

December 2014

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



OFWAT

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A minor correction to this company specific appendix was issued on 13 February 2015.

Overview

This appendix sets out the details of the final determination of price controls that are specific to Sembcorp Bournemouth Water. The final determination protects customers in accordance with our statutory duties. As set out in [‘Policy chapter A1 – introduction’](#) (‘policy chapter A1’), the final determination protects customers in accordance with our statutory duties (summarised in the Introduction document) 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 [‘Setting price controls for 2015-20 – Draft price control determination notice: company-specific appendix – Sembcorp Bournemouth Water’](#) (the ‘draft determination’ for Sembcorp Bournemouth Water) on 29 August 2014. Sembcorp Bournemouth Water is a non-enhanced company.

The company’s customer challenge group (CCG) – the Customer Engagement Planning Forum – played an important role in both the development of its 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, Sembcorp Bournemouth 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. Its revised business plan had many strengths. On the whole, the company addressed the concerns that were identified in the RBR around its cost allocation and some of its special cost claims.

However, we had a number of targeted concerns with the plan mainly relating to the decision that the company took to smooth bills up to 2025 by bringing cash forward into 2015-20. We therefore intervened in this area of the company’s plan. The company proposed a company-specific uplift of 19 basis points, which we replaced with one of 15 basis points. In addition we made some further interventions designed to safeguard customers’ interests. Some of these interventions were around outcomes and associated delivery incentives that were common to all companies.

The company proposed a change to its pay as you go (PAYG) rate compared to our draft determination because it considered that this would create more stable bills.

We also received representations on Sembcorp Bournemouth Water’s draft determination from its CCG, the Environment Agency, the Consumer Council for Water (CCWater) and Natural England.

- The CCG raised a number of specific concerns in relation to our change to the PAYG rate, the disallowed input price pressure claim and some of the wholesale cost adjustments.
- The Environment Agency was concerned that the company's National Environment Programme (NEP) commitments have not been fully funded and that this could delay the company meeting its statutory environmental obligations.
- CCWater raised specific concerns, which included the selective metering performance commitment (PC) and the reduction in the PAYG rate.
- Natural England raised a specific concern in relation to the fact we did not accept the company's selective metering proposals and our partial did not accept its enhanced leakage reduction measures.

In reaching the final determination, we have carefully considered all 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 that we consider are in the interests of customers and in line with our other statutory duties.

The gap between the company's plan and our revised threshold on wholesale water costs has reduced considerably since the draft determination (from £4.6 million, 3.5% to £1.6 million, 1.2% above our threshold). This is because the company has reduced the total expenditure (totex) in its plan and we made an adjustment to account for an inconsistency in relation to metering.

We do not consider that the company's customer engagement on its PAYG proposal is robust as it is based on assumptions about increasing costs in 2020-25 and so evidence of need for an increase in bills in 2020-25 is weak. Our interventions in other areas are, as at the draft determination, limited.

We summarise our final determination for Sembcorp Bournemouth Water in section A1: 'Final determination – at a glance'¹.

The remainder of this document sets out our final determination in more detail 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.

¹ 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.

As we explained in our final methodology statement, these 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 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);
- 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 (also known as the weighted average cost of capital (WACC)) 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;
- the uncertainty mechanisms that form part of each price control; and
- where appropriate, the assumptions we have made to arrive at the allowed revenue for each price control.

Implementing these price limits

Sembcorp Bournemouth 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 Sembcorp Bournemouth Water's licence and the Water Industry Act 1991. We consider that Sembcorp Bournemouth 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 1 April 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 its 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.

This price determination sets out the allowed revenues that Sembcorp Bournemouth Water can recover from its customers in the 2015-20 period. Sembcorp Bournemouth 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

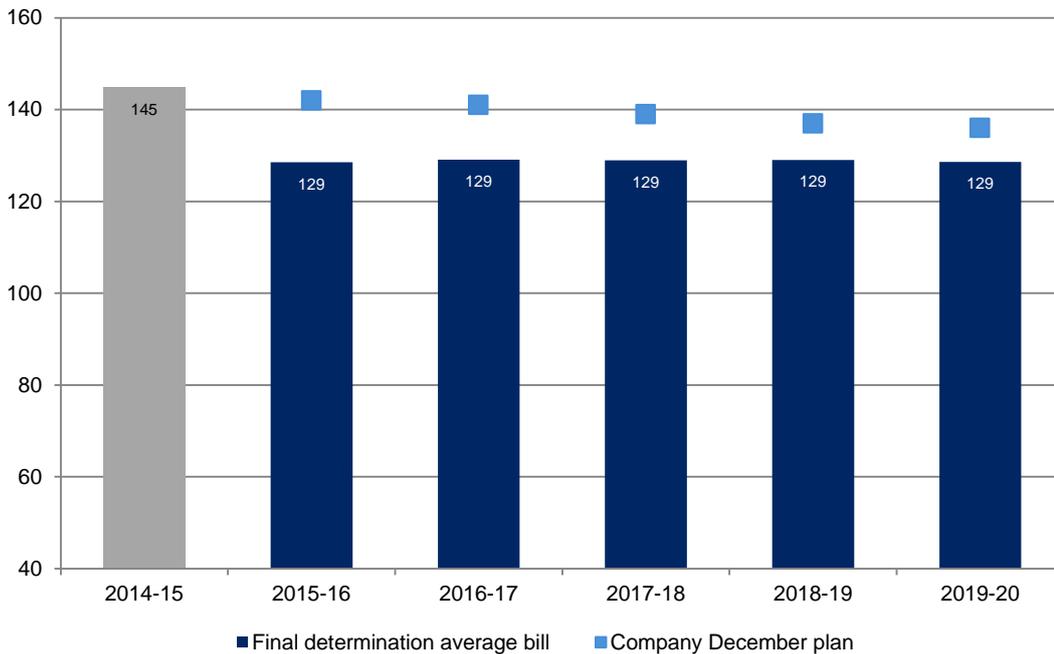
This chapter provides a summary of the final determination for Sembcorp Bournemouth Water. It summarises what the final determination will mean for customers, with respect to the average bills they will pay and the outcomes that the company will deliver in return, and for the company in terms of its 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 their 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 £129, which is 11% lower than current average bill levels (of £145).

The difference between the company's December plan and our final determination is the result of the company's acceptance of our risk and reward guidance, other revisions to its plan and the interventions we have made in its plan. This represents a cumulative saving of £51 for the average customer over the 2015-20 period.

Figure A1.1 Average bills



Note: The comparative bills figures from the ‘Company December plan’ are based on the data submitted by the company its December 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 Sembcorp Bournemouth Water

Sembcorp Bournemouth Water has committed to delivering outcomes that reflect its customers’ views. These are supported by 15 associated PCs that identify the company’s committed level of performance under each outcome. For ten of these PCs the company is subject to associated financial ODIs whereby it will incur a penalty for performance worse than its commitments, but for three of these it can earn a reward for performance better than its commitments during the 2015-20 period.

The table below sets out the outcomes for Sembcorp Bournemouth Water. These outcomes reflect the priorities of customers set out in research and engagement with the CCG. We have undertaken a 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. Details of the types of incentives and level of performance commitments associated with these outcomes are set out in annex 4.

