

December 2014

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



**OFWAT**

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## Overview

This appendix sets out the details of the final determination of price controls that are specific to Portsmouth Water. As set out in the overview document, the final determination protects customers in accordance with our statutory duties (summarised '[Policy chapter A1 – introduction](#)' (policy chapter A1) and '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' (our 'final methodology statement'). We have also had regard to relevant guidance from the UK Government and the principles of best regulatory practice to be transparent, accountable, proportionate, consistent and targeted.

We published '[Draft price control determination notice: company-specific appendix – Portsmouth Water](#)' (the 'draft determination' for Portsmouth Water) on 29 August. Portsmouth Water is not an enhanced company. Portsmouth Water has been treated in the same way as the other non-enhanced companies.

The customer challenge group (CCG) played an important role in both the development of the company's original plan and the company's revised proposals in response to our challenges and published guidance.

Since the first submission of its business plan in December 2013, Portsmouth Water's proposals have also continued to evolve to take into account '[Setting price controls for 2015-20 – risk and reward guidance](#)' (our 'risk and reward guidance'), the outcome of our risk-based review (RBR), our draft determination and other relevant policy consultations.

Portsmouth Water responded well to our challenges. Its proposed wholesale total expenditure (totex) was below our threshold and it received a draft determination with only a small number of interventions. While we allowed an uplift to the allowed return, this was significantly less than the company proposed.

The company focused its representation on key areas, accepting a number of our interventions. It provided additional evidence to support its input price pressure adjustment to household retail costs and provided additional assurance for those aspects of its plan we had indicated as requiring further assurance.

We also received representations from the company's CCG, the Environment Agency, and the Consumer Council for Water (CCWater).

In reaching the final determination we have considered carefully representations we received on the draft determination (which was based upon the latest business plan submitted to us) and taken account of the most up-to-date information available where appropriate. As a result, this

has led to changes which we consider are in the interests of customers and in line with our other statutory duties including:

- Allowing an adjustment to household retail costs for input price pressure.
- In line with all non-enhanced companies, reducing the allowed return to 3.6% for the wholesale business to reflect the significant movement in the cost of new debt since the publication of our risk and reward guidance in January 2014. For Portsmouth Water this, combined with our decision on an uplift to the allowed return, gave an allowed return of 3.75%.

We summarise our final determination for Portsmouth Water in section A1: 'Final determination – at a glance'.

The remainder of this document sets out our final determination in more detail<sup>1</sup> and is structured according to the binding price controls we are setting for the wholesale and retail elements of the appointee (the whole regulated business):

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

As we explained in our final methodology statement, these separate controls are binding, confirmed through the modifications already 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 and cannot transfer costs between the controls.

The revenue allowance for each price control is determined by the costs specific to that particular price control. This provides the companies with more effective incentives. It also helps to avoid distortion to the non-household market, which will be fully open to competition from 2017, as provided for in the Water Act 2014.

To support these separate, binding controls, throughout this document we also provide details on:

- the responses that we have received to our draft determinations and any consequential adjustments that we have made;
- the outcomes for the company to deliver and associated outcome delivery incentive (ODI);

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<sup>1</sup> Figures stated in this document (including wholesale costs and bill information) are in 2012-13 prices; retail data is stated in nominal prices. This is consistent throughout this final determination unless otherwise stated.

- the efficient costs that we consider the company can achieve;
- the adjustments we are making to the wholesale water price control to reflect the company's performance in 2010-15;
- the allowed return for the wholesale water control, and the retail household and non-household net margins;
- the return on regulatory equity (RoRE) range;
- the financial ratios under the notional capital structure<sup>2</sup>; and
- the uncertainty mechanisms that form part of each price control.

## Implementing these price limits

Portsmouth Water must deliver its obligations as required by the Water Industry Act 1991, other relevant legislation and its Instrument of Appointment ("licence"). This price control determination has been made under the terms of Portsmouth Water's licence and the Water Industry Act 1991. We consider that Portsmouth Water must act in an economic and efficient manner in delivering all of its obligations.

Policy chapter A1 sets out the milestones leading up to April 1, 2015 that will ensure effective business plan delivery. These cover menu choices, charges approval, reporting and assurance requirements during 2015-20, and the 2014 price review (PR14) reconciliation.

In [IN 14/15: '2014 price review – timetable for setting charges for 2015-16 and making menu choices'](#) we set out the requirement for companies to notify us of their menu choices by 16 January 2015. We will make any adjustment to the company's allowed revenues that result from its menu choice as part of the price review in 2019 (PR19). A company's menu choice will be influenced by our decisions in this final determination. We confirm in annex 4 of this document a commitment that the ODIs will be recalibrated in the true up calculations, based on a sharing rate that is consistent with the company's menu choice. To facilitate this, we expect the company to publish its ODIs with the cost sharing rate that is implied by its menu choice on 16 January 2015.

This will allow inclusion of the recalibrated ODIs within the framework for reporting and assurance from 1 April 2015, which we will publish on 9 February 2015. We require companies' Boards to provide assurance that the recalibrated ODIs conform with the final determination and are consistent with their menu choice. Any modifications should be confined to correctly adjusting the incentive rates for the difference between the final determination assumption on the cost sharing rate and the rate associated with their final menu choice.

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<sup>2</sup> Notional refers to the capital structure that reflects Ofwat's assumption of an appropriate level of gearing to use in determining the allowed weighted average cost of capital (WACC).

This price determination sets out the allowed revenues that Portsmouth Water can recover from its customers in the period 2015-20. Portsmouth Water is responsible for converting the allowed revenues into charges. In [IN 14/17: 'Approval of charges 2015-16 – our approach, process and information requirements for large and small companies'](#) and the accompanying policy document, we set out the timeline and process for charging approval. Companies are required to provide us with their charges schemes, associated assurances, and the other information requirements, and to provide any new appointees in their area with their charges schemes by 16 January 2015. By 2 February 2015, each company is required to publish its charges scheme.

## A1 Final determination – at a glance

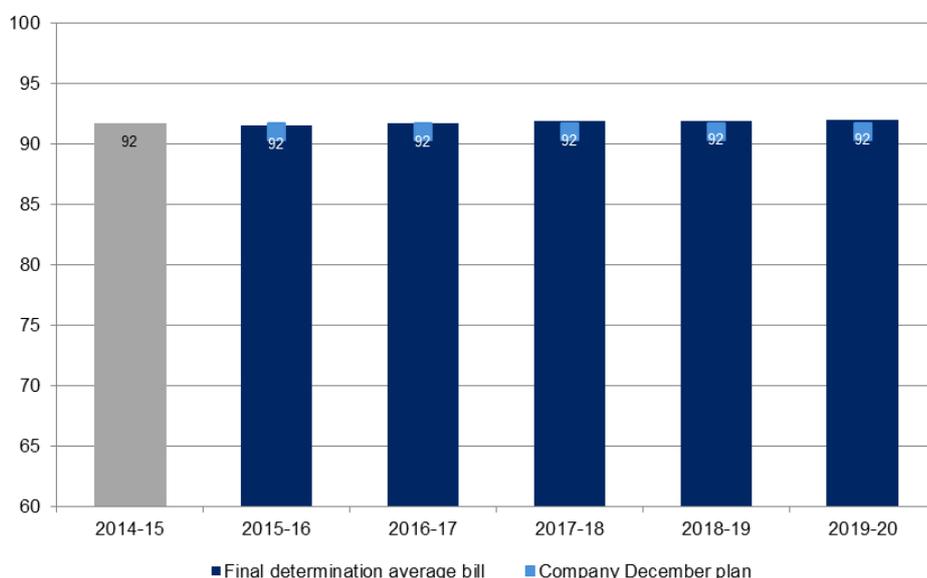
This chapter provides a summary of the final determination for Portsmouth Water. It summarises what the final determination will mean for customers, with respect to the average bills they will pay and the outcomes that the company will deliver in return. For the company, it covers its allowed costs and revenues, return on regulatory equity and financeability ratios. We also summarise the interventions we have made to the company's revised plan in order to protect the interests of customers.

### Combined average household bill (£)

The chart below shows the average bills proposed in the company's December plan, the average bills in our final determination and the level of current bills (2014-15). All bills are shown without the impact of inflation and are indicative as final bills will depend on the growth in the number of customers, changes in its usage and the specific charges that the company sets each year within the overall price controls that we have determined.

Our final determination means that average bills in 2019-20 will be broadly the same as the current average bill levels of £92.

**Figure A1.1 Average bills**



**Note:** The 'bills from 'company's December 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 final determination projection. So the company's proposed bills illustrated above may not necessarily be the same as those described in the revised business plan.

## The outcomes committed to by Portsmouth Water

Portsmouth Water has committed to delivering outcomes that reflect its customers' views. These are supported by 13 associated performance commitments that identify the company's committed level of performance under each outcome. For 9 of these performance commitments the company is subject to associated financial ODIs whereby it will incur a penalty for performance worse than its commitments, but for some can earn a reward for performance better than its commitments during the period from 2015 to 2020. We have undertaken comparative assessment of outcomes where it was possible to draw comparisons across the sector and, where necessary, we have intervened to challenge companies to deliver an upper quartile level of performance

The table below sets out Portsmouth Water's committed outcomes. These outcomes reflect the priorities of customers set out in research and engagement with the CCG. Details of the types of incentives and level of performance commitments associated with these outcomes are set out in annex 4.

### Wholesale water

Safe secure and reliable drinking water  
Less water lost through leakage  
High quality service  
An improved environment supporting biodiversity  
Health and safety culture

### Retail

High quality service  
An improved environment supporting biodiversity  
Supporting the community

## Allowed costs and revenue for Portsmouth Water

The table below shows the wholesale totex we have allowed over the period from 2015 to 2020. The final determination allows Portsmouth Water to receive revenues of £180 million (over the period from 2015 to 2020). This combines allowed costs in wholesale water and household retail together with the regulated margin the company can earn on these activities. For non-household retail, we have also set average revenue controls per customer for each of the customer types proposed by the company. The £2.8 million of non-household revenue shown in the table below is indicative as it does not assume any gains or losses from competition or the company charging customers at levels different to the relevant default tariffs.

Wholesale	Water
Totex 2015-20 total (£m)	140.7
Allowed return(%)	3.75%
Allowed wholesale revenue 2015-20 (£m)	156.5

Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	22.0	
Margin (%)	1.00%	2.50%
Retail allowed revenue (£m)	23.5	2.8

**Note:** Wholesale figures in 2012-13 prices as revenue will be affected by inflation and retail figures in nominal prices – this is consistent throughout this final determination unless otherwise stated.

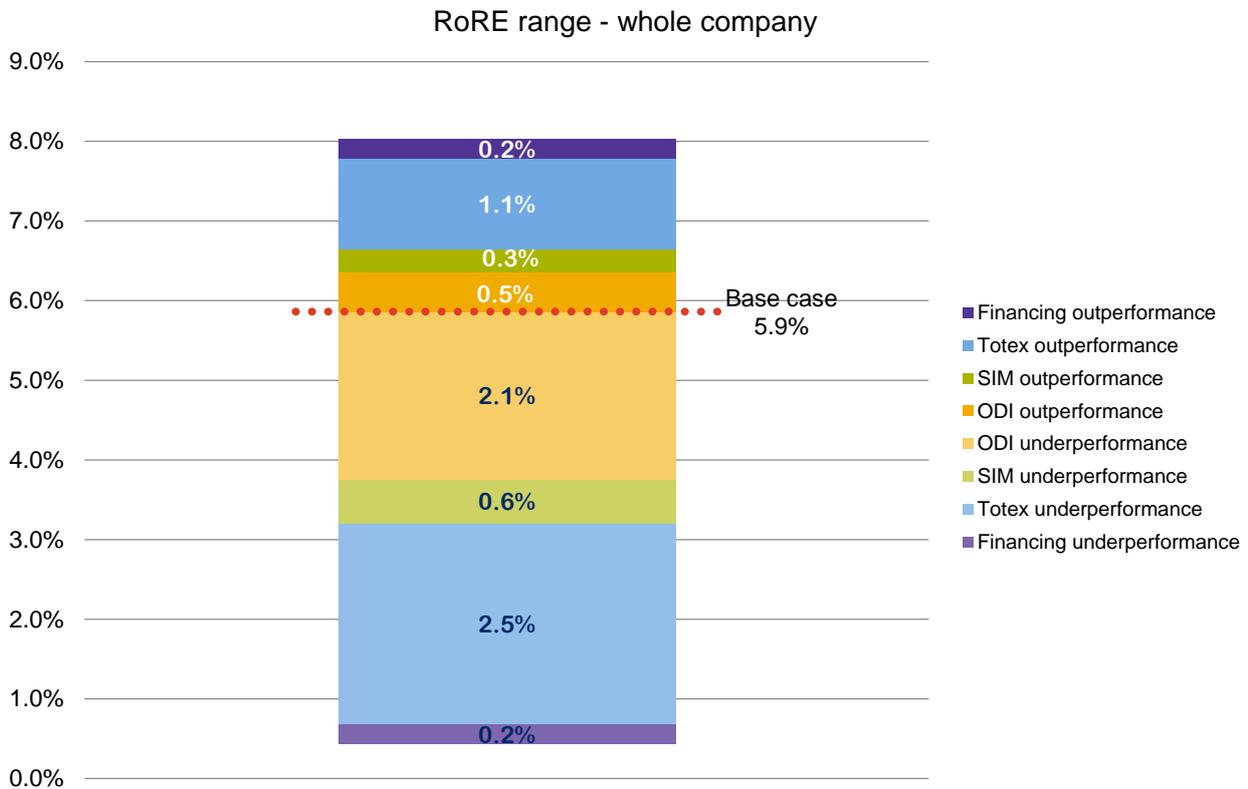
## RoRE ranges – appointee

Portsmouth Water has estimated the range of returns on regulatory equity (RoRE) that it could earn dependent on its performance and external risk factors over the price control period. The RoRE range reflects the company's views and is based on an efficient company with the notional capital structure<sup>3</sup>. We have identified the RoRE impact separately for outcome delivery incentives (ODIs), total expenditure (totex) performance, financing and the service incentive mechanism (SIM). We note that Portsmouth Water's actual returns may differ from notional returns due to differences between notional and actual capital structure and notional and actual cost of debt and level of cost efficiency compared to allowed totex and household retail average cost to serve.

