Waste Disposal Compliance is a proxy measure to monitor Bristol Water's management of environmental risks. The company will use a measure of its internal monitoring of discharges to the environment and calculate the compliance against the Environmental Permitting Regulations (2010) standards.					
Frequency of PC measurement and any use of averaging		This PC will be measured and reported annually.					
Timing and frequency of rewards/penalties		n/a – Reputational incentive					
Form of reward/penalty		n/a – Reputational incentive					
Any other information or clarifications relevant to correct application of incentive		Bristol Water is proposing that waste disposal compliance is a reputational only incentive. This is because the measure targets risk of non-compliance that could cause pollution incidents or other risks					

Incentive rates / Incentive type	Performance levels (assessment)	Incentive rate
	<p>such as health and safety incidents. The risks that the company is aiming to mitigate within its plan are high impact low probability events. If these risks materialise the company is likely to be fined and face statutory enforcement action, meaning that any financial incentive would represent double punishment. Also, Bristol Water does not currently have a robust WTP value for its customers that could reliably be applied to calculate a financial incentive.</p>	

## Outcome G – Efficient use of water by customers (retail)

### Performance commitment G2: Per Capita Consumption

**Detailed definition of performance measure:** Defined as the average amount of water used by each of the company's household consumers each day, measured as litres per head per day (l/h/d).

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – l/h/d				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/h/d	145.6	145.4	144.5	143.6	142.8	142.
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				

#### Additional details

<b>Necessary detail on measurement units</b>	The unit of measurement is post-Maximum Likelihood Estimation weighted average litres per person per day on average over the year.
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<b>Frequency of PC measurement and any use of averaging</b>	This PC will be measured and reported annually.
<b>Timing and frequency of rewards/penalties</b>	n/a – Reputational incentive
<b>Form of reward/penalty</b>	n/a – Reputational incentive
<b>Any other information or clarifications relevant to correct application of incentive</b>	Bristol Water is proposing that average consumption per person per day is a reputational only incentive. The improvement in this measure is being driven by the company's proposals for increased meter penetration, for which it has proposed a separate financial incentive.

## Outcome I – Affordable Bills

### Performance commitment I1: Percentage of customers in water poverty

**Detailed definition of performance measure:** Bristol Water has defined water poverty as the percentage of households within its supply area for whom their water charges represent more than 2% of their disposable income, defined as gross income less income tax.

This is different to the definition used by the Government and organisations such as the Joseph Roundtree Foundation and the Consumer Council for Water; that definition relates to the percentage of customers for whom their water bill, covering water and sewerage charges, represents more than 3% of their disposable income after housing costs and income tax. Because Bristol Water does not have access to the housing costs used in the Government’s definition, it has had to use an alternative definition, and it took advice from one of its main local CABs to determine how best to do this.

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – % customers in water poverty				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	2.1%	2.0%	2.0%	1.9%	1.9%	1.8%
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

**Incentive rates**

Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Penalty	n/a	n/a	n/a
Reward	n/a	n/a	n/a
<b>Additional details Necessary detail on measurement units</b>	The percentage of households within its supply area for whom their water charges represent more than 2% of their disposable income, defined as gross income less income tax.		
<b>Frequency of PC measurement and any use of averaging</b>	This PC will be measured and reported annually.		
<b>Timing and frequency of rewards/penalties</b>	n/a – Reputational incentive		
<b>Form of reward/penalty</b>	n/a – Reputational incentive		
<b>Any other information or clarifications relevant to correct application of incentive</b>	<p>Bristol Water is proposing that the percentage of customers in water poverty is a reputational only incentive. There are three key reasons for proposing a reputational only incentive:</p> <ol style="list-style-type: none"> <li>1. The percentage of customers in water poverty is partially driven by factors outside of the company's control. The general economic situation and customers' own circumstances will influence the volume of customers that are guided to social tariffs by the Citizens Advice Bureau. These factors will also influence the calculation of water bill as percentage of disposable income.</li> <li>2. Bristol Water has introduced a social tariff that will contribute to the success of this measure. As the company has no evidence that customers are willing to pay for a higher social tariff a reward would not be appropriate. In terms of a penalty the revenue cap will ensure that the tariff levels are adjusted if circumstances cause the uptake of the company's social tariff to deviate from its forecasts. This means that the proposed regulatory approach ensures that the social tariff has a cost neutral bill impact, customers are protected and a further outcome</li> </ol>		

Incentive type	Performance levels (assessment)	Incentive rate
	<p>delivery incentive is not appropriate.</p> <p>3. Water poverty is linked to customer debt as customers in water poverty are less likely to pay their bill. As increased debt is a cost to the company it has an inbuilt cost incentive to improve its performance and avoid poor performance against this measure.</p>	

## Outcome J – Satisfied Customers

### Performance commitment J1: SIM

**Detailed definition of performance measure:** Ofwat measure for comparing the customer service performance of water companies in England and Wales.