Wholesale water
Safe wholesome water
Reliable water supply
Providing an excellent customer service
Environmentally sustainable operations
Engage well with the community and customers
Retail
Providing an excellent customer experience
Financially stable business

Allowed costs and revenue for Sembcorp Bournemouth Water

The table below shows the wholesale totex we have allowed over the 2015-20 period. The final determination allows Sembcorp Bournemouth Water to receive revenues of £184.2 million. This combines allowed revenues for the wholesale and household retail controls. For non-household retail, we have also set average revenue controls per customer for each of the customer types proposed by the company. The £3.7 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)	131.2	
Allowed return (%)	3.75%	
Allowed wholesale revenue 2015-20 (£m)	159.9	
Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	22.9	
Margin (%)	1.00%	2.50%
Retail allowed revenue (£m)	24.3	3.7

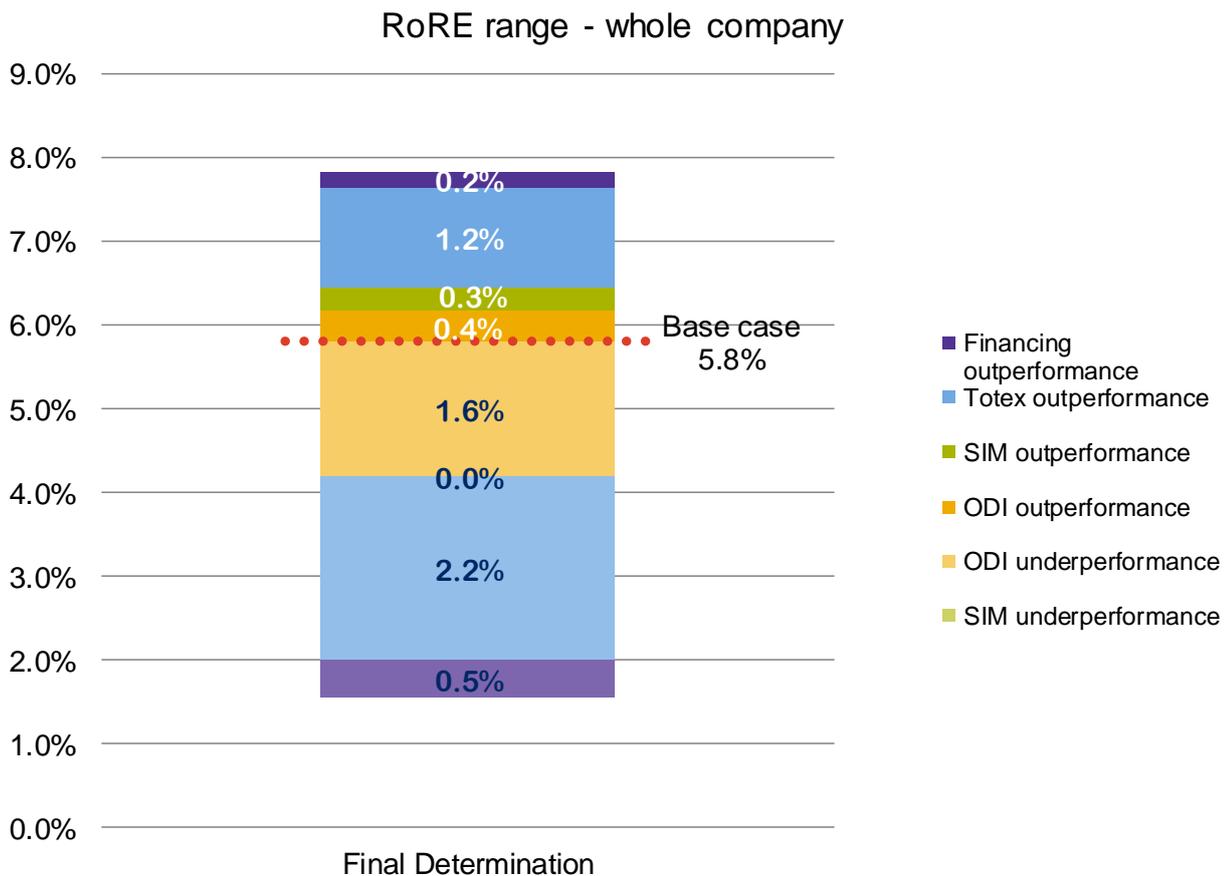
Note: Wholesale figures in 2012-13 prices as revenue will be affected by inflation and retail figures in nominal prices as revenue will not be affected by inflation – this is consistent throughout this final determination unless otherwise stated.

RoRE ranges – appointee

Sembcorp Bournemouth Water has estimated the range of 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

structure¹. We have identified the RoRE impact separately for ODIs, totex performance, financing and the service incentive mechanism (SIM). We note that Sembcorp Bournemouth 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 (ACTS).

Figure A1.2 RoRE range – whole company



Source: Our calculations based on information from Sembcorp Bournemouth 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

¹ 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 return.

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.

Sembcorp Bournemouth Water provided assurance that its plan was financeable on the basis of a notional and its actual structure. 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 five-year average basis below. We have assessed this final determination for Sembcorp Bournemouth Water to be financeable on a notional basis.

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover	3.32
Adjusted cash interest cover ratio (ACICR)	1.90
Funds from operations/debt	11.08%
Retained cash flow/debt	8.45%
Gearing	61.32%
Dividend cover (profit after tax/dividends paid)	1.39
Regulatory equity/regulated earnings for the regulated company	16.81
Regulatory capital value (RCV)/EBITDA ¹	9.46

Note: 1. Earnings before interest, taxes, depreciation, and amortisation

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 carefully considered 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"> • Cap: we imposed an overall cap and collar on ODIs of +/-2% of RoRE • Comparative assessment: We have, among other interventions, amended committed performance levels, collars and deadbands. • Company-specific assessment: We have increased a penalty collar, increased a penalty rate changed a CPL and removed an element from one PC. 	<ul style="list-style-type: none"> • The company proposed wholesale totex of £134.3 million in its plan which is £1.6 million above our final determination threshold of £132.7 million. • The gap to our threshold has reduced from draft determination because the company has reduced the totex in its plan and we have made an adjustment to account for an inconsistency in relation to metering.
Retail	Reconciling 2010-15 performance
<ul style="list-style-type: none"> • We have disallowed the company's input price pressure claim because the company has not provided sufficient evidence that it is affected in a materially different way to other companies. 	<ul style="list-style-type: none"> • We have reduced the company's proposed revenue adjustment by £0.2m (in customers' favour) and increased its proposed RCV adjustment by £0.5m (in the company's favour).
Risk and reward	Financeability and affordability
<ul style="list-style-type: none"> • 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%. • We have allowed a company-specific uplift of 15 basis points to take the company's overall allowed return to 3.75%. • We have accepted the company's gain share mechanism following the evidence which it provided in its draft determination representations. 	<ul style="list-style-type: none"> • We have not accepted the company's proposed amendment to its PAYG rate.

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 Sembcorp Bournemouth Water's wholesale water control and sets out where to find more information on our responses in this document.

Table A2.1 Representations specific to the wholesale water control of Sembcorp Bournemouth Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, PCs and incentives	Sembcorp Bournemouth Water	Annex 4, table AA4.1
Outcome delivery and reporting	None	Annex 4

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Calculating allowed wholesale water expenditure	Sembcorp Bournemouth Water Natural England Environment Agency CCG	Section A2.3.1 and annex 1
Calculation of revenues: PAYG and RCV run-off	None	Section A2.3.2 and A5.5
Return on RCV	Sembcorp Bournemouth Water	Section A2.3.3
Reconciling 2010-15 performance	None	Annex 3
Uncertainty mechanisms	Sembcorp Bournemouth Water	Section A2.4

A2.2 Company outcomes, PCs and delivery incentives

A2.2.1 Outcomes, PCs and incentives

We summarise the outcomes, PCs and ODIs for the wholesale water control for Sembcorp Bournemouth Water in table A2.2 below.

In policy chapter A2, we discuss our approach to outcomes for the wholesale and retail controls. Sembcorp Bournemouth Water has developed and committed to delivering outcomes that reflect its customers' views. These are supported by specific PCs and associated incentives (ODIs) whereby the company can be rewarded or penalised for its performance during the period 2015-20.

The company's outcomes have been developed with input from its CCG. The CCG's role was to challenge how well the company's outcomes, 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 PCs proposed by each company for wholesale water has focused on:

- comparative assessments where it was possible to compare PCs 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 PCs proposed by each company are challenging, appropriately incentivised and supported by customer engagement.

For some PCs 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 they are the result of our comparative assessment or company-specific assessment.

Consistent with our proposal at draft determination we are intervening to impose an overall cap and collar on ODIs for the 2015-20 period, thereby limiting total rewards and penalties. The cap and collar will apply in line with the approach set out in policy chapter A2.