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<sup>3</sup> The notional capital structure is the capital structure which reflects Ofwat's assumption of an appropriate level of gearing to use in determining the allowed weighted average cost of capital (WACC).

**Figure A1.2 RoRE range – whole company**



**Source:** Our calculations based on information from Portsmouth Water

**Note:** Numbers presented based on calibration of the ODIs against an assumed menu choice of a 50% sharing factor.

### Our calculation of notional financeability ratios

Ofwat has a statutory duty to secure that a company is able to finance the proper carrying out of its functions. We interpret this financing duty as requiring that we ensure that an efficient company with a notional capital structure is able to finance its functions. A company’s actual capital structure is a choice for the company and it bears the risk associated with its choices. An efficient company is assumed to be able to deliver its plans based on the expenditure allowance in our final determination.

We sought additional assurance from Portsmouth Water that its plan was financeable on the basis of a notional and an actual structure. The company subsequently provided this assurance. The notional financial ratios on which this final determination is based, which take account of our interventions, are set out in section A5 and summarised on a 5-year average basis below. We have assessed this final determination for Portsmouth Water to be financeable on a notional basis.

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover	2.68
Adjusted cash interest cover ratio (ACICR)	1.33
Funds from operations/debt	8.04%
Retained cash flow/debt	5.45%
Gearing	62.23%
Dividend cover (profit after tax/dividends paid)	0.93
Regulatory equity/regulated earnings for the regulated company	16.91
Regulatory capital value (RCV)/EBITDA	12.50

## Summary of interventions

In reaching our final determination we have intervened in the company's business plan, where necessary, to safeguard the interests of customers. In doing so, we have listened carefully to representations we have received on the draft determination and taken account of the most up-to-date information available where appropriate. We summarise the most significant interventions in the table below.

Outcomes	Wholesale costs
<ul style="list-style-type: none"> <li>• <b>Cap:</b> We are maintaining an overall cap and collar on ODIs of +/- 2% of RoRE.</li> <li>• <b>Comparative assessment:</b> We have revised our proposals for the final determination based on stakeholder representations on the draft determination.</li> <li>• <b>Company-specific assessment:</b> We accepted the company's proposal to assess performance against performance commitments (PCs) after five years. The company removed performance commitment for 'Return on investment' as part of its representation and accepted our draft determination interventions to incentive rates.</li> </ul>	<ul style="list-style-type: none"> <li>• Portsmouth Water's plan contained totex of £137 million over 2015-20, 3% below our threshold of £142million. Portsmouth Water did not make any claims for adjustments to wholesale totex.</li> </ul>
Retail	Reconciling 2010-15 performance
<ul style="list-style-type: none"> <li>• <b>Input price pressure:</b> We accepted the company's claim and are no longer making an intervention in this area.</li> <li>• <b>Price base:</b> We have adjusted companies' costs to align to the 2013-14 base year</li> <li>• <b>Household and non-household retail cost allocation:</b> We accepted the company's reallocated costs and are not intervening in this area</li> </ul>	<ul style="list-style-type: none"> <li>• We are increasing revenue adjustments by £0.6 million (that is, in the company's favour). This represents a very small change from the draft determination. We continue to accept the company's proposal to return £5.2 million of revenue allowance to customers.</li> <li>• We are increasing regulatory capital value (RCV) adjustments by £5.9 million (that is, in the company's favour). This is £0.5 million lower than the draft determination (reflecting a change in the adjustment for actual expenditure in 2009-10).</li> </ul>

Risk and reward	Financeability and affordability
<ul style="list-style-type: none"><li>• <b>Wholesale cost of capital:</b> Based on the latest market evidence for the cost of new debt we have reduced the company's allowed return from 3.7% to 3.6%. The additional uplift to the return remains unchanged from draft determination at 15 basis points.</li></ul>	<ul style="list-style-type: none"><li>• We received additional assurance leading us to make no interventions.</li></ul>

## A2 Wholesale water

### A2.1 Consideration of representations on our draft determinations

In policy chapter A1, we provide a list of the respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made either consequential adjustments to our price control methodology or company-specific interventions.

Our general policies relevant to the wholesale water control are set out in the following policy chapters that accompany our final determination. These include our responses to representations on sector-wide issues.

- [‘Policy chapter A2 – outcomes](#) (‘policy chapter A2’).
- [‘Policy chapter A3 – wholesale water and wastewater costs and revenues](#) (‘policy chapter A3’).
- [‘Policy chapter A4 – reconciling performance for 2010-15](#) (‘policy chapter A4’).
- [‘Policy chapter A7 – risk and reward](#) (‘policy chapter A7’).
- [‘Policy chapter A8 – financeability and affordability](#) (‘policy chapter A8’).

Table A2.1 lists the representations we have received that are specific to Portsmouth Water's wholesale water control. It points to the relevant policy chapters which address more general comments and sets out where to find more information on our responses to company-specific issues in this document.

**Table A2.1 Representations specific to the wholesale water control of Portsmouth Water**

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	Portsmouth Water Environment Agency CCWater	Annex 4
Outcome delivery and reporting	Portsmouth Water	Annex 4
Calculating allowed wholesale water expenditure	None	Section A2.3.1 and Annex 1

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Calculation of revenues: Pay as you go (PAYG) and RCV run-off	None	Section A2.3.2 and A5.5
Return on RCV	CCWater	Section A2.3.3
Reconciling 2010-15 performance	Portsmouth Water	Annex 3
Uncertainty mechanisms- water business rates	CCWater	Section A2.4
New statutory requirements	Environment Agency	Section A2.4

## A2.2 Company outcomes, performance commitments and delivery incentives

### A2.2.1 Outcomes, performance commitments and incentives

In policy chapter A2, we discuss our approach to outcomes for the wholesale and retail controls. Portsmouth Water has developed and committed to delivering outcomes which reflect its customers' views. These are supported by specific performance commitments and associated incentives (ODIs) whereby the company can be rewarded or penalised for its performance during the period from 2015 to 2020.

The company's outcomes have been developed with input from its CCG. The CCG's role was to challenge how well the company's outcome, performance commitments and delivery incentives reflect the views and priorities of customers, both now and in the future, as well as environmental priorities.

Consistent with the draft determination, our assessment of the specific performance commitments proposed by each company for wholesale water has focused on:

- Comparative assessments where it was possible to compare performance commitments and incentives across the sector and so challenge companies to deliver an upper quartile level of performance so that companies are focused on delivering benefits for customers and the environment; and,

- Company-specific assessments to ensure that the performance commitments proposed by each company are challenging, appropriately incentivised and supported by customer engagement.

We summarise the outcomes, performance commitments and ODIs for the wholesale water control for Portsmouth Water in Table A2.2 below.

For some performance commitments and incentives types, we have intervened to change the underlying performance level or incentives. Where we have intervened we have done so to ensure that companies are subject to effective incentives that protect customers against under-delivery and where merited, reward companies for outperformance. We summarise our interventions in Table A2.2 and set out whether it is the result of our comparative assessment review or company-specific assessment.

Full detail of the wholesale water outcomes, performance commitments and incentives, and our consideration of relevant responses, is provided in annex 4.

Consistent with the draft determination, the overall cap and collar we are applying on ODIs for 2015-20 that limits total rewards and penalties.

**Table A2.2 Wholesale water outcomes, performance commitments and incentives**

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
Safe secure and reliable drinking water	Bursts	Financial – reward and penalty	Maintained draft determination approach of multiplying the incentive rates by 5, to reflect assessing average performance over the 5 years.
	Water quality standards	Financial – penalty only	We have adopted a less demanding penalty deadband as a result of revisions to the comparative assessments. We have also adopted a less demanding penalty collar as a result of revisions to the comparative checks. We have revised the PC/ODI to be assessed and applied annually to reflect reduction in penalty deadband
	Water quality contacts	Financial – reward and penalty	Maintained the increased PC level and caps and collars introduced at draft determination to include discolouration and illness. Maintained draft determination approach of multiplying the incentive rates by 5, to reflect assessing average performance over the 5 years.

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
	Temporary usage bans	Reputational	No intervention at draft determination and no representations submitted.
Less water lost through leakage	Leakage	Financial – reward and penalty	Maintained draft determination approach of multiplying the incentive rates by 5, to reflect assessing average performance over the 5 years.
High quality service	Interruptions to supply	Financial – reward and penalty	Maintained draft determination approach of multiplying the incentive rates by 5, to reflect assessing average performance over the 5 years.
An improved environment supporting biodiversity	Biodiversity	Financial – penalty only	Maintained draft determination approach of multiplying the incentive rates by 5, to reflect assessing performance level after 5 years.
	Water Framework Directive	Financial – reward and penalty	No intervention at draft determination and no representations submitted.
	Carbon	Reputational	No intervention at draft determination and no representations submitted.

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
Attractive to investors	Return on investment	Financial – penalty only	The company proposed in its representation that this PC should be removed due to potential duplication of outperformance shared through totex. We agree and have removed this PC/ODI.
Health and safety culture	RoSPA	Reputational	No intervention at draft determination and no representations submitted.

## A2.2.2 Outcome delivery and reporting

Portsmouth Water’s proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach is summarised in annex 4.

## A2.3 Calculating the wholesale water price control

### A2.3.1 Calculating allowed wholesale water expenditure

The cost of delivering wholesale water services is a major driver of customer bills, comprising almost 90% of the value chain. In order to protect the interests of customers, we have determined the efficient level of costs for the company to deliver the outcomes that matter to customers both today and tomorrow and to allow it to meet its statutory obligations.

Our approach to determining efficient wholesale expenditure is set out in policy chapter A3.

Following representations, the company’s proposed wholesale water totex is £137 million over 2015-20 (this is broadly the same as its December plan). This is 3% below the final determination threshold (post additions) of £142million.

The wholesale water allowed expenditure for Portsmouth Water is detailed in Table A2.3. 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 the final determination cost threshold models](#).

**Table A2.3 Wholesale water allowed expenditure (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Final determination cost threshold						141.9
Costs excluded from menu	0.6	0.6	0.6	0.6	0.6	3.0
Menu cost baseline <sup>1</sup>	26.8	29.1	29.1	27.6	26.3	138.9

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Company's view of menu costs <sup>2</sup>						134.1
Implied menu choice						96.5
Allowed expenditure from menu	26.6	28.8	28.8	27.4	26.1	137.7
Costs excluded from menu	0.6	0.6	0.6	0.6	0.6	3.0
Total allowed expenditure <sup>3</sup>	27.2	29.4	29.4	28.0	26.7	140.7
Less pension deficit repair allowance	0.0	0.0	0.0	0.0	0.0	0.0
Totex for input to PAYG	27.2	29.4	29.4	28.0	26.7	140.7

**Notes:**

1. Menu baseline is equal to the final 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 (reflecting its representation on its draft determination) minus costs for items excluded from the menu. The company will make a final menu choice by 16 January 2015 and any difference between this and the implied menu choice will be reconciled as part of PR19
3. Includes pension deficit recovery costs.

**A2.3.2 Calculation of revenues: PAYG and RCV run-off**

Table A2. Table A2.4 shows the PAYG rates and the amount of totex recovered for wholesale water, which we have used as the basis for this final determination. The resulting PAYG (£m) is the amount of money recovered from customers in the short term.

In section A5.5 we discuss financeability at an appointee (whole regulated company) level.

Table A2.5 shows the RCV run-off amounts included within the wholesale water charge. This is the amount of money recovered in the long term through the company's RCV.

**Table A2.4 Portsmouth Water’s wholesale water PAYG rates**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	27.2	29.4	29.4	28.0	26.7	140.7
PAYG (%)	82.9%	72.2%	71.3%	74.4%	77.9%	75.7%
Resulting PAYG (£m)	22.5	21.2	21.0	20.8	20.8	106.4

**Note:** The figures in this table reflect our change in PAYG rates as described in section A5.5 on financeability.

**Table A2.5 Portsmouth Water’s wholesale water RCV run-off (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	4.6	4.4	4.2	4.1	3.9	21.1
RCV run-off of totex additions	0.1	0.4	0.7	1.1	1.4	3.6
Total RCV run-off	4.7	4.8	5.0	5.1	5.3	24.7

**Note:** This reflects a run-off rate of 3.8% for the RCV as at 31 March 2015 and 23 years for the totex additions to the RCV over 2015-20.

### A2.3.3 Return on the RCV

As stated in policy chapter A3, the return on the RCV is a key component of allowed wholesale revenues. The return on the RCV is the wholesale allowed return applied to the RCV during the 2015-20 period. The RCV is calculated as the RCV at the start of the period plus totex that is not funded on a PAYG basis minus RCV run-off (or regulatory depreciation).

In our risk and reward guidance, we set out a single industry cost of capital for both wholesale water and wastewater services based on market evidence, which at the time was 3.7%. The company accepted this guidance in its revised business plan. As we set out in policy chapter A7, based on the latest market evidence for the cost of new debt we have set the wholesale cost of capital at 3.6%.

The company had proposed a 50 basis points uplift to the wholesale allowed return in its plan. Our draft determination replaced the company’s proposal with a 15 basis points uplift. This decision was based on the approach which we set out in our risk and reward guidance.

In its representations on the draft determination the company argued that its original proposal for a 50 basis points uplift to the wholesale allowed return remained

appropriate. But, it said it would not challenge our intervention on this on the assumption that its totex threshold remained unchanged.