Includes quantitative measures relating to the number of written complaints and unwanted contacts that the company receives and a qualitative measure derived from a survey of consumers' views on the service Bristol Water has provided in response to a contact they have made. The measure also includes a SIM survey carried out four times a year by Ofwat's appointed market researcher.

As the SIM for 2015-20 is currently under development Bristol Water has not proposed a target score, but aims to retain its position in the industry's top 5.

**Incentive type:** Reward and penalty. No additional incentive to that provided by Ofwat.

#### Performance commitments

		Starting level	Committed performance levels – ranking				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	85.3	top 5	top 5	top 5	top 5	top 5
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

**Incentive rates**

Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Penalty	n/a	n/a	n/a
Reward	n/a	n/a	n/a
<b>Additional details Necessary detail on measurement units</b>	Details of this performance measure are included in the company's Retail Household Plan, pages 43-44		
<b>Frequency of PC measurement and any use of averaging</b>	This PC will be measured and reported annually.		
<b>Timing and frequency of rewards/penalties</b>	Any rewards or penalties will be applied at the end of the regulatory period 2015-20.		
<b>Form of reward/penalty</b>	Revenue adjustment.		
<b>Any other information or clarifications relevant to correct application of incentive</b>	The calculation of this performance commitment may change following more detailed methodology information from Ofwat.  Penalty or reward is determined by Ofwat.		

**Performance commitment J2: General Satisfaction from Surveys**

**Detailed definition of performance measure:** The percentage of customers responding to the company's annual household customer tracking survey who rate their satisfaction in respect of the company's service as excellent, very good or good.

**Incentive type:** Reputational

**Performance commitments**

		Starting level	Committed performance levels – %				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	93%	93%	93%	93%	93%	>93%
Penalty collar			n/a	n/a	n/a	n/a	n/a

		Starting level	Committed performance levels – %				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				

### Additional details

<b>Necessary detail on measurement units</b>	<p>The measure is calculated from 1000 completed surveys with customers who may or may not have had cause to contact Bristol Water during the year. It is carried out annually by an independent market researcher in line with Market Research Society code of conduct (internationally recognised as best practice).</p> <p>The survey includes a question asking respondents to rate overall how satisfied they are with the services the company provides. This measure is the percentage of customers who rate the performance as good, very good or excellent.</p>
<b>Frequency of PC measurement and any use of averaging</b>	This PC will be measured and reported annually.
<b>Timing and frequency of rewards/penalties</b>	n/a – Reputational incentive
<b>Form of reward/penalty</b>	n/a – Reputational incentive

**Any other information or clarifications relevant to correct application of incentive**

This measure complements Ofwat's SIM, because it includes customers and consumers who have not had reason to contact the company during the year. Unlike the survey used for the qualitative SIM measure, the company's annual survey captures satisfaction from a random sample of all of its customers, whereas the SIM survey is limited only to those who have had cause to contact the company.

Bristol Water has not proposed a financial incentive as the results of this measure are highly likely to correlate with the results of the Service Incentive Mechanism which is incentivised separately through a financial regulatory incentive.

### Performance commitment J3: Value for Money

**Detailed definition of performance measure:** Each month a market researcher carries out for the company a survey of 200 consumers who have contacted it about an operational issue. Within the survey respondents are asked to rate their satisfaction in terms of the value-for-money the company provides. The measure is calculated as the percentage of respondents who rate this as very good or good (using a five-point scale).

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – %				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	70%	71%	71%	72%	72%	72%
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a

Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate
	Lower	Upper	
Penalty	n/a	n/a	n/a
Reward	n/a	n/a	n/a
<b>Additional details Necessary detail on measurement units</b>	<p>The measure is calculated from 2400 completed surveys annually (200 per month) with customers who have had cause to contact Bristol Water on an operational issue. It is carried out monthly by an independent market researcher in line with Market Research Society code of conduct (internationally recognised as best practice).</p> <p>Within the survey respondents are asked to rate their satisfaction in terms of the value-for-money Bristol Water provides. The measure is calculated as the percentage of respondents who rate this as very good or good (using a five-point scale).</p>		
<b>Frequency of PC measurement and any use of averaging</b>	This PC will be measured and reported annually.		
<b>Timing and frequency of rewards/penalties</b>	n/a – Reputational incentive		
<b>Form of reward/penalty</b>	n/a – Reputational incentive		
<b>Any other information or clarifications relevant to correct application of incentive</b>	<p>The company recognises that some consumers struggle to make this assessment, often citing that they cannot compare against other water suppliers, but it has found the measure to be sufficiently well understood by most respondents to its surveys.</p> <p>This measure will overlap with the results of the Service Incentive Mechanism which is incentivised separately through a financial regulatory incentive.</p>		