Table A2.2 Wholesale water outcomes, PCs and incentives

Company proposal			Final determination intervention
Outcome	Performance commitment	Incentive type	
A: Safe wholesome water	A1: Water quality contacts from customers re appearance – reduce numbers	Financial – penalty only	<p>We confirm our draft determination intervention where, following our comparative assessment, we reduced the committed performance level (CPL), and increased the penalty collar and the penalty deadband, from 2017-18 onwards.</p> <p>We have further increased the penalty deadband and penalty collar from 2017-18.</p> <p>We have increased the</p>

Company proposal			Final determination intervention
Outcome	Performance commitment	Incentive type	
			penalty collars and penalty deadbands in 2015-16 and 2016-17.
	A2: Maintain compliance with all water regulations	Financial – penalty only	We confirm our draft determination intervention where, following our comparative assessment, we adjusted the CPL, the penalty deadband and penalty collar from 2017-18 onwards. We confirm our draft determination intervention of using mean zonal compliance as the standard industry measure.
B: Reliable water supply	B1: Reduce leakage	Financial – reward and penalty	We confirm our draft determination intervention to increase the penalty collar.
	B2: Minimise customer disruption (minimise risk of large scale interruption to 12,000 customers)	Financial – reward and penalty	No intervention
	B3: Minimise customer disruption re supply interruptions \geq 3 hours	Financial – penalty only	We confirm our draft determination intervention where, following our comparative assessment, we adjusted the CPLs, caps and collars. We have accepted the CPL which the company proposed in its representations and increased the penalty

Company proposal			Final determination intervention
Outcome	Performance commitment	Incentive type	
			deadband and penalty collar.
	B4: Serviceability (maintain assets – Ofwat methodology)	Financial – penalty only	We confirm our draft determination to change the penalty rate. We have removed the drinking water quality elements from this PC.
	B5: Metering – continue current strategy	Financial – penalty only	We have changed the definition to be optants only and changed the CPL.
	B6: Water use – reduce average consumption	Reputational	We have increased the CPL.
C: Providing an excellent customer experience	C1: fixing visible leaks – improve response time (improve the number repaired in 7 days of Sembcorp Bournemouth Water becoming aware-average)	Financial – penalty only	No intervention
D: Environmentally sustainable operations	D1: Reduce carbon created delivering water (reduce average energy used by 2020)	Reputational	No intervention
	D2: Help support a natural healthy water environment	Reputational	No intervention
E: Engage well with our community and customers	E1 : Contribute to our community	Reputational	No intervention

A2.2.2 Outcome delivery and reporting

Sembcorp Bournemouth 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 £134 million over 2015-20 (versus £136 million in its December plan). This is 1% above the final determination threshold (post additions) of £133 million. Table A2.3 below notes the comments that we have received that are specific to this aspect of the wholesale water control of Sembcorp Bournemouth Water and outlines how our interventions have been influenced by our consideration of these responses.

Table A2.3 Representations specific to the wholesale water totex for Sembcorp Bournemouth Water

Respondent	Summary of comment	Ofwat response
Sembcorp Bournemouth Water	The company provided further evidence on inconsistencies of metering variables.	The final determination takes account of the identified inconsistency between exogenous metering variables and includes a reduction in the company plan totex. See table AA1.4

Respondent	Summary of comment	Ofwat response
<p>Sembcorp Bournemouth Water, Natural England and CCG</p>	<p>The company provided further evidence in support of the programme for enhanced leakage reduction. This was also supported by Natural England and the CCG.</p>	<p>While we consider that the company has provided evidence in support of the programme, in assessing need we also consider whether the activity is sufficiently exceptional to justify a change to our cost threshold. In relation to modest reductions in leakage this could be reasonably considered to be business as usual for a water company. We did not find compelling evidence in the submission from the company that would contradict this view.</p> <p>The final determination is unchanged from draft determination where company proposal of £0.94 million was excluded.</p>
<p>Sembcorp Bournemouth Water, Environment Agency and CCG</p>	<p>The company provided further evidence on catchment management and invasive species components of the NEP special cost factor claim. The CCG considered that a third party review supported the company's claim. The Environment Agency was concerned that if NEP commitments were not fully funded this could delay the company in meeting its statutory obligations.</p>	<p>We do not consider that the company has demonstrated how the investment relates to costs for enhancement (including catchment management) that are accounted for within the basic cost threshold. We consider that the investment can be funded from the cost allowance.</p> <p>The final determination is unchanged from draft determination where company proposal of £0.80 million was excluded.</p>

Respondent	Summary of comment	Ofwat response
CCG and Natural England	The CCG was disappointed that Ofwat did not allow the company's claim for an increased metering programme because it believes that selective metering is an important part of encouraging the efficient use of water. Natural England was also disappointed that the company's proposal for selective metering was not accepted because of the role it can play in reducing abstraction with the positive impacts this can have on the environment.	We have not made an adjustment to our draft determination position. We have specific concerns relating to the cost benefit analysis and robustness of estimate gates. We also do not consider that it is appropriate to make allowances for selective metering programmes where the company does not have a projected 2015-20 deficit to meet.

The wholesale water allowed expenditure for Sembcorp Bournemouth Water is detailed in table A2.4 below. We provide a further breakdown of some of the calculations in annex 1. Further information about our assessment of each claim is set out in the [populated version of the final determination cost threshold models](#).

Table A2.4 Wholesale water allowed expenditure (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Final determination cost threshold						132.7
Costs excluded from menu	0.4	0.4	0.4	0.4	0.4	2.0
Menu cost baseline ¹	28.0	27.3	26.4	24.9	24.1	130.7
Company's view of menu costs ²						132.3
Implied menu choice						101.2
Allowed expenditure from menu	28.1	27.3	26.5	25.0	24.2	131.1
Costs excluded from menu	0.4	0.4	0.4	0.4	0.4	2.0
Total allowed expenditure ³	28.5	27.7	26.8	25.4	24.6	133.1

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Less pension deficit repair allowance	0.4	0.4	0.4	0.4	0.4	1.9
Totex for input to PAYG	28.2	27.4	26.5	25.0	24.2	131.2

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 2016 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

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

Table A2.5 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. Table A2.6 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 A2.5 Sembcorp Bournemouth Water's wholesale water PAYG rates

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	28.2	27.4	26.5	25.0	24.2	131.2
PAYG (%)	70.1%	72.0%	74.2%	78.1%	80.8%	75.0%
Resulting PAYG (£m)	19.7	19.7	19.6	19.5	19.6	98.2

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

Table A2.6 Sembcorp Bournemouth Water's wholesale water RCV run-off (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	5.6	5.4	5.2	5.0	4.8	26.0
RCV run-off of totex additions	0.2	0.5	0.8	1.0	1.2	3.7

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Total RCV run-off	5.8	5.9	6.0	6.0	6.0	29.7

Note: The figures in this table reflect a run-off rate of 4% for the RCV as at 31 March 2015 and 25 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 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 proposed a company-specific uplift of 19 basis points in its business plan, which we replaced with one of 15 basis points to the wholesale allowed return at the draft determination. This decision was based on the approach that we set out in our risk and reward guidance:

“To justify a company-specific uplift in the allowed return, 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 Sembcorp Bournemouth 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 Sembcorp Bournemouth 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 Sembcorp Bournemouth Water.

We have therefore concluded that it would be in the interests of customers for the company to receive an allowed return that 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, Sembcorp Bournemouth Water has been given an allowed return of 3.75% in this final determination. This results in a return on capital of £27.1 million over 2015-20.

As discussed in policy chapter A3, 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).

Table A2.7 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 A2.8 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 A2.5 and table A2.6 above.

Table A2.7 Sembcorp Bournemouth Water's wholesale water opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	139.2
Land sales ¹	0.1
Adjustment for actual expenditure 2009-10 ²	0.5
Adjustment for actual expenditure 2010-15 ³	1.3
Net adjustment from logging up and logging down ^{3,4}	-0.4
Adjustment for shortfalls ³	0.0
Adjustment for serviceability shortfalls ⁴	0.0
Other adjustments ⁵	0.0
Opening RCV 1 April 2015	140.6

Notes:

1. Land sales adjustment is set out in table AA3.15.
2. 2009-10 actual expenditure adjustment is set out in table AA3.15.
3. A component of the capital expenditure incentive scheme (CIS) adjustment as set out in table AA3.12.

4. The serviceability shortfall adjustment is set out in table AA3.9.
5. Other RCV adjustments are set out in table AA3.15.