We have considered whether it would continue to 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 [weighted average cost of capital], 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 policy chapter A7, we consider that Portsmouth Water, in common with five other small water only companies, faces a higher cost of raising debt equivalent to 15 basis points on the allowed return. This means that the company passed the first of our tests – we are satisfied that the company has 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 Portsmouth Water. For the reasons set out in policy chapter A7, we consider that the benefits from providing the company-specific uplift to the company more than offset the higher financing costs. This means that the company passed the second of our tests.

In addition, the company has provided evidence that customers support paying the company-specific uplift to Portsmouth Water.

We have therefore concluded that it would be in the interests of customers for the company to receive an allowed return which reflects these higher notional financing costs. We are allowing an uplift of 15 basis points on the allowed return.

While the industry’s wholesale allowed return has been reduced to 3.6%, with the company-specific uplift, Portsmouth Water has been given an allowed return of 3.75% in this final determination. This results in a return on capital of £23.4 million over 2015-20.

Table A2.6 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A2.3.4 below. The average RCV, set out in Table A2.7 for each year, takes into account the proportion of totex additions to the RCV determined by the PAYG rate and RCV run-off as set out in Table A2.4 and Table A2.5 above.

**Table A2.6 Portsmouth Water’s wholesale water opening RCV (£ million)**

	2015-16
Closing RCV 31 March 2015	108.4
Land sales <sup>1</sup>	0.0
Adjustment for actual expenditure 2009-10 <sup>2</sup>	5.9
Adjustment for actual expenditure 2010-15 <sup>3</sup>	6.1
Net adjustment from logging up and logging down <sup>3,4</sup>	-0.5
Adjustment for shortfalls <sup>3,4</sup>	0.0
Adjustment for serviceability shortfalls	0.0
Enhanced reward	0.0
Other adjustments <sup>5</sup>	0.0
Opening RCV 1 April 2015	119.9

**Notes:**

1. Land sales adjustment is set out in Table AA3.18
2. 2009-10 actual expenditure adjustment is set out in Table AA3.18.
3. A component of the CIS (Capital Expenditure Incentive Scheme) adjustment as set out in Table AA3.15
4. The net adjustment from the change protocol is set out in Table AA3.9.
5. Other RCV adjustments are set out in Table AA3.18

**Table A2.7 Portsmouth Water’s wholesale water return on RCV (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	119.9	120.7	123.9	127.1	128.9
RCV additions (from totex)	5.5	8.0	8.2	6.9	5.6
Less RCV run-off	4.7	4.8	5.0	5.1	5.3
Closing RCV	120.7	123.9	127.1	128.9	129.2
Average RCV (year average)	120.3	122.3	125.5	128.0	129.0
Return on capital	4.5	4.6	4.7	4.8	4.9

**A2.3.4 Reconciling 2010-15 performance**

When we last set price controls in 2009 (PR09), we included a number of incentive mechanisms designed to encourage companies to improve and deliver services

more efficiently, and, to manage uncertainty. Consistent with the broad approach set out at the time of final determination in 2009, we have made adjustments at this price review (PR14) to 2015 to 2020 revenues to take account of company performance in the 2010 to 2015 period.

Our approach to reconciling 2010-15 performance is set out in policy chapter A4.

Table AA3.1 in annex 3 notes the comments that we have received that are specific to this aspect of the wholesale water control and outlines how our interventions have been influenced by our consideration of these responses.

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 £1.6 million to £2.2 million.

The minor changes we have made in the final determination in reconciling the company's 2010-15 performance result from our CIS methodology change (which applies to all companies) and our revised adjustment to the RCV for actual expenditure in 2009-10.

We summarise these interventions in Table A2.8 below. The impact on the opening RCV of 2010-15 adjustments is shown in Table A2.6 and we discuss our interventions in this area further in annex 3.

When making this final determination we do not have the full information on companies' performance in 2014-15. We set out in '[Setting price controls for 2015-20 – further information on reconciling 2010-15 performance](#)' that we would reconcile for the revenue correction mechanism (RCM), change protocol and serviceability in 2015, and in 2016 for the capital expenditure incentive scheme, when we have the company's actual performance for 2014-15. In carrying out this reconciliation we will take a proportionate approach (for example, applying materiality thresholds where appropriate) to making adjustments for company's actual performance and implement these changes at the next wholesale price control review in 2019.

**Table A2.8 Portsmouth Water’s wholesale water revenue adjustments to reflect 2010-15 performance (£ million)**

Area of intervention	Intervention	Company view	Total revenue adjustment (post intervention)	
			Draft determination	Final determination
SIM	<p>This final determination includes our view of the company’s SIM penalty, which we have calculated as -0.5%. This is the same as our draft determination where our intervention updated the company's resubmitted plan estimation of a penalty of -1.0%.</p> <p>This intervention adjusted revenue by £0.9 million in the company’s favour.</p>	-1.8	-0.9	-0.9
RCM	<p>We have intervened in the following areas.</p> <ul style="list-style-type: none"> <li>• final determination (FD09) assumptions.</li> <li>• Outturn financial year average RPI.</li> </ul> <p>Combined, these interventions reduced revenue by £0.4 million compared with the company’s revised business plan.</p>	9.4	9.0	9.0
Opex incentive allowance (OIA)	There are no interventions in this area.	1.6	1.6	1.6
CIS	We have used the post-tax basis of the PR09 WACC for the discount rate when calculating the future value of the revenue adjustment in	-2.4	-2.4	-2.3

Area of intervention	Intervention	Total revenue adjustment (post intervention)		
		Company view	Draft determination	Final determination
	the 2010-15 period. In carrying out our assessment, we have included our view of the applicable change protocol amounts and we have used the values from table A9 of the revised business plan. This applies to all companies. Combined, these interventions increased revenue by less than £0.1 million compared with the company's revised business plan.			
Other adjustments	There are no interventions in this area.	-5.2	-5.2	-5.2

### A2.3.5 Calculation of allowed revenue

We set out the calculation of the allowed revenue for Portsmouth Water's wholesale water control in Table A2.9.

Overall, Portsmouth Water's wholesale water revenue allowance will be £30.9 million in 2015-16, increasing by 1.4% to £31.7 million in 2019-20.

**Table A2.9 Portsmouth Water's wholesale water allowed revenue (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	27.2	29.4	29.4	28.0	26.7	140.7
PAYG rate (%)	82.9%	72.2%	71.3%	74.4%	77.9%	
Totex additions to the RCV	4.6	8.2	8.4	7.2	5.9	34.3
RCV (year average)	119.9	121.6	125.0	127.8	129.1	

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
<b>Wholesale allowed revenue build up:</b>						
PAYG <sup>1</sup>	22.5	21.2	21.0	20.8	20.8	106.4
Return on capital	4.5	4.6	4.7	4.8	4.9	23.4
RCV run-off	4.7	4.8	5.0	5.1	5.3	24.7
Tax <sup>2</sup>	0.2	0.1	0.0	0.0	0.0	0.2
Income from other sources <sup>3,4</sup>	-1.3	-1.3	-1.3	-1.3	-1.3	-6.4
Reconciling 2010-15 performance	-0.7	0.6	0.7	0.7	0.7	2.2
Ex ante additional menu income	0.1	0.1	0.1	0.1	0.1	0.6
<b>Wholesale allowed revenue adjustments:</b>						
Capital contributions from connection charges and revenue from infrastructure charges	0.9	0.9	1.1	1.2	1.2	5.3
<b>Final allowed revenues</b>	<b>30.9</b>	<b>31.0</b>	<b>31.3</b>	<b>31.6</b>	<b>31.7</b>	<b>156.5</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.
3. We have adjusted other income values to remove the deferred income element relating to IFRIC18, as this is an accounting adjustment.
4. Our assessment of income from other sources is discussed in policy chapter A3.
5. Our bill profiling adjustments are discussed in section A5.6

## A2.4 Uncertainty mechanisms

We have set the company's allowed revenues for the 2015-20 period. All companies face uncertainty about future costs and revenues and this is reflected in the rate of return and the established framework in the licence. We outline our approach to incremental uncertainty mechanisms in policy chapter A7, where we set out our response to the representations made by stakeholders in support of sector wide uncertainty mechanisms.

We have allowed all companies an uncertainty mechanism for business rates as the revaluation of business rates in 2017 is a material risk that is largely outside the control of companies. This mechanism allows a proportion of the additional costs to be passed through to customers, reflecting the fact that companies have more control than customers in managing the risk.

In table A2.10 below, we set out Portsmouth Water’s proposed wholesale water uncertainty mechanisms and our final assessment of these proposals.

**Table A2.10 Portsmouth Water’s proposals for wholesale water uncertainty mechanisms**

Portsmouth Water’s proposals	Our final assessment
<p>In the draft determination we adjusted the company’s proposed sharing rate for its proposed uncertainty mechanism on water business rates from 80:20 to 75:25 (customer:company).</p>	<p>For our final determination we confirm the uncertainty mechanism included in our draft determination. The specific text of this Notified Item is in the annex to the final determination letter. The rationale for its inclusion in the final determination is set out in policy chapter A7.</p>
<p>No other uncertainty mechanisms for wholesale water were included in our draft determination.</p>	<p>Portsmouth Water has not objected to our approach in the draft determination. We have not included any additional uncertainty mechanisms for Portsmouth Water.</p>

## A3 Household retail

### A3.1 Consideration of representations on our draft determinations

In policy chapter A1, we provide a list of the non-confidential respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made either consequential adjustments to our industry-wide approach or company-specific interventions.

Our general policies relevant to the household retail control are set out in the following policy chapters that accompany our final determination. These include our responses to representations on sector-wide issues.

- Policy chapter A2.
- Policy chapter A5.
- Policy chapter A7.

Table A3.1 lists the representations we have received that are specific to Portsmouth Water's household retail control and sets out where to find more information on our responses in this document.

**Table A3.1 Representations specific to the household retail control of Portsmouth Water**

Area	Policy chapter	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	A2	None	N/a
Outcome delivery and reporting	A2	None	N/a
Allocation of costs	A5	Portsmouth Water	Section A3.3
Adjustments	A5	Portsmouth Water	Section A3.3
New costs	A5	None	N/a

Area	Policy chapter	Company-specific representations	Detailed commentary in this company-specific appendix
Uncertainty mechanisms	A5	None	N/a

### A3.2 Outcomes, performance commitments and incentives

In policy chapter A2, we discuss our approach to outcomes for the wholesale and retail controls. Portsmouth Water has developed and committed to delivering outcomes which reflect its customers' views.

The company's outcomes have been developed with input from its CCG. The CCG's role was to challenge how well the company's outcome, performance commitments and delivery incentives reflect the views and priorities of customers, both now and in the future, as well as environmental priorities.

Our assessment of the specific performance commitments proposed by each company for household retail has focused on a company-specific assessment to ensure that the performance proposed by each company is challenging, appropriately incentivised and supported by customer engagement.

Table A3.2 summarises the outcomes, performance commitments and ODIs for the household retail control.

For some performance commitments and incentives types, we have intervened to change the underlying performance level or incentives. Where we have intervened we have done so to ensure that companies are subject to effective incentives that protect customers against under-delivery and where merited, reward companies for outperformance. We summarise any interventions in table A3.2.

**Table A3.2 Household retail outcomes, performance commitments and incentives**

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
High quality service	Service Incentive Mechanism	Financial – reward and penalty	We maintain our draft determination position and confirm that the scale and scope would be similar to the current SIM but only apply to household retail.
An improved environment supporting biodiversity	Reducing per capita consumption	Financial – Penalty only	Maintain PC level as at draft determination and clarify that the definition of the PC level is a “normal year” weighted average of measured and unmeasured.
Supporting the community	Survey of developers	Reputational	No intervention at draft determination and no representations submitted.

### A3.3 Costs

Our approach to the household retail control is set out in policy chapter A5. We have adjusted companies’ costs to align to the 2013-14 base year. Historic costs are therefore presented in 2013-14 prices, and all future costs and revenues in nominal prices. We set out our final household retail adjustments, the modification factors for household retail allowed revenue and the assumed number of customers we have used to calculate the total revenues in annex 2.

### A3.3.1 Allocation of costs

In Table A3.3 below, summarises our final assessment of Portsmouth Water’s cost allocation methodology.

**Table A3.3 Our assessment of Portsmouth Water’s cost allocation methodology**

Area assessed	Assessment
No potential material misallocations	Pass
Adequate assurance provided	Pass
Reconciliation to regulatory accounts and December business plan provided	Pass

We are satisfied that the company has addressed all of the cost allocation issues we highlighted in the draft determination (including reallocation of costs in line with our guidance). The impact of the company’s reallocations is to decrease household retail costs for 2013-14 by £0.09 million, to increase non-household retail costs for 2013-14 by £0.01 million and to increase wholesale costs by £0.08 million for 2013-14.

We have used the company’s cost allocation between retail and wholesale and between household and non-household retail to set our final determination.

### A3.3.2 Adjustments

In its revised business plan, submitted in June 2014, Portsmouth Water sought adjustments to the average cost to serve (ACTS) for input price pressure, we have also adjusted all companies pension deficit repair costs as at draft determination.

#### Input price pressure

In the final determination for Portsmouth Water we have included an adjustment to the ACTS for input price pressure. The company proposed this adjustment in its revised business plan but we did not accept it at the draft determination. Our final assessment has changed since the draft determination due to the new evidence provided by the company in its representations.

Table A3.4 outlines our assessment of Portsmouth Water’s proposed ACTS adjustments. The value of the adjustments we have accepted in our final determination is summarised in Table A3.5. Further details on our assessment are set out in Annex 2 – Household retail.

**Table A3.4 Portsmouth Water’s 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	0.6	Pass	Pass	Efficiency benchmarking evidence: Pass	Pass
				Upper quartile: Pass	

**Notes:**

1. The four criteria used in our final assessment are the same for all proposed adjustments to the ACTS
2. For household retail materiality is defined as being 2.25% of household retail opex plus depreciation over 2015-20

**Pension deficit repair costs**

In the final determination we have included an adjustment for all companies to reflect the pension deficit recovery costs that our modelling shows is appropriate for household retail as set out in [IN 13/17 “Treatment of companies’ pension deficit repair costs at the 2014 price review”](#).