## Outcome K – Easy to Contact

### Performance commitment K1: Ease of Contact from surveys

**Detailed definition of performance measure:** Defined as the percentage of consumers who consider that Bristol Water is easy to contact by telephone, based on responses to monthly telephone survey.

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – %				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	96.2%	96.3%	96.4%	96.5%	>96.5%	>96.5%
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				
<b>Additional details Necessary detail on measurement units</b>			<p>The measure is calculated from 2400 completed surveys annually (200 per month) with customers who have had cause to contact Bristol Water on an operational issue. It is carried out monthly by an independent market researcher in line with Market Research Society code of conduct (internationally recognised as best practice).</p> <p>Within the survey respondents are asked to rate how easy it is to contact Bristol Water by telephone. The</p>				

Incentive rates / Incentive type	Performance levels (assessment)	Incentive rate
		measure is calculated as the percentage of respondents who rate this as very good or good (using a five-point scale).
Frequency of PC measurement and any use of averaging		This PC will be measured and reported annually.
Timing and frequency of rewards/penalties		n/a – Reputational incentive
Form of reward/penalty		n/a – Reputational incentive
Any other information or clarifications relevant to correct application of incentive		The company has included a reputational incentive for this outcome. Customer effort and ease of contact is a driver of consumer satisfaction and therefore links directly to the company's SIM performance, which is incentivised separately through a regulatory financial incentive

## Outcome L – Bills are accurate and easy to understand

### Performance commitment L1: Negative Billing Contacts

**Detailed definition of performance measure:** Data used is a subset of the ‘unwanted contacts’ data collated for the Quantitative measures in the SIM (Service Incentive Mechanism), calculated using a specific set of reason codes used by BWBSL for root cause analysis.

An ‘unwanted’ customer contact is defined by Ofwat within the SIM.

**Incentive type:** Reputational

#### Performance commitments

		Starting level	Committed performance levels – no. contacts				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	No.	2,570	2,480	2,395	2,315	2,240	2,170
Penalty collar			n/a	n/a	n/a	n/a	n/a
Penalty deadband			n/a	n/a	n/a	n/a	n/a
Reward deadband			n/a	n/a	n/a	n/a	n/a
Reward cap			n/a	n/a	n/a	n/a	n/a
Incentive rates / Incentive type	Performance levels (assessment)		Incentive rate				
	Lower	Upper					
Penalty	n/a	n/a	n/a				
Reward	n/a	n/a	n/a				

Incentive rates / Incentive type	Performance levels (assessment)	Incentive rate
Additional details Necessary detail on measurement units	Data used is a subset of the 'unwanted contacts' data collated for the Quantitative measures in the SIM (Service Incentive Mechanism), calculated using a specific set of reason codes used by Bristol Wessex Billing Services Ltd for root cause analysis. An 'unwanted' customer contact is defined by Ofwat within the SIM.	
Frequency of PC measurement and any use of averaging	This PC will be measured and reported annually.	
Timing and frequency of rewards/penalties	n/a – Reputational incentive	
Form of reward/penalty	n/a – Reputational incentive	
Any other information or clarifications relevant to correct application of incentive	<p>Bristol Water recognises that if it is to meet its aim of being responsive to customers, it needs to ensure that that its bills are clear and easy for customers to understand and that bills are accurate.</p> <p>This outcome therefore reflects the importance of this for customers and focuses on minimising the need for customers to have to contact the company because of dissatisfaction or service failure relating to the bills the company issues.</p> <p>Bristol Water has developed a performance measure, using a subset of unwanted contacts data which is already collated for the SIM, which allows it to track its performance associated with this outcome.</p> <p>The measure for negative billing contact is part of the Ofwat service incentive mechanism (SIM), which is incentivised separately through a regulatory financial incentive.</p>	

## **Future incentives proposed for the period post-2020**

No further incentives are currently proposed for the period post 2020.

**Ofwat** (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water sector in England and Wales provides customers with a good quality and efficient service at a fair price.



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