Table A2.8 Sembcorp Bournemouth Water’s wholesale water return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	140.6	143.3	145.0	145.9	145.4
RCV additions (from totex)	8.4	7.7	6.8	5.5	4.7
Less RCV run-off	5.8	5.9	6.0	6.0	6.0
Closing RCV	143.3	145.0	145.9	145.4	144.0
Average RCV (year average)	142.0	144.2	145.5	145.6	144.7
Return on capital	5.3	5.4	5.5	5.5	5.4

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 determinations in 2009 we have made adjustments at this price review (PR14) to 2015-20 revenues to take account of company performance in the 2010-15 period.

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

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 -£2.4 million to -£2.6 million. We summarise these interventions in table A2.9 below. The impact on the opening RCV of 2010-15 adjustments is shown in table A2.7 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 CIS, 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 A2.9 Sembcorp Bournemouth Water's wholesale water revenue adjustments to reflect 2010-15 performance (£ million)

Area of intervention	Intervention	Company view	Total revenue adjustment 2010-15 (post intervention)	
			Draft determination	Final determination
SIM	There are no interventions in this area. (A data error was corrected between draft and final determination.)	1.1	0.9	1.1
RCM	<p>We have intervened in the following areas:</p> <ul style="list-style-type: none"> • 2009 final determination (FD09) assumptions • Number of households billed • Outturn financial year average RPI <p>Combined, these interventions reduced revenue by a further £0.1 million compared with the company's revised business plan.</p>	-2.0	-2.1	-2.1
Operating expenditure incentive allowance (OIA)	There are no interventions in this area.	0.0	0.0	0.0
CIS	In carrying out our assessment (for all companies), we have used the values from tables A9 and W15 of the revised business plan. We have included our view of the	-1.5	-1.6	-1.6

Area of intervention	Intervention	Company view	Total revenue adjustment 2010-15 (post intervention)	
			Draft determination	Final determination
	<p>applicable change protocol amounts reclassifying the company's shortfall claim to a log down.</p> <p>Combined these interventions reduced revenue by £0.1 million compared with the company's revised business plan.</p>			
Other adjustments	There are no interventions in this area.	0.0	0.0	0.0

A2.3.5 Calculation of allowed revenue

We set out the calculation of the allowed revenue for Sembcorp Bournemouth Water's wholesale water control in table A2.10.

Overall, we consider that the company's wholesale water revenue allowance will be £31.8 million in 2015-16, increasing by 0.9% to £32.1 million in 2019-20.

Table A2.10 Sembcorp Bournemouth Water's wholesale water allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	28.2	27.4	26.5	25.0	24.2	131.2
PAYG rate (%)	70.1%	72.0%	74.2%	78.1%	80.8%	
Totex additions to the RCV	8.4	7.7	6.8	5.5	4.7	33.0
RCV (year average)	142.0	144.2	145.5	145.6	144.7	
Wholesale allowed revenue build up:						
PAYG ¹	20.1	20.1	20.0	19.9	19.9	100.0

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Return on capital	5.3	5.4	5.5	5.5	5.4	27.1
RCV run-off	5.8	5.9	6.0	6.0	6.0	29.7
Tax ²	0.5	0.4	0.4	0.5	0.6	2.4
Income from other sources ^{3,4}	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
Reconciling 2010-15 performance	-0.5	-0.5	-0.5	-0.5	-0.5	-2.6
Ex ante additional menu income	0.0	0.0	0.0	0.0	0.0	-0.2
Wholesale allowed revenue adjustments:						
Capital contributions from connection charges and revenue from infrastructure charges	0.9	0.9	0.9	0.9	0.9	4.5
Final allowed revenues	31.8	31.9	32.0	32.1	32.1	159.9

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.

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 costs to be passed through to customers, reflecting the fact that companies have more control than customers in managing the risk.

In table A2.11 below, we set out Sembcorp Bournemouth Water’s proposed wholesale water uncertainty mechanisms and our final assessment of these proposals.

Table A2.11 Sembcorp Bournemouth Water’s proposals for wholesale water uncertainty mechanisms

Assessment at draft determination	Our final assessment
<p>In the draft determination, we amended the proposed sharing rate from 80:20 to 75:25 for water business rate risk. However, Sembcorp Bournemouth Water has submitted a revised version of its proposed gain sharing mechanism, which provides greater detail on how the mechanism will function (see table A5.4 for further detail).</p>	<p>We have increased the sharing rate to 80:20 as we have accepted the company’s revised proposal for a gain sharing mechanism because it has provided greater detail on how the gain sharing proposal works, the role of the customer forum and that it will not involve pain sharing to customer.</p> <p>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>

A3 Household retail

A3.1 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.

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 – household retail costs and revenues’](#) (‘Policy chapter A5’)
- Policy chapter A7.

Table A3.1 lists the representations we have received that are specific to Sembcorp Bournemouth 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 Sembcorp Bournemouth Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, PCs and incentives	Sembcorp Bournemouth Water	Annex 4
Outcome delivery and reporting	None	Annex 4
Allocation of costs	None	Section A3.3.1 and annex 1
Adjustments	Sembcorp Bournemouth Water CCWater	Section A3.3.2 A5.5 and A5.6
New costs	Sembcorp Bournemouth Water	Section A3.3.3
Uncertainty mechanisms	None	Section A3.5

A3.2 Outcomes, PCs and incentives

In policy chapter A2, we discuss our approach to outcomes for the wholesale and retail controls. Sembcorp Bournemouth 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 outcomes, 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 PCs proposed by each company for household retail has focused on company-specific assessments to ensure that the performance proposed by each company is challenging, appropriately incentivised and supported by customer engagement.

Table A3.2 below summarises the outcomes, PCs and ODIs for Sembcorp Bournemouth Water's household retail control.

For some PCs 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, PCs and incentives

Company proposal			Final determination intervention
Outcome	Performance commitment	Incentive type	
A: Providing an excellent customer experience	A1: Improve customer experience – increase SIM score ¹ . (Maintain position > 1 standard deviation above the industry average)	Financial – reward and penalty	Following company representation, we have accepted the company's proposal to set itself a non-financial ODI. This is additional to the standard national SIM incentive.

Company proposal			Final determination intervention
Outcome	Performance commitment	Incentive type	
A: Providing an excellent customer experience	A2: New customer relationship management (CRM) system	Financial – penalty-only	We have introduced a penalty-only incentive to protect customers in the event that the company does not deliver, or is late in delivering, its new customer relationship management (CRM) system.
B: A financially stable business	B1: Fair customer bills (Efficient debt management – percentage of average bill)	Reputational	No intervention

Notes:

1. We have required all companies to include a PC based on the SIM.

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

Table A3.3 below summarises our final assessment of Sembcorp Bournemouth Water's cost allocation methodology.

Table A3.3 Our assessment of Sembcorp Bournemouth Water’s cost allocation methodology

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

We have used the company’s cost allocation between wholesale and retail 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, Sembcorp Bournemouth Water sought adjustments to the ACTS for:

- pension deficit repair costs;
- general and support recharges from wholesale; and
- input price pressure.

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](#)'.

General and support costs

In the final determination for Sembcorp Bournemouth Water we have not included an adjustment for movement on general and support costs recharged from wholesale. These costs are immaterial as a standalone adjustment and so been added onto the base operating expenditure as a new cost.

Input price pressure

In the final determination for Sembcorp Bournemouth Water we have not included an adjustment to the ACTS for input price pressure.

Table A3.4 outlines our assessment of Sembcorp Bournemouth Water's proposed ACTS adjustments. Further details on our assessment are set out in annex 2.

Table A3.4 Our assessment of Sembcorp Bournemouth Water's proposals for ACTS adjustments

		Our final assessment ¹			
Adjustment	Value (£m over 2015-20)	Materiality ²	Beyond efficient management control	Impact company in materially different way	Value of adjustment appropriate
Input price pressure	1.1	Pass	Pass	Efficiency benchmarking evidence: Pass	n/a
				Upper quartile: Fail	

Notes:

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in final determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.082	0.082	0.082	0.082	0.082	0.411
Movement on GandS costs recharged from wholesale	Not included as adjustment – forms part of new costs					
Adjustments included in final determination	0.082	0.082	0.082	0.082	0.082	0.411

A3.3.3 New costs

In the draft determination, we disallowed new costs above the materiality threshold as the company did not provide sufficient and convincing evidence to support these costs. The company failed to demonstrate the need for the new costs, that its proposed solution was the most cost beneficial, that the cost estimates were robust and that customers were sufficiently protected.