**Table A3.5 Household retail adjustments (£ million, nominal prices)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Input price pressure	0.061	0.092	0.123	0.155	0.187	0.618
<b>Adjustments included in final determination</b>	<b>0.061</b>	<b>0.092</b>	<b>0.123</b>	<b>0.155</b>	<b>0.187</b>	<b>0.618</b>

**Note:** There will be no automatic indexation for retail price controls to RPI. This company has been allowed a £m adjustment to reflect input price pressure – this is reflected in the values in this table. The wholesale price controls are indexed linked to RPI. This will affect the retail net margins.

### A3.3.3 New costs

Portsmouth Water did not propose material household retail new costs. The value of any modification for immaterial new costs is quantified in table A3.6.

**Table A3.6 New household retail costs (£/customer)**

	Value
Modification made to 2013-14 cost to serve for ACTS calculation	0.00

**Note:** There will be no automatic indexation for retail price controls to RPI.

### A3.4 Calculating the allowed revenues

As set out in policy chapter A5, total allowed household retail revenues are calculated taking account of our assessment of the cost to serve per customer (after the impact of our efficiency challenge), the projected customer numbers in the company's revised business plan and the household retail net margin. The company proposed net margins of 1%. This is in line with our risk and reward guidance and our further consideration of margins following representations on draft determination. We have therefore accepted the company's proposals.

**Table A3.7 Household retail net margins (%)**

	2015-16	2016-17	2017-18	2018-19	2019-20
Household retail net margin	1.0%	1.0%	1.0%	1.0%	1.0%

Table A3.8 below sets out the components of the allowed household retail revenue. We set out the household retail revenue modification in Annex 2.

**Table A3.8 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	14.0					
Metered water only customers	18.3					

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
<b>Industry ACTS (£/customer)</b>						
Unmetered single service customers	21.47					
Metered water only customers	27.26					
<b>Allowed cost to serve<sup>1</sup> (£/customer)</b>						
Unmetered single service customers		13.5	13.6	13.6	13.6	13.6
Metered water only customers		17.8	17.9	17.9	17.9	17.9
<b>Total allowed (£m)</b>						
Cost to serve (excluding net margin)		4.2	4.3	4.4	4.5	4.5
Forecast household wholesale charge (including forecast RPI <sup>2</sup> ) <sup>3</sup>		28.3	29.4	30.5	31.7	32.9
Household retail revenue (including an allowance for the net margin) <sup>4</sup>		4.5	4.6	4.7	4.8	4.9

**Notes:**

There will be no automatic indexation for retail price controls to RPI. However, the wholesale price controls are indexed linked to RPI. This will affect the retail net margins.

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, however, our assumed allocation of wholesale revenue is binding for the purposes of determining the allowance for the net margin which is one component of allowed household retail revenue.

4. This number is indicative as allowed revenue will depend upon actual customer numbers.

### A3.5 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in policy chapter A7.

Portsmouth Water did not propose any household retail uncertainty mechanisms beyond those that will already form part of the regulatory framework for 2015-20.

## A4 Non-household retail

In ‘[Policy chapter A6 – non-household retail costs and revenues](#)’ (‘policy chapter A6’), we outline our overall approach to the non-household retail price control.

In this chapter, we set out Portsmouth Water’s non-household retail final price control.

### A4.1 Consideration of representations on our draft determination

Our general policies relevant to the non-household control are set out in policy chapter A6. This includes our responses to representations on sector-wide issues.

Table A4.1 lists the representations we have received that are specific to Portsmouth Water’s non-household retail control and sets out where to find more information on our responses in this document.

**Table A4.1 Representations specific to the non-household retail control of Portsmouth Water**

Area	Policy chapter	Company-specific representations	Detailed commentary in this company-specific appendix
Net margins	Policy chapter A6	None	N/a
Cost proposals	Policy chapter A6	Portsmouth Water	Section A4.4
Form of control	Policy chapter A6	Portsmouth Water	Section A4.5

### A4.2 Indicative non-household retail total revenue

Table A4.2 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. Furthermore, the controls for each customer type we have set now will only apply for two years; there

will be a review in 2016. Years 2017-18 to 2019-20 below are shown for illustrative purposes only.

**Table A4.2 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	0.6	0.6	0.6	0.6	0.6

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

### A4.3 Net margins

We have accepted the company's proposed net margins that equal 2.5% in aggregate. This is in line with our risk and reward guidance and our further consideration of margins following representations on the draft determination.

### A4.4 Cost proposals

We have accepted updated cost allocations between different non-household retail customer types as proposed by the company. The changes appear to correct for a misallocation between household retail, non-household retail, and wholesale. Upon reviewing the proposed changes we did not identify any concerns with the company's proposals. We have therefore accepted the company's updated allocations.

As set out in policy chapter A6, we have adjusted companies' costs to align to the 2013-14 base year. Historical costs are therefore presented in 2013-14 prices, and all future costs and revenues in nominal prices.

As set out in policy chapter A6, we expect our decisions on the total level of non-household retail costs now, will still apply for years 2017-18 to 2019-20 – the 2016 review will focus on the allocations between different non-household customer types.

The company proposed pension deficit repair costs over the control period of zero. This aligned to our forecast.

Overall the company's proposed costs do not increase by more than our non-household retail materiality threshold of 5.3% between 2015 and 2020. We have therefore accepted the company's cost proposal – that is £1.603 million over the control period.

## A4.5 Form of control

In 'Setting price controls for 2015-20, Draft price control determination notice: technical appendix A5 – non-household retail', we recognised that some companies could benefit from having further time to consider and address any issues ahead of the introduction of competition into the non-household retail market in April 2017.

Our final determination on the form of control is set out in policy chapter A6. In that document we confirm the basic form of control set out in our final methodology statement, but with a two-year initial duration and with a review carried out in 2016.

## A4.6 Average revenue controls

The allowed average retail cost component (£) and the allowed net margin (%) for each customer type are shown in the table below for Portsmouth Water.

The average retail revenue per customer – £ (r) – is also shown. For the avoidance of doubt, it is the average cost component and the allowed net margin that make up the non-household retail control. The average retail revenue per customer is shown only to help comparisons to be drawn.

**Table A4.3 Non-household retail average controls per customer**

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Water Unmeasured Non-Household	£	16.51	16.61	16.67	16.71	16.72
	%	2.4%	2.4%	2.3%	2.2%	2.2%
	£ (r)	21.44	21.62	21.64	21.63	21.81
Water Measured Non-Household < 10MI	£	20.42	20.47	20.22	20.13	20.12
	%	2.4%	2.4%	2.4%	2.4%	2.4%
	£ (r)	29.15	29.42	29.38	29.46	29.52

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Water Measured Non-Household > 10MI and < 50MI	£	40.35	40.35	40.35	40.35	40.35
	%	2.8%	2.8%	2.8%	2.8%	2.9%
	£ (r)	372.67	384.70	397.27	409.03	420.63
Water Measured Non-Household > 50MI	£	36.74	36.74	36.74	36.74	36.74
	%	2.5%	2.5%	2.5%	2.5%	2.5%
	£ (r)	1,926.34	1,953.15	1,986.76	2,034.11	2,078.05

## **A5 Appointee financeability and, affordability**

In this section we discuss at an appointee level:

- bills and K factors;
- return on regulatory equity;
- financeability; and
- affordability.

However, we first consider the responses to our draft determination that are specific to Portsmouth Water's treatment in these areas below.

### **A5.1 Consideration of representations on our draft determinations**

In policy chapter A1, we provide a list of the respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made either consequential adjustments to our industry-wide approach or company-specific interventions.

Table A5.1 lists the representations we have received that are specific to Portsmouth Water at an appointee level. It points to the relevant policy chapters which address more general comments and sets out where to find more information on our responses to company-specific issues in this document.

Where representations have addressed issues that are common to a number of companies, these comments, and any consequential changes to our approach, are discussed in the relevant policy chapter. Representations that are specific to Portsmouth Water at an appointee level in the areas listed above, and any consequential impact on our final determination, are summarised in the table below.

**Table A5.1 Representations specific to issues at an appointee level for Portsmouth Water**

Area	Policy chapter	Company-specific representations	Detailed commentary in this company appendix
Bills and K factors	N/a	None	Section A5.2
Appointee level uncertainty and gain share mechanisms	Policy chapter A7	Portsmouth Water	Section A5.3
Return on regulatory equity range	Policy chapter A7	None	N/a
Financeability	Policy chapter A8	Portsmouth Water	Section A5.5
Affordability	Policy chapter A8	CCWater	Section A5.6

## A5.2 Bills and K factors

As outlined in section A5.5, in its representations on the draft determination Portsmouth did not use PAYG to manage financeability or affordability.

Table A5.2 below sets out the allowed revenues we have assumed in our final determination for Portsmouth Water to deliver for its customers on its:

- statutory duties; and
- associated performance commitments.

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

**Table A5.2 Portsmouth Water’s final determination – K factors, allowed revenues and customer bills<sup>1</sup>**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (£m) <sup>2</sup>	30.9	31.0	31.3	31.6	31.7	156.5
Wholesale water –	0.0%	0.9%	1.0%	0.8%	0.1%	-

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
K (%) <sup>3</sup>						
Retail household allowed revenue (£m)	4.5	4.6	4.7	4.8	4.9	23.5
Retail non-household expected revenue (£m)	0.6	0.6	0.6	0.6	0.6	2.8
Average household bill – water (£) <sup>4</sup>	92	92	92	92	92	-

**Notes:**

1. Wholesale figures in 2012-13 prices as revenue will be affected by inflation and retail figures in nominal prices as revenue will not be affected by inflation.

2. The allowed revenue for our final 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 from 2020. Customer bills in the regulatory period from 2020 will also be affected by Portsmouth 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.

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 Portsmouth Water's household and non-household customer base. In practice, this will depend upon the structure of wholesale charges implemented by Portsmouth Water.

As discussed in policy chapter A3, 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 existing reference point against which to express a change in K.

The base (2014-15) revenue allowance we have set is the financial year average revenue for 2015-16 adjusted for inflation. We set this out for Portsmouth Water in the table below.

**Table A5.3 Portsmouth Water's allowed wholesale revenue 2014-15**

	Wholesale water
Allowed wholesale revenue 2014-15 (£ million)	32.6

### A5.3 Uncertainty and gain share mechanisms

We outline our approach to uncertainty mechanisms and "pain and gain share" in policy chapter A7. In Table A5.4 below, we set out Portsmouth Water's proposed appointee level uncertainty mechanisms and our assessment of these proposals.

**Table A5.4 Portsmouth Water proposals for appointee level uncertainty and gain share mechanisms**

Portsmouth Water’s proposals	Our assessment
<p>We did not intervene on Portsmouth Water’s proposed gain sharing mechanism. However, we noted that the mechanism may not be consistent with incentive-based regulation and that it largely duplicated outperformance sharing through the totex menus.</p> <p>Following further engagement with the CCG and CCWater the company has decided to remove the proposed gain sharing mechanism from its PR14 plan. Both the CCG and CCWater noted this change in its representations.</p>	<p>No change to draft determination position.</p>

## A5.4 Return on regulatory equity range

Portsmouth Water has estimated the range of returns on regulatory equity (RoRE) that it could earn dependent on its performance and external risk factors over the price control period. The RoRE range reflects the company’s views and is based on an efficient company with the notional capital structure<sup>4</sup>. We have identified the RoRE impact separately for ODIs, totex performance, financing and the SIM. We note that Portsmouth Water’s actual returns may differ from notional returns due to differences between notional and actual capital structure and notional and actual cost of debt and level of cost efficiency compared to allowed totex and household retail average cost to serve.

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<sup>4</sup> The notional capital structure is the capital structure which reflects Ofwat’s assumption of an appropriate level of gearing to use in determining the allowed weighted average cost of capital (WACC).

**Table A5.5 Whole company RoRE range**

	Lower bound (%) – appointee	Upper bound (%) – appointee
Overall	-5.4%	+2.2%
ODIs	-2.1%	+0.5%
Totex	-2.5%	+1.1%
Financing	-0.2%	+0.2%
SIM	-0.6%	+0.3%

**Commentary:**

The whole company RoRE range is from 0.4% to 8.0%, with a base case of 5.9% and overall impacts from -5.4% to +2.2%. This range reflects Portsmouth Water's higher cost of debt financing and the company-specific uplift we have allowed for the company (See policy chapter A7). We have modified the draft determination RoRE range to exclude additional returns from non-household retail control to be consistent with approach in our risk and reward guidance. This lowers the base case returns from 6.1% to 5.9%.

The totex range from -2.5% to +1.1% is unchanged from the draft determination. The overall impacts are broadly in line with other companies.