The company provided additional evidence to support its claim, which relates to a new billing system, in its representation on the draft determination. We have decided to allow the company's new costs in the final determination. Further details on our assessment are set out in annex 2.

In table A3.6 below, we outline Sembcorp Bournemouth Water's proposal for household retail new costs and our assessment of this proposal. Our decision is quantified in table A3.7.

Table A3.6 Sembcorp Bournemouth Water proposals for household retail new costs

	New costs assessment criteria				
Value above the threshold (£m over 2015-20)	Materiality ¹	Need	Options and CBA	Robustness of costs	Customer protection
1.1	Pass	Pass	Pass	Pass	Pass

Note:

1. For household retail materiality is defined as being 2.25% of household retail opex plus depreciation over 2015-20.

The value of the modification for the company's new costs is quantified in table A3.7.

Table A3.7 New household retail costs (£/customer)

	Value
Modification made to 2013-14 cost to serve for ACTS calculation	1.71

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 a net margin of 1%. This is in line with our risk and reward guidance and our further consideration of margins following representations on the draft determinations. We have therefore accepted the company's proposal.

Table A3.8 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 A3.9 below sets out the components of the allowed household retail revenue. We set out the household retail revenue modification in annex 2.

Table A3.9 Components of the allowed household retail revenue (nominal prices)

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Company cost to serve (£/customer)						
Unmetered single service customers	22.4					
Metered water only customers	27.8					
Industry ACTS (£/customer)						
Unmetered single service customers				21.47		
Metered water only customers				27.26		
Allowed cost to serve¹ (£/customer)						
Unmetered single service customers		19.6	19.8	20.0	20.3	20.1
Metered water only customers		25.4	25.6	25.7	26.0	25.9

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Total allowed (£m)						
Cost to serve (excluding net margin)		4.4	4.5	4.6	4.7	4.7
Forecast household wholesale charge (including forecast RPI ²) ³		25.8	26.8	27.7	28.6	29.4
Household retail revenue (including an allowance for the net margin) ⁴		4.7	4.8	4.9	5.0	5.0

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.

Sembcorp Bournemouth 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 Sembcorp Bournemouth Water’s non-household retail price control.

A4.1 Consideration of representations on our draft determinations

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 Sembcorp Bournemouth 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 Sembcorp Bournemouth Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Net margins	None	Section A4.3
Cost proposals	Sembcorp Bournemouth Water	Section A4.4
Form of control	Sembcorp Bournemouth Water CCG	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 that we have set 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	0.7	0.7	0.7	0.7	0.7

Note: There will be no indexation for retail price controls from this price base. The non-household wholesale charge includes forecast RPI so that the total non-household retail revenue can be displayed 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 draft determinations.

A4.4 Cost proposals

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.

In a query response after its representations were submitted, the company stated that it had incorrectly calculated its 2015-20 forecast costs. The company stated that it had initially excluded the costs from its baseline due to not updating its forecast for 2013-14 actuals. The residual represented the account management activities conducted by two new members of staff. The company provided Board and independent consultant assurance as to the validity of the updated forecast.

We have decided to accept the company's update. This is because of the assurance provided, the fact that the original profile had a large (20% nominal) reduction in costs over the control period, the fact that company's costs appeared low compared to the rest of the industry, and that the update did not result in a material increase in costs over 2015-20 relative to 2013-14 levels. However, the fact that the company's

Board allowed such an error in the company's original submission is a cause for concern. In total this changed the company's forecast from £1.629 million to £1.927 million over 2015-20.

In IN 13/17 we explained how we would treat the costs associated with water companies reducing the deficits in their defined benefit pension schemes at the 2014 price review. Where companies' proposals have differed from our calculations we have over-written their proposals in line with our overall approach. As a result, we adjusted the company's proposals from £0.077 million over the control period, to £0.066 million.

In total, we adjusted the company's proposed costs from £1.927 million over the control period to £1.916 million.

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 table A4.3 below for Sembcorp Bournemouth 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
Domestic Commercials 0 to 750 m3/a Water Metered	£	21.08	20.64	20.09	19.55	18.74
	%	1.4%	1.4%	1.4%	1.4%	1.4%
	£ (r)	22.95	22.53	22.04	21.61	20.73
Small Commercials 750 to 2000 m3/a Water Metered	£	20.52	20.21	19.78	19.36	18.67
	%	1.9%	1.9%	1.9%	1.9%	1.9%
	£ (r)	44.17	44.16	44.70	44.60	45.05
Small Medium Commercials 2000 to 4000 m3/a Water Metered	£	26.24	25.84	25.29	24.75	23.87
	%	4.3%	4.3%	4.3%	4.3%	4.3%
	£ (r)	156.38	160.93	163.67	166.07	170.17
Large Medium Commercials 4000 to 10,000 m3/a Water Metered	£	160.55	158.06	154.75	151.44	146.06
	%	4.3%	4.3%	4.3%	4.3%	4.3%
	£ (r)	454.11	459.98	465.42	466.47	472.36
High Commercials 10,000 to 50,000 m3/a Water Metered	£	189.49	186.56	182.65	178.74	172.39
	%	3.8%	3.8%	3.8%	3.8%	3.8%
	£ (r)	869.23	880.44	903.86	911.39	929.08
Very High Commercials > 50,000 m3/a Water Metered	£	792.89	780.63	764.27	747.91	721.33
	%	1.7%	1.7%	1.7%	1.7%	1.7%
	£ (r)	2,058.72	2,077.98	2,097.62	2,107.78	2,137.13
Special Agreement- water metered	£	4,167.18	4,102.71	4,016.74	3,930.78	3,791.09
	%	1.7%	1.7%	1.8%	1.8%	1.8%
	£ (r)	84,653.81	86,405.25	90,386.17	96,512.76	100,447.37
Domestic Commercials unmetered	£	20.95	20.62	20.19	19.76	19.06
	%	0.7%	0.7%	0.7%	0.7%	0.7%
	£ (r)	23.48	23.34	23.07	22.79	22.30

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.

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.

Our general policies relevant at appointee level 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 A7.
- Policy chapter A8.

Table A5.1 lists the representations we have received that are specific to Sembcorp Bournemouth Water at an appointee level and sets out where to find more information on our responses in this document.

Table A5.1 Representations specific to issues at an appointee level for Sembcorp Bournemouth Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Bills and K factors	Sembcorp Bournemouth Water CCG CCWater	Section A5.2 and A5.6

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Appointee level uncertainty and gain share mechanisms	Sembcorp Bournemouth Water	Section A5.3
Return on regulatory equity range	None	Section A5.4
Financeability	Sembcorp Bournemouth Water	Section A5.5
Affordability	CCWater	Section A5.6

A5.2 Bills and K factors

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

- statutory duties; and
- associated PCs.

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

Table A5.2 Sembcorp Bournemouth Water’s final determination – K factors, allowed revenues and customer bills¹

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (£m) ²	31.8	31.9	32.0	32.1	32.1	159.9
Wholesale water – K (%)	0.0%	0.8%	0.3%	0.0%	0.0%	-
Retail household allowed revenue (£m)	4.7	4.8	4.9	5.0	5.0	24.3
Retail non-household expected revenue (£m)	0.7	0.7	0.7	0.7	0.7	3.7
Average household bill – water (£) ³	129	129	129	129	129	-

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 Sembcorp Bournemouth 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 Sembcorp Bournemouth Water's household and non-household customer base. In practice, this will depend upon the structure of wholesale charges implemented by Sembcorp Bournemouth 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 Sembcorp Bournemouth Water in table A5.3 below.

Table A5.3 Sembcorp Bournemouth Water – allowed wholesale revenue for 2014-15

Sembcorp Bournemouth Water	Wholesale water
Allowed wholesale revenue 2014-15 (£ million)	33.6

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 Sembcorp Bournemouth Water's proposed appointee level gain share mechanism and our assessment of these proposals.