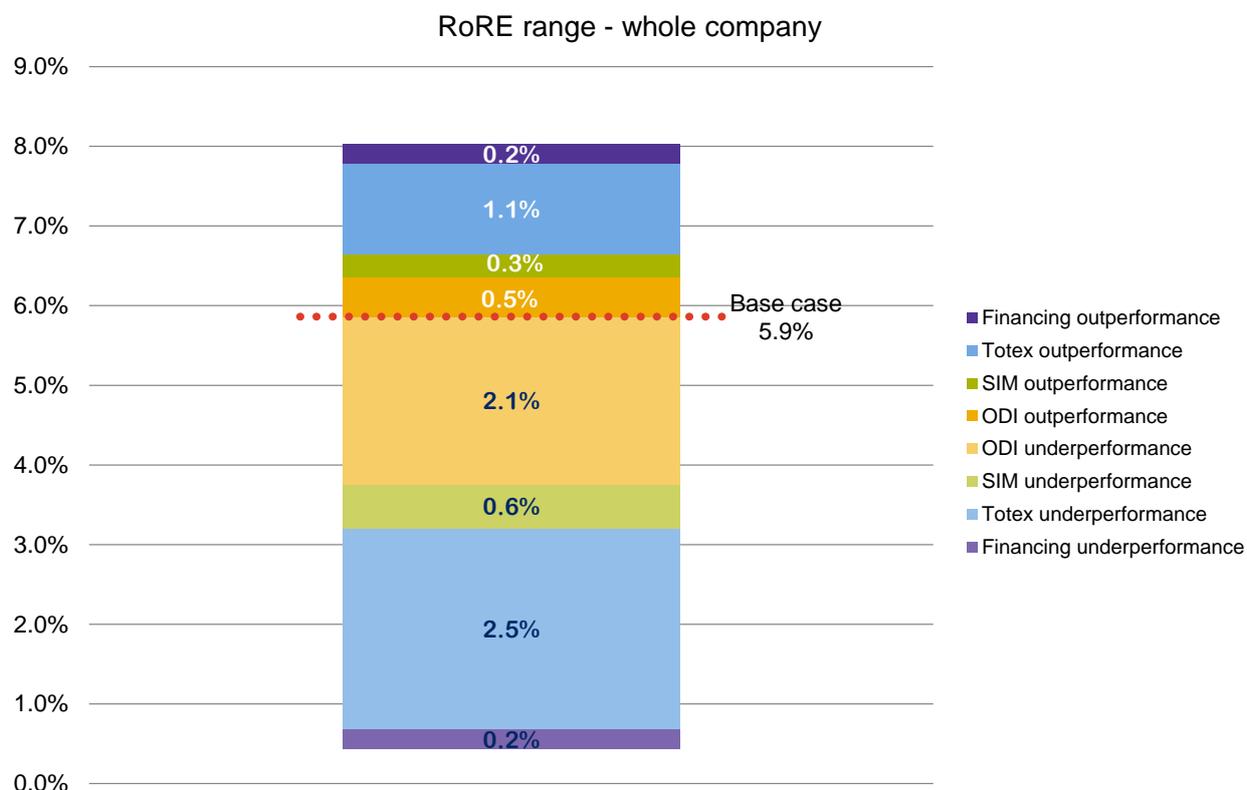
The ODI range proposed by Portsmouth in response to the draft determination was from -2.6% to +0.5%. This is wider than the -1.8% to +0.3% in the draft determination and reflects the company's representations on ODIs. We have adjusted this to -2.1% to +0.5% to take account of the interventions discussed in annex 4. The adjustment includes the effect of capping, in the downside case of the water element (which reduces the water ODI downside from -2.5% to 2.0%). This limits the overall appointee ODI impact to -2.1%. The capped impact is slightly greater than -2.0% due to the impact of the P10 retail ODI, which is not limited by ODI capping.

Financing impacts from -0.2% to +0.2% are unchanged from the draft determination.

The SIM range of -0.6% to +0.3% is also unchanged from the draft determination.

The composition of the RoRE range for Portsmouth Water at an appointee level is shown in Figure A5.1 below.

**Figure A5.1 Portsmouth Water’s RoRE range – appointee**



**Source:** Our calculations based on information from Portsmouth Water

**Note:** Numbers presented based on calibration of the ODIs against an assumed menu choice of a 50% sharing factor

## A5.5 Financeability

Ofwat has a statutory duty to secure that a company is able to finance the proper carrying out of its functions. We interpret this financing duty as requiring that we ensure that an efficient company with a notional capital structure is able to finance its functions. A company’s actual capital structure is a choice for the company and it bears the risk associated with its choices. An efficient company is assumed to be able to deliver its plans based on the expenditure allowance in our final determination.

We set out our approach to assessing financeability in policy chapter A8. Consistent with our PR14 methodology, we have asked companies to provide board assurance on its financeability and to set out its target credit ratings and financial ratios for the notional company. As part of our assessment, we consider the evidence of financeability provided by companies and model its business plan and our draft and final determination financial ratios.

In the draft determination we requested that Portsmouth Water provided additional Board and third party assurance that it was financeable on a notional basis. A company's actual capital structure is a choice for the company and it bears the risk associated with its choices.

The company provided this information as part of its representations on the draft determination.

In Table A5.6 we set out the notional financeability ratios associated with Portsmouth Water's business plan, draft determination and final determination

**Table A5.6 Company and Ofwat financial ratio calculations based on the company business plan and financial ratios based on our final determination**

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on Ofwat calculations (average 2015-20)	
	Company calculation	Ofwat calculation	Draft determination	Final determination
Cash interest cover (ICR)	2.84	2.68	2.64	2.68
Adjusted cash interest cover ratio (ACICR)	1.47	1.40	1.32	1.33
Funds from operations(FFO)/debt	8.94%	8.56%	8.09%	8.04%
Retained cash flow/debt	6.40%	5.63%	5.50%	5.45%
Gearing	60.50%	61.81%	62.11%	62.23%
Dividend cover (profit after tax/dividends paid)	1.55	1.00	0.96	0.93
Regulatory equity/regulated earnings for the regulated company	15.29	15.27	16.99	16.91
RCV/EBITDA	11.92	11.83	12.35	12.50

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

**Commentary:**

**Financial ratios:** Portsmouth Water’s current credit rating is BBB with Standard & Poor’s and Baa1 with Moody’s. It is targeting maintaining this credit rating under its actual and notional structure. In its revised business plan Portsmouth Water provided Board assurance that it was financeable on an actual and notional basis based on its business plan.

On the basis of notional financial ratios we considered that our draft determination allowed the company to be financeable. Given the low level of the FFO/debt ratio on an actual basis and the issues identified on financial data that arose during the review of the company’s business plan, we asked Portsmouth Water to provide third party assurance that it is financeable.

As part of its representations the company has provided third party evidence that it is financeable. The final determination ratios are at levels consistent with those at draft determination. We therefore consider that the final determination is financeable.

As explained in the financeability and affordability policy chapter, companies have been allowed to use new tools in the form of pay as you go (PAYG) rates (the proportion of totex recovered in the period 2015-20) and RCV run-off rates (depreciation of the RCV). Both PAYG and RCV run-off rates can be adjusted to change the proportion of costs recovered within the 2015-20 period and the amount added to the RCV and recovered over a longer period.

Table A5.7 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. Portsmouth Water did not propose any changes to smooth bills. The small change in PAYG in the final determinations reflects the impact of in period bill smoothing described below.

**Table A5.7 Impact of changes in cost recovery rates on RCV growth**

	PAYG rate	RCV run-off	RCV growth (%) – 1 Apr 2015 to 31 Mar 2020
Company December plan	75.7%	4.5%	9.0%
Company June plan	75.9%	3.8%	6.8%
Draft determination	75.9%	3.8%	7.7%
Final determination	75.7%	3.8%	8.0%

## A5.6 Affordability

We set out our approach to assessing affordability in the financeability and affordability policy chapter. Table A5.8 sets out the change in household bill profile between the company's December and June business plans and the draft and final determination

**Table A5.8 Household bill profile**

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	91	91	91	91	91	91
Company June plan	91	91	91	91	91	91
Ofwat calculation for June plan	92	91	91	91	91	91
Ofwat calculation for draft determination – pre-reprofiling	92	89	92	92	92	92
Ofwat calculations for draft determination	92	92	92	92	92	92
<b>Ofwat calculations for final determination</b>	<b>92</b>	<b>92</b>	<b>92</b>	<b>92</b>	<b>92</b>	<b>92</b>

Companies have not necessarily used the same method of calculating household bills as us. So the ‘Ofwat’ calculations are not directly comparable to the company plans (lines 1 and 2 of Table A5.8).

The final determination leads to flat bills over 2015-20. We have reprofiled Portsmouth Water’s bills consistent with the revised business plan.

The following text sets out the reasons why this final determination is assessed as affordable. It describes key changes in relation to Portsmouth Water’s December business plan (which we also assessed as affordable).

### A5.6.1 Acceptability

Portsmouth Water passed our risk based review on affordability. The company conducted customer research to support its original December 2013 business plan submission. Its research found 99% of household customers supported a plan that had an associated bill of £91 in 2019-20 (flat in real terms).

In the draft determination we intervened to flatten the company’s bill profile and to make a 15 basis point company-specific uplift to the allowed return. Portsmouth conducted new research in September 2014, to obtain up to date results for customer acceptability of the overall plan, the small company premium and ODIs. In terms of acceptability, 82% of household customers rated the business plan as ‘acceptable’ or ‘completely acceptable’ when presented with the full details of the plan.

As the final determination bill profile is the same as the draft determination bill profile, we consider that it is likely to remain acceptable to the majority of the company’s customers.

Table A5.9 explains the comments that we received that are specific to affordability and outlines how our interventions have been influenced by our consideration of these responses.

**Table A5.9 Representations specific of Portsmouth Water’s affordability measures**

Respondent	Summary of comment	Ofwat response
CCWater <sup>1</sup>	CCWater conducted research on the acceptability of the draft determination to customers. CCWater did not seek to produce comparable results to the company.	We note that the CCWater research was not intended to be comparable. It has produced a significant difference to the research that the company undertook on its revised

Respondent	Summary of comment	Ofwat response
	The CCWater research suggests 74% of customers find the draft determination acceptable after it has been provided with information on bills, inflation and what the water company will deliver.	business plan, which was that 99% found the plan acceptable. The company's plan has been developed with input from its CCG. The CCG's role was to help ensure the business plan reflected the views and priorities of customers. We have reviewed the company's acceptability research, which included reviewing the transparency and accuracy of the bill and inflation information. We consider that the acceptability that the company reported is sufficiently robust. We also consider that the CCWater survey results indicate the importance of continued engagement with customers.

**Note:**

1. CCWater acceptability results sourced from final version of 'Customers' views on Ofwat's draft determinations for process and service 2015-20' October 2014.

### A5.6.2 Identification of affordability issues and appropriate support measures

The company has a range of affordability measures in place. The key measures are summarised in table A5.10.

**Table A5.10 Key affordability measures**

Measure	Current coverage (no. of customers)	Forecast 2019-20 coverage
WaterSure	178	No target set
Water direct	1,300	No target set
Flexible payment plans	3,500	No target set
Debt advice – in house	Advice provided as part of collections process.	
Debt advice – 3rd party		
Write-off scheme	100	Expected to increase
Water efficiency advice/audits	Advice provided under general efficient use of water duty	

### **A5.6.3 Longer-term affordability**

Portsmouth Water explicitly considered future affordability in its assessment of intergenerational equity issues arising from setting PAYG rates and RCV run-off. The company reduced the RCV run-off rates from its original submission and proposed to maintain them through to 2025 to avoid upward pressure on bills in the longer term.

Portsmouth Water is not proposing any changes to PAYG or RCV in its representation to the draft determination, and did not therefore find it necessary to reengage with customers on the issue. We do not consider that there should be issues with longer term affordability.

### **A5.6.4 Longer-term affordability – ODIs**

The company's proposals for maximum ODI rewards will not have a negative impact on overall affordability in the longer term as the impact of the maximum reward on bills will be minimal at less than £1. Given the 99% acceptance level of a flat real term bill profile across 2015-20 it is a reasonable assumption that such an impact would still be acceptable to the majority of customers.

Portsmouth Water broadly agreed with the amendments we made to its ODI package in the draft determination. It is proposing a minor amendment to its mean zonal compliance measure.

The company conducted research into its customers' preferences for in or out of period ODI adjustments, which found that customers favoured annual adjustments. However, despite these findings, Portsmouth Water has opted to maintain an out of period adjustment.

## **Annex 1 Wholesale costs**

### **Establishing final determination thresholds**

Our approach to establishing final determination thresholds is outlined in policy chapter A3.

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 final determination initial cost threshold models.

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

Basic cost threshold	Policy additions <sup>1</sup>	Unmodelled costs adjustment	Deep dives	Final determination threshold	Deep dives fully or partially not added <sup>2</sup>
128.4	12.8	-1.0	1.7	141.9	None

**Notes:**

1. See Table AA1. below.
2. Deep dives are net of implicit allowances. A value of zero means deep dives are wholly covered by IAs.

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

Business rates	Pension deficit payments	Third party costs	Open market costs	Net v gross adjustments	Total
9.6	0.0	3.0	0.2	0.0	12.8

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

Plan <sup>1</sup>	Final determination threshold	Gap <sup>2</sup>	2010-15 v plan
137.0	141.9	-4.9	9.0

**Note:**

1. Where the company's business plan total has been adjusted by the company as part of its representations on its draft determination, this is reflected here.
2. 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.

**Table AA1.4 Summary of wholesale water deep dive assessments**

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment	Amount allowed
Deep dives							
Supply demand balance <sup>1</sup>	5.5	0.0	Pass	N/a	N/a	Pass	1.7

**Note:**

1. This claim was considered in the draft determination but was omitted from this table when we published the draft determination on 29 August. We include the claim for completeness, there is no change from draft determination.

## **Annex 2 Household retail**

### **Details on our assessment of proposed adjustments to the ACTS**

Our approach to setting the industry ACTS is outlined in policy chapter A5.

Below we provide information on our assessment of the company-specific adjustments to the ACTS.

#### **Input price pressure – summary**

- In its revised business plan, Portsmouth Water sought an adjustment for input price pressure of £0.6 million over 2015-20.
- We did not accept the company's proposal for input price pressure in the draft determination.
- At final determination we have accepted the input price pressure adjustment due to new evidence submitted by the company

#### **Input price pressure – our final assessment**

##### **Materiality**

The adjustment is material (2.8% of household retail opex plus depreciation over 2015-20).

##### **Beyond efficient management control**

Portsmouth Water provided convincing evidence of management practices in relation to achieving efficient retail costs.

##### **Impact company in materially different way**

The company provided convincing evidence that it is relatively efficient compared to its peers both within and beyond the water sector. In addition, the company has been shown to be upper quartile efficient for unmetered and metered retail costs.