Table A5.4 Sembcorp Bournemouth Water proposals for appointee level uncertainty and gain share mechanisms

Assessment at draft determination	Our assessment
<p>In the draft determination, we did not accept the company’s proposed pain-gain share within the 2015-20 period.</p> <p>The company has submitted a revised version of its proposed gain-share mechanism, which contains greater detail than its June submission. Its revised proposal clarifies that the mechanism will only have potential for gain sharing with customers – that is, no pain sharing. The company has also provided further detail regarding the membership of the Customer View group, the roles and responsibilities of the group, and the scope of potential gain sharing, in particular, that any gain sharing will relate to financial windfalls in addition to sharing from totex menus and ODIs.</p>	<p>We accept the company’s gain share mechanism. This is because of the changes to the company's proposal from the draft determination; in particular it is has provided greater detail on how the gain sharing proposal works, the role of the customer forum and set out that it will not involve pain sharing to customers. We request the company works with the CCG on a detailed implementation plan.</p>

A5.4 Return on regulatory equity range

Sembcorp Bournemouth Water has estimated the range of 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. We have identified the RoRE impact separately for ODIs, totex performance, financing and the SIM. We note that Sembcorp Bournemouth 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.

Table A5.5 Whole company RoRE range

	Lower bound (%) – appointee	Upper bound (%) – appointee
Overall	-4.3%	+2.0%
ODIs	-1.6%	+0.4%
Totex	-2.2%	+1.2%
Financing	-0.5%	+0.2%
SIM	0.0%	+0.3%

Commentary:

The whole company RoRE range is from 1.6% to 7.8%, with a base case of 5.8% and overall impacts from -4.3% to 2.0%. This range reflects our view of the appropriate small company uplift (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 6.0% to 5.8%.

The totex risk range from -2.2% to +1.2% is unchanged from the draft determination. The company based this on (a) modelling of the economic and rainfall scenarios published with the PR14 methodology; and (b) a consideration of specific downside opex risks that may arise over 2015-20. The overall impacts are broadly in line with other companies.

The ODI risk range proposed by Sembcorp Bournemouth Water in response to the draft determination was from -1.2% to +0.4%. This includes a smaller downside than the -2.0% to +0.4% in the draft determinations and reflects the company's representations related to the level of ODI penalties. We have adjusted this to -1.6% to +0.4% to take account of the interventions discussed in annex 4.

Financing risk impacts from -0.5% to +0.2% are unchanged from the draft determination. The financing risk range is based on analysis carried out by external advisors as well as the company's own analysis of current bond yields relative to its long-term averages. Financing risk is applied to the cost of new debt and is calculated on a notional basis

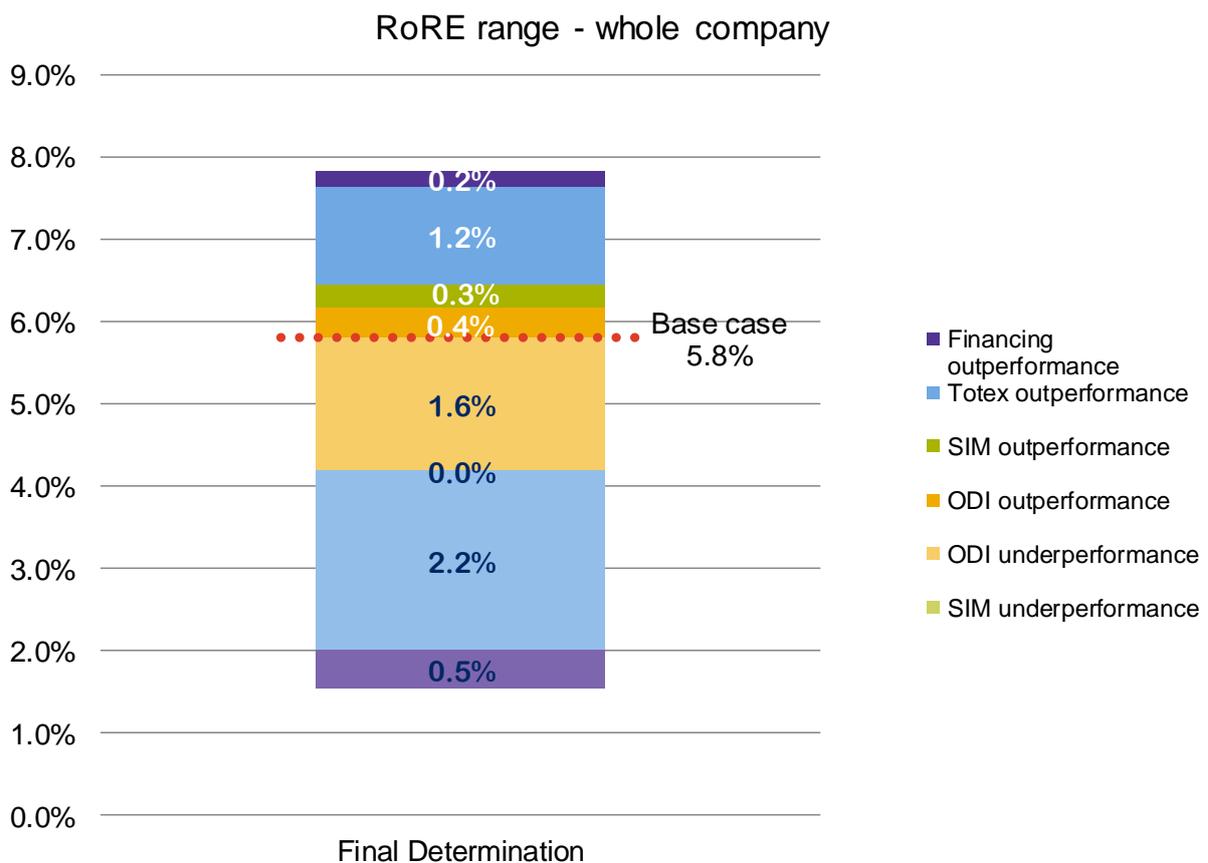
The SIM risk range of 0.0% to +0.3% is also unchanged from the draft determination. The company has estimated SIM impacts using an assumption of a maximum reward of 0.5% of revenue, while it has assumed a downside of 0%. Given that the company has consistently achieved a SIM ranking in the upper quartile, we consider this range to be acceptable.

As noted in Sembcorp Bournemouth Water's draft determination, as part of its risk analysis, the company included a scenario in which it lost a single large special agreement customer. The loss of this customer had a large negative revenue impact in its scenario modelling. In practice, the company would be able to largely mitigate this negative revenue impact via the wholesale revenue forecasting incentive mechanism (WRFIM). However, Sembcorp Bournemouth Water considered that the

bill increases that this would lead to for its remaining customers would not be “politically acceptable”. We, therefore recognise that this is a plausible risk for the company, but we have not included this in its RoRE analysis.

The composition of the RoRE range for Sembcorp Bournemouth Water at an appointee level is shown in figure A5.1 below.

Figure A5.1 Sembcorp Bournemouth Water’s RoRE range – appointee



Source: Our calculations based on information from Sembcorp Bournemouth 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.

Table A5.6 below notes the representations that we have received in relation to financeability and sets out our response. A company's actual capital structure is a choice for the company and it bears the risk associated with its choices.

Table A5.6 Representations specific to Sembcorp Bournemouth Water's financeability

Respondent	Summary of comment	Ofwat response
Sembcorp Bournemouth Water	The costs used by Ofwat are significantly less than what we expect to incur during 2015-20, leaving the household retail business un-financeable in the short term, and unsustainable in the long term.	Consistent with our approach elsewhere, retail financeability should be assessed on the basis of an efficient operator. We have run our stand-alone retail financeability test and consider the retail control is financeable.

In table A5.7 we set out the notional financeability ratios associated with Sembcorp Bournemouth Water's business plan, draft determination and final determination.

Table A5.7 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)	3.65	3.65	3.27	3.32

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
Adjusted cash interest cover ratio (ACICR)	2.22	2.24	1.88	1.90
Funds from operations(FFO)/debt	12.40%	13.08%	11.16%	11.08%
Retained cash flow/debt	8.72%	10.37%	8.49%	8.45%
Gearing	61.46%	59.48%	60.88%	61.32%
Dividend cover (profit after tax/dividends paid)	1.25	2.02	1.41	1.39
Regulatory equity/regulated earnings for the regulated company	16.72	16.91	16.94	16.81
RCV/EBITDA	8.58	8.49	9.37	9.46

Commentary:

Sembcorp Bournemouth Water targeted a credit rating of BBB+ in its revised business plan and provided Board assurance that the company is financeable on an actual and notional basis. Based on the company's plan the financial ratios calculated by Ofwat are broadly consistent with the ratios that Sembcorp Bournemouth Water presented to us. As we intervened to reduce PAYG rates, the ratios for the draft determination were lower than those for the company's plan, although we considered the draft determinations was financeable. The financial ratios from the final determination are at levels consistent with those from the draft determination. We therefore consider that the final determination is financeable.

As explained in policy chapter A8, companies have been allowed to use new tools in the form of 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 A5.8 sets out the PAYG and RCV run-off rates which shows 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. As set out in Table A5.8 we have not included Sembcorp Bournemouth Water's proposed increase in PAYG rates and so PAYG rates are broadly the same as draft determinations (the small change reflects the use of PAYG to reprofile bills see below).

Table A5.8 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	80.4%	4.0%	-1.5%
Company June plan	79.6%	4.0%	-1.3%
Draft determination	74.9%	4.0%	2.4%
Final determination	75.0%	4.0%	2.4%

A5.6 Affordability

We set out our approach to assessing affordability in policy chapter A8.

Table A5.9 sets out the change in household bill profile between the company's December and June business plans and the draft and final determination.

Table A5.9 Household bill profile (£)

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	149	142	141	139	137	136
Company June plan	151	140	140	138	136	135
Ofwat calculation for June plan	145	140	140	140	140	139
Ofwat calculation for draft determinations – pre-reprofiling	145	130	130	129	126	125

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Ofwat calculations for draft determinations	145	130	130	129	126	125
Ofwat calculations for final determination	145	129	129	129	129	129

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 A5.9).

The final determination leads to a reduction in bills in 2015-20. Given Sembcorp Bournemouth Water's customer research suggesting a preference for smooth customer bills over 2015-25 and the company's concern about bills increasing in the 2020-25 period we have re-profiled bills so that there is a large reduction in the first year with broadly flat bills for the remainder of the period. This equalises the customer benefits across the period and minimises the potential for a bill increase in the 2020-25 period.

The following sections set out the reasons why this final determination is assessed as affordable. It describes key changes in relation to Sembcorp Bournemouth Water's December business plan (which we assessed as affordable).

A5.6.1 Acceptability

In its December plan, Sembcorp Bournemouth Water reported that its research had found that 79% of customers found its proposals acceptable. In its June resubmission, the company's proposed average bills that were slightly lower than those in the December plan, as a result of changes to PAYG and RCV-run-off rates designed to produce a stable bill profile across 2015-20 and 2020-25.

However, we concluded in the draft determination that there was no evidence of customer support for the proposed use of PAYG rates to provide stable bills between 2015-20 and 2020-25 by raising bills in 2015-20 by use of PAYG. So we intervened in the plan to set PAYG rates consistent with a stable PAYG rate over 2015-25 and to reduce bills in the 2015-20 period. We reduced the PAYG rates in our draft determinations, which reduced bills further.

The company has proposed increasing PAYG to reflect customer preferences for smooth bills over the 2015-25 period. We have not accepted the company's

proposals and so the bills in the final determination are lower than the company's December plan. We therefore consider bills should be acceptable to customers.

Table A5.10 notes the representations that we have received that are specific to affordability for Sembcorp Bournemouth Water and sets out our response.

Table A5.10 Representations specific to Sembcorp Bournemouth Water's affordability

Respondent	Summary of comment	Ofwat response
CCWater ¹	CCWater conducted research on the acceptability of the draft determination to customers. CCWater did not seek to produce comparable results to the company. The CCWater research suggests 85% of customers find the draft determination acceptable after they have been provided with information on bills, inflation and what the water company will deliver.	While we note that the research was not intended to be comparable it provides similar results to the research the company undertook on its business plan, which was that 79% found the plan acceptable.
Sembcorp Bournemouth Water CCG CCWater	The company proposed to increase PAYG rates to increase revenue in 2015-20 to smooth bills over the 2015-20 period. The CCG support the company's proposed revision. CCWater was concerned about our proposed reduction in the PAYG rate and stated that we should consider the company's research which showed that 70% of customers preferred smoothed bills (which can be associated with the PAYG rate).	We have not accepted Sembcorp Bournemouth Water's proposals because the company could instead address the issue by the bill profiles within each period, there is no evidence that the scale of the adjustment fits the scale of the issue and it is not clear that the revised profile is aligned with the bill profile preference of customers. The assessment against each of our criteria is set out in section A5.6.3 below.

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 comprehensive range of affordability measures in place. The key measures are summarised in table A5.11.

Table A5.11 Key affordability measures

Measure	Current coverage (no. of customers)	Forecast 2019-20 coverage
WaterSure	863	No changes to approach planned
Water direct	1,511	No changes to approach planned
Flexible payment plans	4,429	No changes to approach planned
Debt advice – in house	Available to all contacts	Available to all contacts
Debt advice – 3rd party	Started working with StepChange	No changes to approach planned
Trust fund/hardship fund	1 (plus Auriga grant)	No changes to approach planned
Write-off scheme	6,492	No changes to approach planned
Water efficiency advice/audits	44	No changes to approach planned
Targeted assistance for students	2,231	No changes to approach planned
Social tariff	Further research planned in 2015	

A5.6.3 Longer-term affordability

In its December plan, the company outlined how it had used the PAYG rate to smooth customers' bill profiles in the 2015-20 period, and also demonstrated that it had surveyed customers about levels of future bills, and used the results to ensure that it will not impose unaffordable price increases beyond 2020.

In the revised plan, the company has slightly reduced the PAYG rate for 2015-20 and for 2020-25, and left the RCV run-off rate unchanged. As discussed above, Sembcorp Bournemouth Water is using PAYG rates to bring revenue forward, and we intervened to reset PAYG rates.

In its representation, the company proposed to increase PAYG rates based on customer survey evidence of support for a smooth bill profile over ten years. The company has CCG support for its approach. We have not accepted the company's proposal based on the assessment against our criteria as set out in table A5.12 below.

Table A5.12 Assessment of changes to RCV run off rates

Area assessed	Commentary	Our final assessment
Quality of engagement	The company carried out a face-to-face survey, it has CCG support and the impact of inflation was explained.	Pass
Basis of engagement	The company proposed to increase PAYG to increase revenue required in 2015-20 to address the shape of the capex profile, the impact of inflation and the risk of increased costs in 2020-25. This issue could be better addressed by re-profiling bills in each period. We consider that the company's engagement is likely to overstate bill increases in 2020-21.	Fail
Proportionality	The impact of the proposal is to increase revenue by 2.7% in 2015-20. There is no evidence that this scale of adjustment fits scale of issue.	Fail
Evidence of net benefits	It is not clear that the revised profile is aligned with the bill profile preferences of customers.	Fail
Overall	We have not accepted the changes the company proposed	Fail

A5.6.4 Longer-term affordability – ODIs

The company provided evidence that it has revisited its package of ODIs for the June submission, in accordance with the risk and reward guidance. As a result of the revision, the company has added financial rewards to two of its measures. However, we note that the company had not conducted specific customer research to support its revised ODIs, or to assess its customers' attitudes towards the concept of linking bills to performance, but had used its existing willingness to pay research as the basis for adding reward incentives to the ODIs. The CCG was supportive of the company's overall ODI package.

In the draft determination, we recommended that companies incorporate a range of 'comparative' indicators into their ODI packages. In its representation, the company proposed to amend its ODIs to reflect our draft determination feedback. The company's CCG reviewed these changes and is satisfied with the approach it has taken.

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 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 ¹	Unmodelled costs adjustment	Deep dives	Final determination threshold	Deep dives fully or partially not added ²
110.6	18.5	-2.4	6.0	132.7	1.4

Notes:

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

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
16.4	1.9	0.0	0.2	0.0	18.5

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

Plan ¹	Final determination threshold	Gap ²	2010-15 v plan
134.3	132.7	1.6	0.3

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 (£ million)

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment	Amount allowed
Deep dives							
Fawley oil refinery	19.7	0.0	Partial pass	N/a	Partial pass	Partial pass	2.6
Greater number of meters installed (selectives and optants combined) compared with modelling assumptions	3.8	1.9	N/a	Fail	Fail	Partial pass	0.6
Representation: additional NEP expenditure	0.8	0.0	Fail	N/a	N/a	Fail	-
Representation: enhanced leakage reduction	0.6	0.0	-	-	-	-	-
Greater length of mains renewal undertaken	1.9	0.0	Pass	Partial pass	Pass	Partial pass	1.9
Representation: cost modelling – metering inconsistency	0.8	0.0	Pass	N/a	Pass	Pass	0.8

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, Sembcorp Bournemouth Water sought an adjustment for input price pressure of £1.1 million over 2015-20.
- We did not accept the company's proposal for input price pressure in the draft determination.
- We have assessed further evidence provided in the company's representation. However, our position is unchanged for the final determination, and we have not accepted the adjustment for the final determination.