Therefore the company has demonstrated that it is affected in a materially different way to the average company because of our assessment of its relative efficiency.

## Value of adjustment

We have not based the value of the adjustment on RPI indexation, as in previous controls. The size of the requested adjustment is instead calculated bottom up from inflation rates for different cost areas by Portsmouth Water. The approach appears reasonable and results in a low rate of unavoidable price increases (0.7% per year). We have therefore accepted the full value of the adjustment proposed by Portsmouth Water, as opposed to RPI indexation.

**Table AA2.1 Household retail adjustments (£ million, nominal prices)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
<b>Adjustments proposed in Portsmouth Water's business plan</b>						
Input price pressure	0.061	0.092	0.123	0.155	0.187	0.618
<b>Adjustments included in business plan</b>	<b>0.061</b>	<b>0.092</b>	<b>0.123</b>	<b>0.155</b>	<b>0.187</b>	<b>0.618</b>
<b>Adjustments included in draft determination</b>						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
<b>Adjustments included in draft determination</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>
<b>Adjustments proposed in Portsmouth Water's representations</b>						
Input price pressure	0.061	0.092	0.123	0.155	0.187	0.618
<b>Adjustments included in business plan</b>	<b>0.061</b>	<b>0.092</b>	<b>0.123</b>	<b>0.155</b>	<b>0.187</b>	<b>0.618</b>
<b>Adjustments included in final determination</b>						
Input price pressure	0.061	0.092	0.123	0.155	0.187	0.618
<b>Adjustments included in final determination</b>	<b>0.061</b>	<b>0.092</b>	<b>0.123</b>	<b>0.155</b>	<b>0.187</b>	<b>0.618</b>

**Note:** There will be no automatic indexation for retail price controls to RPI. This company has been allowed a £m adjustment to reflect input price pressure – this is reflected in the values in this table. The wholesale price controls are indexed linked to RPI. This will affect the retail net margins.

## Household retail revenue modification

We outline our approach to revenue modification in policy chapter A5.

Table AA2.2 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 AA2.3 sets out the baseline number of customers.

**Table AA2.2 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	14.40	14.47	14.53	14.56	14.60
Metered water only customer	19.00	19.09	19.14	19.19	19.23

**Note:** There will be no automatic indexation for retail price controls to RPI.

**Table AA2.3 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	207.7	202.7	197.7	192.7	187.7
Metered water only	80.4	87.6	95.1	103.1	111.0

## **Annex 3 Reconciling 2010-15 performance**

When we last set price controls in 2009 (PR09), we included a number of incentive mechanisms designed to encourage companies to improve and deliver services more efficiently, and, to manage uncertainty. Consistent with the approach set out at the time of the final determinations in 2009 we have made adjustments at this price review (PR14) to 2015 to 2020 revenues to take account of company performance in the 2010 to 2015 period.

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 policy chapter A4.

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

As part of the final determination of the 2010-15 adjustments we have undertaken detailed calculations within our models for the RCM, OIA, CIS and serviceability shortfalls. While we provide an explanation of our interventions within this annex, each model contains the detail of the specific calculation.

We make a "midnight adjustment" to the closing RCV from the previous period (ending on 31 March 2015) to obtain the opening RCV for the next period (starting on 1 April 2015). Our detailed calculations are contained within the RCV midnight adjustment model published alongside this final determination.

In this annex we provide an overview – comparing 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. We then consider each adjustment mechanism in turn.

However, we first consider the responses to our draft determination that are specific to Portsmouth Water's treatment in these areas.

### **Consideration of representations on our draft determination**

In policy chapter A1, we provide a list of the non-confidential respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made

either consequential adjustments to our industry-wide approach or company-specific interventions.

Where representations have addressed issues that are common to a number of companies, these comments, and any consequential changes to our approach, are discussed in the reconciling 2010-15 performance policy chapter. Representations that are specific to reconciling 2010-15 performance for Portsmouth Water, and any consequential impact on our final determination, are summarised in the table below.

**Table AA3.1 Representations specific to reconciling 2010-15 performance for Portsmouth Water**

Area	Respondent	Summary of comment	Ofwat response
Service standard outputs	Portsmouth Water	The company provided an Engineer's certificate of completion for the relevant sites and a report from its assurers as part of its representation. The company also provided further evidence in its response to a query (rFBP/PRT/legacy/query 073) on the representation to confirm that the FD09 service standard output had been achieved.	Having reviewed the evidence provided as part of its representations and query response, we are satisfied that FD09 service standards (exceptional items and flood resilience) have been achieved.
CIS	There were no representations in this area.		As explained in policy chapter A4, we have corrected a minor error in the CIS model for all companies with respect to the discount rate used when calculating the future value of the revenue adjustment in the 2010-15 period. This minor change had no material impact of the final revenue adjustments.

## Summary of 2010-15 adjustments

All companies were required to include in business plans its own adjustments for PR09 reconciliation. Table AA3.2 below sets out for each of the incentive tools:

- the company's view of the required revenue adjustments included in its revised business plan, and
- 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, subsequent query responses and representations on our draft determination. 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. notes the comments that we have received that are specific to this aspect of the wholesale water control of Portsmouth Water and outlines how our interventions have been influenced by our consideration of these responses.

The changes we have made in the final determination compared to our draft determination result from revising our adjustment to the RCV for actual expenditure in 2009-10 and using the post-tax cost of capital as the discount rate when calculating the future value of revenue adjustments.

**Table AA3.2 Revenue adjustments 2015-20 (£ million)**

	Company view	Ofwat view
SIM	-1.766	-0.870
RCM	9.420	8.992
OIA – post-tax	1.584	1.585
CIS	-2.410	-2.329
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	-5.224	-5.224
Total wholesale legacy adjustments	1.604	2.154

**Notes:** 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 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 A2.6. Totals may not add up due to rounding.

## SIM

We provide our view of each company’s SIM reward/penalty in the reconciling 2010-15 performance policy chapter.

Table AA3.3 provides the company’s view and our view of the annualised rewards or penalties from the company’s SIM performance. These are unchanged from the draft determination.

**Table AA3.3 SIM annualised rewards (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.350	-0.351	-0.353	-0.355	-0.357	-1.766
Ofwat view	-0.174	-0.174	-0.174	-0.174	-0.174	-0.870

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

Area of intervention	What we did	Why we did it
SIM penalty	This final determination includes our view of the company’s SIM penalty, which we have calculated as -0.5%. This is the same as our draft determination where our intervention updated the company’s resubmitted plan estimation of a penalty of -1.0%.	We have arrived at this by application of our final methodology which compares the company’s actual SIM performance in 2011-12, 2012-13 and 2013-14, to the industry three-year average performance during 2011-14. The 2013-14 information was not available at the time the companies submitted its business plans.

## RCM

This final determination includes our view of the company’s RCM annualised adjustment amounts as detailed in Table AA3.5 below. Table AA3.6 summarises our interventions in relation to Portsmouth Water’s proposed 2010-15 RCM adjustments.

For the RCM, we apply the vanilla wholesale WACC (real; pre-tax cost of debt, post-tax cost of equity) as the PR14 discount rate. For the final determination, we have applied a discount rate of 3.75% which includes the company-specific uplift. This has contributed to a small movement in the RCM from the draft determination.

**Table AA3.5 RCM annualised adjustments for 2015-20 (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	1.884	1.884	1.884	1.884	1.884	9.420
Ofwat view	1.798	1.798	1.798	1.798	1.798	8.992

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

Area of intervention	What we did	Why we did it
FD09 assumptions – Measured Non-household's revenue for the Measured Non-household group immediately above and below the 50ML threshold	<p>Our assumptions reflect our view of the FD09 assumptions.</p> <p>Our view of the company's revenue assumptions for the measured non-household group immediately below and above the 50 ML tariff basket threshold originate from the company's FD09 revenue forecasts that come from the tariff basket model, which we used for PR09.</p>	<p>There are inconsistencies between the company's and our view of the FD09 assumptions used in the company's populated RCM model. The company applied different assumptions for 'FD09 Measured Non-household's revenue for the Measured Non-household group immediately above and below the 50ML threshold' compared with our view of its FD09 assumptions.</p> <p>Our assumptions for the final determination include the FD09 revenue forecasts as contained in the PR09 tariff basket model in accordance with our published methodology 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance'.</p>

Area of intervention	What we did	Why we did it
Outturn financial year average RPI	We use the out-turn financial year average RPI data that the company submitted in business plan table A9 to calculate our view of the RCM adjustment for the final determination.	There are inconsistencies with the out-turn financial year average RPI between business table A9 and the company's populated RCM model. Our assumptions for the final apply the data from table A9.

## OIA

Table AA3.7 below summarises the company's view and our view of the incentive allowances for 2015-20. Table AA3.8 summarises our interventions in relation to Portsmouth Water's proposed 2010-15 OIA adjustments. There are no changes from our draft determination.

**Table AA3.7 OIAs for 2015-20 (£ million)**

		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Incentive allowance (post-tax)	Company view	1.458	0.114	0.012	0.000	0.000	1.584
	Ofwat view	0.317	0.317	0.317	0.317	0.317	1.585

**Table AA3.8 Interventions on proposed 2010-15 OIA adjustments**

Area of intervention	What we did	Why we did it
Profiling of the post-tax allowance.	We spread the post-tax incentive allowance evenly over the 2015-20 period.	In line with the approach the company set out in its early engagement submission commentary, where the company used even phasing to ensure customer bills remain flat.

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

Table AA3.9 and Table AA3.10 below summarise Portsmouth 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.

There are no changes from our draft determination and there are no interventions in this area.

**Table AA3.9 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)	-0.460	-0.460
Shortfalls (one-sided)	0.000	0.000

**Note:**

1. 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 AA3.10 Summary of post-efficiency opex for logging up, logging down and shortfalls included in the OIA calculation (£ million)**

2009-10 to 2014-15 – post-efficiency opex	Company view	Ofwat view
Logging up	0.000	0.000
Logging down	-0.046	-0.046
Shortfalls	0.000	0.000
Shortfalls for serviceability	0.000	0.000

## Service standard outputs

Service standards are regulatory outputs that we set out in the 2009 final determination (FD09) supplementary reports.<sup>5</sup> Where companies have not reported

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<sup>5</sup> In the 2009 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

progress on these service standards before submitting business plans, we would have expected them to do so within the price review process.

Having reviewed the evidence provided as part of its representations and query response, (rFBP / PRT / legacy / query 073) we are satisfied that FD09 service standards (exceptional items and flood resilience) have been achieved. We have therefore not applied shortfalls for these outputs.

### Serviceability performance

Table AA3.11 below summarises our serviceability assessments for Portsmouth Water and Table AA3.12 quantifies the value and impact of any serviceability shortfall on the RCV. There are no changes from our draft determination and there are no interventions in this area.

**Table AA3.11 Serviceability assessments for 2010-15**

		2010-11	2011-12	2012-13	2013-14	2014-15
Water infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Owat view	Stable	Marginal	Stable	Stable	Stable
Water non-infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Owat view	Stable	Stable	Stable	Stable	Stable

**Note:**

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

**Table AA3.12 Impact of serviceability shortfalls on the RCV (£ million)**

2009-10 to 2014-15		Total
Amount subtracted from RCV	Company view	0.0
	Owat view	0.0

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.”

## The 2009 agreed overlap programme

As the company did not propose an overlap programme at PR09, our 2009 final determination 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.

## The 2014-15 transition programme

Portsmouth Water did not propose any transitional investment.

## CIS

Table AA3.13 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
- adjustment to the opening RCV.

Table AA3.14 then sets out the profiled values of the revenue adjustments in each year 2015-20, Table AA3.15 shows the components of the opening RCV which are included in the CIS adjustment, and Table AA3.16 summarises our interventions in relation to Portsmouth Water's proposals.

There are no representations in this area from Portsmouth Water. The only change from our draft determination relates to use of the post-tax cost of capital as the discount rate when calculating the future value of revenue adjustments as explained in policy chapter A4, to address these issues we have changed the CIS model.

**Table AA3.13 CIS true-up adjustments**

		Total
Restated FD09 CIS bid ratio <sup>1</sup>	Company view	108.577
	Ofwat view	108.566
Out-turn CIS ratio	Company view	123.344
	Ofwat view	123.211
Incentive reward/penalty (%) <sup>2</sup>	Company view	-6.176

		Total
	Ofwat view	-6.144
Reward/penalty (£m)	Company view	-2.392
	Ofwat view	-2.382
Adjustments to 2015-20 revenue (£m) <sup>3</sup>	Company view	-2.242
	Ofwat view	-2.166
RCV adjustment (£m) <sup>4</sup>	Company view	5.593
	Ofwat view	5.593

**Notes:**

1. The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol shown in **Error! Reference source not found.**
2. 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.
3. 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 final determination.
4. In Table AA3.15 we show how the components of this agree to those shown in Table A2.6.

**Table AA3.14 Profiled revenue adjustments from the CIS reconciliation (£ million)**

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.482	-0.482	-0.482	-0.482	-0.482	-2.410
Ofwat view	-0.466	-0.466	-0.466	-0.466	-0.466	-2.329

**Table AA3.15 CIS components of the opening RCV adjustment (£ million)**

	Total
Adjustment for actual expenditure 2010-15	6.052
Net adjustment from logging up and logging down	-0.460
Adjustment for shortfalls	0.000
RCV adjustment	5.593

**Table AA3.16 Interventions on proposed CIS adjustments**

Area of intervention	What we did	Why we did it
Methodology	We have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period.	As explained in policy chapter A4, to address these issues we have changed the CIS model.
Change protocol adjustments	In carrying out our assessment, we have included our view of the applicable change protocol amounts.	We have applied Ofwat's published methodology.
Data inconsistencies	In carrying out our assessment, we have used the values from table A9 of the revised business plan.	We identified minor discrepancies between the RPI financial year average values in the company's populated CIS feeder model and table A9.

### Other adjustments

Table A3.17 below confirm the assumptions included in this final determination with respect to the following revenue adjustments:

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

There are no changes from our draft determination and there are no interventions in this area.

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

	Company view	Ofwat view
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	-5.224	-5.224

**Note:** The ‘other adjustment’ relates to a proposal by Portsmouth Water in its plan not to take up some of the revenue it was due when 2010-15 performance was reconciled. We accepted this proposal as part of the final determination

Table AA3.18 and Table AA3.19 below confirm the assumptions included in this final determination with respect to other adjustments to the opening RCV.

There is a small change from our draft determination in relation to our adjustment for actual expenditure in 2009-10.

**Table AA3.18 Other adjustments to the opening RCV (£ million)**

	Company view	Ofwat view
Land sales	0.000	0.000
2009-10 adjustment	0.000	5.864
Enhanced rewards	0.000	0.000
Other adjustments	0.000	0.000

**Table AA3.19 Interventions on proposed adjustments to the opening RCV**

Area of intervention	What we did	Why we did it
2009-10 adjustment	We calculated the 2009-10 adjustment using the capex figures from the June return. For some companies there was an incomplete dataset with regard to historic grants and contributions, we have corrected this for final determination. This means that for those companies, the adjustment included in the draft determination overstated the increase in the RCV. After the correction, the actual net capex being used in the 2009-10 calculation for final determination is lower than that used in draft determination.	This provided a consistent approach with all companies.

## **Annex 4 Outcomes, performance commitments and ODIs**

We set out our methodology for performance commitments and ODIs policy chapter A2.

In this annex we provide an overview of the performance commitments and ODIs for Portsmouth Water. We then set out in detail these performance commitments and ODIs for the company's wholesale water and household retail outcomes, presented in that order. However, we first consider the responses to our draft determination in relation to the performance commitments and ODIs for Portsmouth Water.

The company has used a cost sharing rate of 50% to calibrate the reward and penalty rates included in this annex. Companies are required to notify us of its menu choices by 16 January 2015. This might result in the company having a cost sharing rate higher or lower than 50%. Once the company has chosen its position on the menu, it will need to recalibrate its ODIs with the cost sharing rate associated with that position, and provide us with the updated incentive calculations

### **Consideration of representations on our draft determination**

In policy chapter A1, we provide a list of the non-confidential respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made either consequential adjustments to our industry-wide approach or company-specific interventions.

Where representations have addressed issues that are common to a number of companies, these comments, and any consequential changes to our approach, are discussed in the outcomes policy chapter. Representations that are specific to performance commitments and ODIs for Portsmouth Water, and any consequential impact on our final determination, are summarised in the tables below as follows.

- Table AA4.1 considers representations received on the interventions we proposed in our draft determinations as a result of comparative assessment in six areas for wholesale water.
- Tables AA4.2 considers representations received on the interventions we proposed in our draft determinations as a result of our company-specific assessments for wholesale water.

- Table AA4.3 considers representations received on the interventions we proposed in our draft determinations as a result of our company-specific assessments for household retail.
- Table AA4.4 lists the performance commitments that were proposed by companies but that have been removed as part of our final determination.
- Table AA4.5 lists performance commitments excluded from the commentary tables above because we received no representations on them and we made no interventions at draft determination or through the comparative assessment.

**Table AA4.1 Representations specific to the comparative assessments on wholesale water**

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
A2 Water quality standards	<p>Increased the performance commitment level to 100% from 2017-18.</p> <p>Adjusted incentive rate to an annual figure, such that the incentive rate is now:</p> <p>Penalty = £319,420/year</p>	<p>Portsmouth Water support our comparative intervention for the performance commitment level but propose a reduction in the penalty deadband to 99.96%.</p> <p>CCG and CCWater accept that the target should be 100% compliance but ask that Ofwat consider a suitable dead-band to take account of the company's particular circumstances.</p>	<p>Reduce the penalty deadband from 99.97% to 99.95% in every year.</p> <p>Assess and apply performance commitment and incentive annually</p>	<p>We revised our comparative assessments for final determinations based on stakeholder representations on the draft determination.</p> <p>To bring Portsmouth Water in line with other companies and to reflect the reduction in the penalty deadband we have replaced the assessment of average performance with an annual application</p>
A3 – Water quality contacts	<p>Reintroduced discolouration and illness to the measure</p> <p>Increased the performance commitment level to reflect the inclusion of discoloration and illness, such that the level reduces from 0.434 in 2014-15 to 0.413 in 2019-20. Caps</p>	<p>Portsmouth Water support our draft determination interventions</p>	<p>Maintain approach in draft determination</p>	<p>All the representations received on this performance commitment were in agreement on our draft determination approach.</p>

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
	<p>and collars also increase relative to the performance commitment level</p> <p>Changed the measurement basis to an average over 2015-20 and multiplied penalty and reward rates to reflect a five-year average measurement, such that incentive rates are now:</p> <p>Penalty = £226,550/0.01 contacts per 1,000 population</p> <p>Reward = £58,855/0.01 contacts per 1,000 population</p>			
C1 – Interruptions to supply	<p>Multiplied the incentive rates by 5, such that incentive rates are now:</p> <p>Penalty = £418,660/minute</p> <p>Reward = £60,435/minute</p> <p>Removed the reward deadband and cap following comparative check.</p>	Portsmouth Water support our draft determination interventions	Maintain approach in draft determination	All the representations received on this performance commitment were in agreement on our draft determination approach.

**Table AA4.2 Representations specific to the company-specific assessments on wholesale water**

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
A1 – Bursts	Multiplied the incentive rates by 5, such that incentive rates are now: Penalty = £4,457/burst Reward = £1,642/burst	Portsmouth Water support the intervention of increasing the incentive rates by a factor of five to align with the assessment period.	Maintain approach in draft determination	All the representations received on this performance commitment were in agreement on our draft determination approach.
B1 – Leakage	Multiplied the incentive rates by 5, such that incentive rates are now: Penalty = £871,210/MI/d Reward = £61,060/MI/d  Adjusted deadbands	Portsmouth Water support the intervention of increasing the incentive rates by a factor of five to align with the assessment period.	Maintain approach in draft determination  Adjust the penalty collar so that it decreases linearly from 33.30 MI/d in 2015-16 to 33.10 MI/d in 2019-20	All the representations received on this performance commitment were in agreement on our draft determination approach.  We adjusted the penalty collar in line with the performance commitment level so that the penalty range remains the same in each year
D1 – Biodiversity	Multiplied the incentive rate by 5, such that incentive rate is now: Penalty = £44,095/10% not delivered	Portsmouth Water support the intervention of increasing the incentive rates by a factor of five to align with the assessment period.	Maintain approach in draft determination	All the representations received on this performance commitment were in agreement on our draft determination approach.

**Table AA4.3 Representations specific to the company-specific assessments on household retail**

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
A1 – Service Incentive Mechanism	N/a	CCWater propose that we should continue to apply SIM to the wholesale business to ensure that the monopoly wholesale business is incentivised to resolve problems quickly and effectively for customers and retailers.	Confirm approach in draft determination	We are not requiring the company to include a SIM PC in the wholesale control – the PR14 methodology confirmed that we would use the SIM as a standard minimum national incentive for customer service for 2015-20. We also confirmed that its likely scale and scope would be similar to the current SIM, but that (in England) it would apply only to the household retail price control
B1 – Reducing per capita consumption	We amended the performance commitment levels associated with determining incentives to align with the commitments in table R1	The Environment Agency requested clarification on whether the figures are for a normal year and a weighted average of measured and unmeasured PCC.	Confirm PC level as at draft determination and clarify that the definition of the PC level is a “normal year” weighted average of measured and unmeasured	In response to the Environment Agency comment we have clarified the definition of the measure

**Table AA4.4 Performance commitments proposed by the company that we have removed from this final determination**

Performance commitment	Reason for its removal
<b>Wholesale Water</b>	
F1 – Return on investment	Portsmouth Water proposed in its representation that this PC should be removed due to potential duplication of outperformance shared through Totex. Both the CCG and CCWater are supportive of Portsmouth Water’s proposal to remove this PC/ODI.  We agree that this PC duplicates outperformance shared through Totex and is supported by all other representations so we have removed this PC/ODI.

**Table AA4.5 Performance commitments excluded from the commentary tables because we received no representations to our draft determination on them and we made no interventions at draft determination or through the comparative checks**

Wholesale water	Household retail
A4 – Temporary usage bans	C1 – Survey of developers
D2 – Water Framework Directive	
D3 – Carbon	
E1 – RoSPA	

## Summary of ODIs

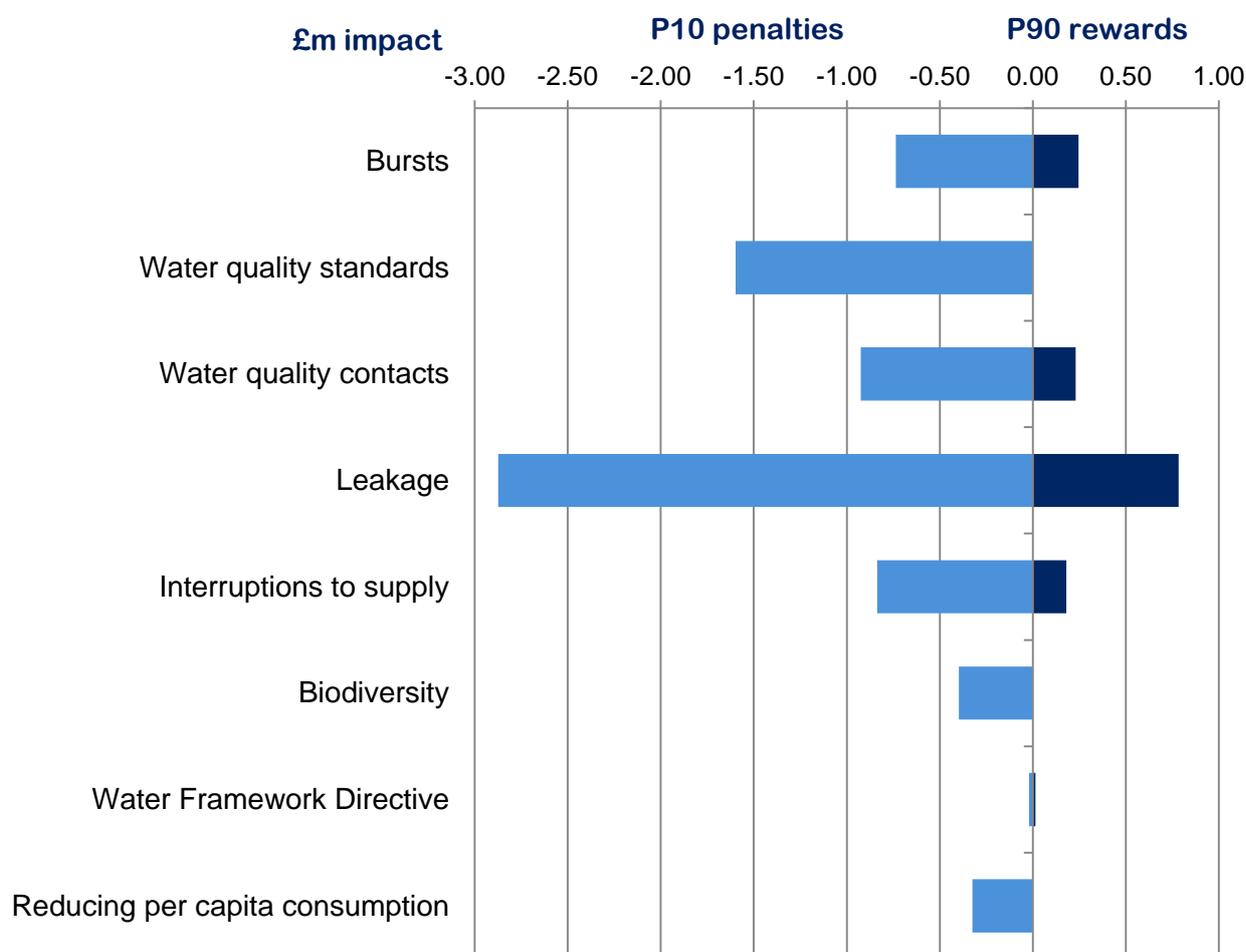
Table AA4.6 shows the balance between reward and penalty, penalty only and reputational incentives in the package of incentives for the company, and Figure AA4.1 shows the potential financial impact of each of the financial incentives.

**Table AA4.6 The composition of the package of ODIs**

	Reward and penalty	Penalty only	Non-financial incentive
Wholesale water	5	2	3
Household retail	1	1	1
Total	6	3	4

The following graph shows the potential financial consequences of the individual financial ODIs. The figures represent the penalties and rewards associated with the p10 and p90 scenarios over the five years (2015-16 to 2019-20). This means there is a 10% chance of performance being higher or lower than these assumed levels. In most cases the potential maximum will be bigger but is very unlikely to occur. The p10 and p90 therefore represent a more realistic estimate of potential financial consequences.

Figure AA4.1 Overview of financial ODIs



As explained in the outcomes policy chapter, we are introducing an aggregate cap on rewards and collar on penalties from the ODIs. Details of how the cap/collar will operate are set out in section A2.4 of the outcomes policy chapter.

There are no specific exclusions from the cap/collar for Portsmouth Water. In the remainder of this chapter, we provide the following information on each performance commitment included as part of this final determination:

- the name and detailed definition of the performance commitment;
- 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>6</sup>; and
- the incentive rates;
- additional details on the measure; and
- 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.

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<sup>6</sup> Unless otherwise stated, a deadband is the level of service against which an incentive is calculated and the cap or collar is the level of service at which the maximum reward or penalty occurs. So for example, if the deadband is 1.29 and the actual performance level is 1.39, the result of the incentive would be a penalty of  $(1.39-1.29)$  times the specified penalty rate.

## Performance commitments and ODIs in detail

### Wholesale water outcome: Safe secure and reliable drinking water

#### Performance commitment A1: Bursts

**Detailed definition of performance measure:** Bursts on the network are a measure of its serviceability. The definition is that provided by Ofwat BP3121.

**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
Performance commitment	No.	342	342	342	342	342	342
Penalty collar			600	600	600	600	600
Penalty deadband			435	435	435	435	435
Reward deadband			250	250	250	250	250
Reward cap			100	100	100	100	100

#### Incentive rates

Incentive type	Incentive rate (£/burst)
Penalty	£4,457
Reward	£1,642

#### Additional details

Necessary detail on measurement units	Bursts; this is as defined by Ofwat – Reference BP3121
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Frequency of PC measurement and any use of averaging	Performance will be measured annually. Commitment is to achieve the PC on <b>average</b> over the period. The incentive rate in the table above is applied to average performance (it is not a year).
Timing and frequency of rewards/penalties	Rewards and penalties will apply at the end of the period
Form of reward/penalty	Adjustment to revenue in 2020-2025
Any other information or clarifications relevant to correct application of incentive	None

## Performance commitment A2: Water quality standards

**Detailed definition of performance measure:** Water quality standards as measured by mean zonal compliance. This is the average of the compliance rates (at a zonal level) for the 39 parameters tested and reported to the Drinking Water Inspectorate to demonstrate compliance.

**Incentive type:** Financial – penalty only.

### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	99.98	99.98	99.98	100	100	100
Penalty collar			N/a	N/a	N/a	N/a	N/a
Penalty deadband	%		99.95	99.95	99.95	99.95	99.95

### Incentive rates

Incentive type	Incentive rate (£/year)
Penalty	£319,420

## Additional details

Necessary detail on measurement units	The unit is percentage compliance with standards on a calendar year basis.
Frequency of PC measurement and any use of averaging	Performance will be measured annually. Penalties will apply annually for any year that performance drops below the penalty deadband
Timing and frequency of rewards/penalties	Penalties will apply at the end of the period.
Form of reward/penalty	Adjustment to revenue in 2020-2025.
Any other information or clarifications relevant to correct application of incentive	

## Performance commitment A3: Water quality contacts

**Detailed definition of performance measure:** A measure of customer contact for taste, odour, discolouration and illness calculated as the number of contacts per 1,000 population measured on a calendar year basis. This is reported annually to the Drinking Water Inspectorate.

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

### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Commitment	Nr/1000 pop	0.434	0.429	0.425	0.421	0.417	0.413
Penalty collar	Nr/1000 pop		0.505	0.505	0.505	0.505	0.505
Penalty deadband	Nr/1000 pop		0.429	0.425	0.421	0.417	0.413
Reward deadband	Nr/1000 pop		0.429	0.425	0.421	0.417	0.413

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Reward cap	Nr/1000 pop		0.337	0.337	0.337	0.337	0.337

### Incentive rates

Incentive type	Incentive rate (£/0.01 contacts per 1,000 population)
Penalty	£226,550
Reward	£58,855

### Additional details

Necessary detail on measurement units	The number of customers contacting the company relating to the taste, odour, discolouration and illness on a calendar year basis.
Frequency of PC measurement and any use of averaging	Performance will be measured annually. Commitment is to achieve the PC <b>on average</b> over the period. The incentive rate in the table above is applied to average performance (it is not a year).
Timing and frequency of rewards/penalties	Rewards and penalties will apply at the end of the period
Form of reward/penalty	Adjustment to revenue in 2020-2025
Any other Information or clarifications relevant to correct application of incentive	None

## Performance commitment A4: Temporary usage bans

**Detailed definition of performance measure:** Introduction of water restrictions in the period in accordance with the company's approved drought plan.

**Incentive type:** Reputational.

### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	No/year	0	0	0	0	0	0

### Additional details

Necessary detail on measurement units	The number of water restrictions in place on customers in the report year. 'Water restriction' refers to any application of use or availability restrictions as per the Portsmouth Water Drought Plan.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year
Any other information or clarifications relevant to correct application of incentive	None

## Wholesale water outcome: Less water lost through leakage

### Performance commitment B1: Leakage

**Detailed definition of performance measure:** The total level of leakage, including customer supply pipe leakage, as measured on an average MI/d basis; this is as defined by Ofwat – Reference BN2345

**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	MI/d	30.0	30.00	29.95	29.90	29.85	29.80
Penalty collar	MI/d		33.30	33.25	33.20	33.15	33.10
Penalty deadband	MI/d		30.0	29.95	29.9	29.85	29.80
Reward deadband	MI/d		30.0	29.95	29.9	29.85	29.80
Reward cap	MI/d		17.0	17.0	17.0	17.0	17.0

### Incentive rates

Incentive type	Incentive rate (£/MI/d)
Penalty	871,210
Reward	61,060

### Additional details

Necessary detail on measurement units	Leakage as measured on an average MI/d basis; this is as defined by Ofwat – Reference BN2345
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Frequency of PC measurement and any use of averaging	Performance will be measured annually. Commitment is to achieve the PC of 29.9MI/d on <b>average</b> over the period. The incentive rate in the table above is applied to average performance (it is not a year).
Timing and frequency of rewards/penalties	Rewards and penalties will apply at the end of the period.
Form of reward/penalty	Adjustment to revenue in 2020-2025.
Any other information or clarifications relevant to correct application of incentive	None.

## Wholesale water outcome: High quality service

### Performance commitment C1: Interruptions to supply

**Detailed definition of performance measure:** Average time of supply interruption per property within the Portsmouth supply area (includes both planned and unplanned interruptions) as defined for the Ofwat KPI in IN13/03.

**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	Min	5 min 0 s	5 m 0 s	5 m 0 s	5 m 0 s	5 m 0 s	5 m 0 s
Penalty collar	Min		8 m 0 s	8 m 0 s	8 m 0 s	8 m 0 s	8 m 0 s
Penalty deadband	Min		6 m 0 s	6 m 0 s	6 m 0 s	6 m 0 s	6 m 0 s
Reward deadband	Min		5 m 0 s	5 m 0 s	5 m 0 s	5 m 0 s	5 m 0 s
Reward cap	Min		N/a	N/a	N/a	N/a	N/a

#### Incentive rates

Incentive type	Incentive rate (£/minute)
Penalty	£418,660
Reward	£60,435

#### Additional details

Necessary detail on measurement units	Average time of supply interruption per property within the Portsmouth supply area (includes both planned and unplanned interruptions) as defined for the Ofwat KPI in IN13/03.
Frequency of PC measurement and any use of averaging	Performance will be measured annually. Commitment is to achieve the PC on <b>average</b> over the period.

	The incentive rate in the table above is applied to average performance (it is not a year).
<b>Timing and frequency of rewards/penalties</b>	Rewards and penalties will apply at the end of the period.
<b>Form of reward/penalty</b>	Adjustment to revenue in 2020-2025.
<b>Any other information or clarifications relevant to correct application of incentive</b>	The incentive rate is set out as £/minute. However, the size of the incentive will be determined to the second and the relevant proportion of the incentive will apply.

## Wholesale water outcome: An improved environment supporting biodiversity

### Performance commitment D1: Biodiversity

**Detailed definition of performance measure:** The company will agree its Biodiversity Action Plan with the relevant stakeholders including its customer challenge group (CCG) and incur a penalty if it does not complete 90% of the agreed actions.

**Incentive type:** Financial – penalty only.

#### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	N/a	0	25	50	75	90
Penalty collar							0
Penalty deadband							90

#### Incentive rates

Incentive type	Incentive rate (£/10%)
Penalty	£44,095

#### Additional details

Necessary detail on measurement units	The measurement is against the agreed plan.
Frequency of PC measurement and any use of averaging	Performance will be measured annually. However, the commitment is to achieve 90% of the agreed plan by the end of the AMP period and this will determine whether an incentive should apply.
Timing and frequency of rewards/penalties	Penalties will apply at the end of the period

Form of reward/penalty	Adjustment to revenue in 2020-2025
Any other information or clarifications relevant to correct application of incentive	None

## Performance commitment D2: Water Framework Directive

**Detailed definition of performance measure:** Obligations under Water Framework Directive are required to be complete by 2021. The company commits to deliver by 2017-18, with a penalty for later delivery and a reward for earlier delivery.

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

### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC					Target date		
Penalty collar							Delivered
Reward cap			Delivered				

### Incentive rates

Incentive type	Incentive rate (£/annum)
Penalty	£9,838 per year later than PC
Reward	£7,152 per year earlier than PC

### Additional details

Necessary detail on measurement units	Completion of the programme, signed off by EA.
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Frequency of PC measurement and any use of averaging	At the point of project completion, or the end of the AMP period, whichever is sooner.
Timing and frequency of rewards/penalties	Rewards and penalties will apply at the end of the period.
Form of reward/penalty	Adjustment to revenue in 2020-2025.
Any other information or clarifications relevant to correct application of incentive	None.

## Performance commitment D3: Carbon

**Detailed definition of performance measure:** The company will increase the amount of electricity it uses from renewable sources by 10% by the end of the period.

**Incentive type:** Reputational.

### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	% increase	0	2	4	6	8	10

### Additional details

Necessary detail on measurement units	The company will report on its performance annually.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year.
Any other information or clarifications relevant to correct application of incentive	None.

## Wholesale water outcome: Health and safety culture

### Performance commitment E1: RoSPA

**Detailed definition of performance measure:** The company will apply for its Health and Safety accreditation annually.

**Incentive type:** Reputational.

#### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC		Awarded	Awarded	Awarded	Awarded	Awarded	Awarded

#### Additional details

Necessary detail on measurement units	Outcome of the RoSPA assessment.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year.
Any other information or clarifications relevant to correct application of incentive	None.

## Retail outcome: High quality service

### Performance commitment A1: Service incentive mechanism

**Detailed definition of performance measure:** SIM score as defined in Ofwat's SIM guidance and updated in IN13/03.

**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	Industry score	Upper quartile	Upper quartile				
Penalty collar			Ofwat methodology				
Penalty deadband			Ofwat methodology				
Reward deadband			Ofwat methodology				
Reward cap			Ofwat methodology				

#### Incentive rates

Incentive type	Performance levels		Incentive rate
	Lower	Upper	
Penalty			Ofwat methodology
Reward			Ofwat methodology

### Additional details

Necessary detail on measurement units	All companies report and Ofwat publish an annual industry SIM score.
Frequency of PC measurement and any use of averaging	Performance will be measured annually through the risk and compliance statement.
Timing and frequency of rewards/penalties	Rewards and penalties will apply at the end of the period.
Form of reward/penalty	Adjustment to revenue in 2020-2025.
Any other information or clarifications relevant to correct application of incentive	None.

## Retail outcome: An improved environment supporting biodiversity

### Performance commitment B1: Reducing per capita consumption

**Detailed definition of performance measure:** The company will report its weighted average household per capita consumption annually. The PC levels are the weighted average of the number of measured and unmeasured customers in a “normal” year. Definitions will be as per Ofwat guidance in the water balance, table 10. Weightings will relate to the measured and unmeasured property counts

**Incentive type:** Financial – penalty only applying only at year 5.

#### Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/h/d	147.29	146.63	145.96	145.29	144.61	143.93
Penalty collar	l/h/d						148

#### Incentive rates

Incentive type	Incentive rate (£/l/h/d)
Penalty	£81,244

#### Additional details

Necessary detail on measurement units	The measurement is against the agreed PC target by year 5.
Frequency of PC measurement and any use of averaging	Performance will be measured annually but the incentive will be determined based on performance in 2019-20 only.
Timing and frequency of rewards/penalties	Penalties will apply at the end of the period.
Form of reward/penalty	Adjustment to revenue in 2020-2025.

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

None.

## Retail outcome: Supporting the community

### Performance commitment C1: Survey of developers

**Detailed definition of performance measure:** The company will develop a satisfaction survey relating to the service delivered to developers.

**Incentive type:** Reputational.

#### Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Survey	-	70%	70%	70%	70%	70%

#### Additional details

Necessary detail on measurement units	Survey to be established and agreed with stakeholders (including CCG) in Q3 and Q4 2014-15.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year.
Any other information or clarifications relevant to correct application of incentive	None.

## Outcome delivery and reporting

In the outcomes policy chapter, we outline a framework against which we have assessed Portsmouth Water's proposals in relation to outcome delivery and reporting.

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

**Table AA4.7 Portsmouth Water’s proposals for outcome delivery and reporting**

Portsmouth Water’s proposals	Our assessment
<p>Portsmouth Water sets out full details of its approach to outcome delivery and reporting in section 5 of ‘Response to Ofwat’s Risk and Reward Guidance and Risk-based review’. These can be summarised as follows.</p> <p><b>CCG involvement:</b> CCG will review performance against performance commitments, with sub-groups created for specific interest areas.</p> <p><b>Measurement and data capture:</b> processes already in place for data capture against all PCs. Individuals responsible for reporting against company/industry methodologies</p> <p><b>Audit and assurance:</b> use existing risk and compliance statement process with existing auditors to financially and technically review performance reports, with Board having ultimate responsibility for assurance.</p> <p><b>Governance and accountability:</b> Risk and compliance statement to be reviewed by CCG, supported by technical auditor</p> <p><b>Transparency and publication:</b> Risk and compliance statement will be published on the company website and included in subsequent customer communications</p>	<p>In our methodology statement we set out our expectation that companies should demonstrate that its proposed PCs can be measured and recorded consistently and that it will have the appropriate governance and quality assurance processes in place to achieve this. We also expect companies to be transparent with customers about its performance against its outcomes and commitments.</p> <p>Portsmouth Water has provided sufficient evidence demonstrating the approach it will undertake to ensure the PCs will be measured and reported consistently, and the proposed governance and assurance processes. Therefore, we have accepted the company’s proposal.</p> <p>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>

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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