Input price pressure – our final assessment

Materiality

The company's proposed adjustment of £1.1 million is material, at 9.7% of household retail operating expenditure plus depreciation over 2015-20.

Beyond efficient management control

Sembcorp Bournemouth Water's evidence on management practices is sufficient and convincing. Sembcorp Bournemouth Water provided evidence on how staff and other costs (for example, bill printing costs) are managed within its business that convinced us that it uses efficient management practices. The company has demonstrated that the input price pressure it faces is beyond efficient management control.

Impact company in materially different way

The company provided convincing benchmarking evidence on relative efficiency compared to companies beyond the water sector. However, our assessment for ACTS shows that the company is not upper quartile efficient for unmetered retail costs. Therefore the company has not demonstrated that it is affected in a materially different way to other companies as the company has not demonstrated that it is efficient relative to other companies in the industry and could not absorb further input price pressures through efficiency gains. We have therefore not accepted the adjustment.

Value of proposed adjustment

As Sembcorp Bournemouth Water has not justified an adjustment being made, we have not assessed the justification for the value of the adjustment.

The adjustments proposed by Sembcorp Bournemouth Water and the amounts we have included in our draft and final determination are quantified in table AA2.1 below.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments proposed in Sembcorp and Bournemouth Water's June business plan						
Input price pressure	0.347	0.438	0.520	0.624	0.741	2.670
Pension deficit repair costs	0.145	0.145	0.145	0.000	0.000	0.435
Movement on GandS costs recharged from wholesale	0.085	0.124	0.164	0.198	0.228	0.799
Adjustments included in business plan	0.577	0.708	0.829	0.822	0.969	3.905
Adjustments included in draft determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.082	0.082	0.082	0.082	0.082	0.411

Movement on GandS costs recharged from wholesale	Not included as adjustment – forms part of new cost					
Adjustments included in draft determination	0.082	0.082	0.082	0.082	0.082	0.411
Adjustments proposed in Sembcorp Bournemouth Water's representations						
Input price pressure	0.347	0.438	0.520	0.624	0.741	2.670
Pension deficit repair costs	0.145	0.145	0.145	0.000	0.000	0.435
Movement on GandS costs recharged from wholesale	0.085	0.124	0.164	0.198	0.228	0.799
Adjustments included in business plan	0.577	0.708	0.829	0.822	0.969	3.905
Adjustments included in final determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.082	0.082	0.082	0.082	0.082	0.411
Movement on GandS costs recharged from wholesale	Not included as adjustment – forms part of new costs					
Adjustments included in final determination	0.082	0.082	0.082	0.082	0.082	0.411

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

Details on our assessment of new costs

Sembcorp Bournemouth Water has demonstrated the need for the investment by describing the consequences on customer service when keeping its current system.

The company has put forward sufficient evidence of cost benefit analysis (CBA) and subsequent competitive tendering. The company demonstrated that key

stakeholders were engaged during the selection process and costs, benefits and risks evaluated for major options.

The cost estimate is based on market tested supplier quotations from a suitable tendering process and therefore we consider this to be sufficiently robust.

The company provided evidence of the impact on customer bills. It also provided evidence that customers are the main beneficiary of the new cost. Customers will be protected from cost overruns as Sembcorp Bournemouth Water has committed to absorb any cost increases.

In order to ensure customers are protected against late or non-delivery of the investment, we have introduced a PC and an ODI. This has been discussed and agreed with the company. The PC and ODI are set out in annex 4.

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	20.73	20.98	21.16	21.49	21.37
Metered water only customer	26.86	27.12	27.30	27.63	27.52

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	59.8	56.2	52.6	49.0	45.4
Metered water only	128.0	132.7	137.5	142.2	146.8

Annex 3 Reconciling 2010-15 performance

When we last set price controls at PR09 we included a number of incentive mechanisms designed to encourage companies to improve and deliver services more efficiently and manage uncertainty. Consistent with the approach set out at the time of the final determinations in 2009 we have made adjustments at PR14 to 2015-20 revenues to take account of company performance in the 2010-15 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 Sembcorp Bournemouth Water resulting from the company's actual performance during the 2010-15 period.

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.

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 covers the detail of the specific calculation. Similarly, our detailed calculations behind the midnight adjustments such as land sales (but excluding those relating to the change protocol) are contained within the RCV midnight adjustment model 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 determinations that are specific to Sembcorp Bournemouth Water's treatment in these areas below.

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.

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 policy chapter A4. Representations that are specific to reconciling 2010-15 performance for Sembcorp Bournemouth Water, and any consequential impact on our final determination, are summarised in the table AA3.1 below.

Table AA3.1 Representations specific to reconciling 2010-15 performance for Sembcorp Bournemouth Water

Area	Respondent	Summary of comment	Ofwat response
SIM	There were no representations in this area.		
RCM	There were no representations in this area.		
OIA	There were no representations in this area.		
Change protocol	There were no representations in this area.		
Service standard outputs	There were no representations in this area.		
Serviceability performance	Sembcorp Bournemouth Water	The company provided an external assurance report from Halcrow on water treatment works non-compliance to demonstrate that there have been no coliform failures since 2012.	We have accepted the company's view that serviceability performance in this indicator is likely to be stable. There is therefore no shortfall intervention.
2009 agreed overlap programme	There were no representations in this area.		
2014-15 transition programme	There were no representations in this area.		

Area	Respondent	Summary of comment	Ofwat response
CIS	There were no representations in this area.		As explained in policy chapter A4, we have changed the methodology 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. The impact of the methodology change on the discount rate has increased the final determination by less than £0.1 million.
Other adjustments	There were no representations in this area.		

Summary of 2010-15 adjustments

Each company was required to put in its business plan its own adjustments for PR09 reconciliation. Table AA3.2 below sets out for each of the incentive tools for water services:

- the company's view of the required revenue adjustments included in its revised business plan; and
- our 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 determinations. The table also shows other adjustments, such as those relating to tax resulting from the company's actual performance during the 2010-15 period.

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

The main change we have made in the final determination compared to our draft determination, is revising our adjustment to the RCV for actual expenditure in 2009-10 as described in table AA3.15.

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

	Company view	Ofwat view
SIM	1.050	1.050
RCM	-1.950	-2.059
OIA – post-tax	0.000	0.000
CIS	-1.470	-1.579
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000
Total wholesale legacy adjustments	-2.370	-2.588

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 AA3.10. 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 AA3.6.

Totals may not add up due to rounding.

Adjustments by 2010-15 incentive mechanism

SIM

We provide our view of each company's SIM reward/penalty in policy chapter A4.

Table AA3.3 provides the company's and our view of the annualised rewards or penalties from the company's SIM performance. These are slightly different to the draft determination because we have corrected an error in the company's data for predicted turnover in 2014-15.

Table AA3.3 SIM annualised rewards or penalties (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.210	0.210	0.210	0.210	0.210	1.050
Ofwat view	0.210	0.210	0.210	0.210	0.210	1.050

RCM

This final determination includes our view of the company's RCM annualised adjustment amounts as detailed in table AA3.4 below. Table AA3.5 summarises our interventions in relation to Sembcorp Bournemouth Water's proposed 2010-15 RCM adjustments.

For the RCM, we apply the vanilla wholesale allowed return (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 AA3.4 RCM annualised adjustments for 2015-20 (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.390	-0.390	-0.390	-0.390	-0.390	-1.950

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Ofwat view	-0.412	-0.412	-0.412	-0.412	-0.412	-2.059

Table AA3.5 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 50 megalitre (MI) threshold	Our assumptions include our view of the FD09 assumptions. Our view of the company's revenue assumptions for the measured non-household group immediately below and above the 50 MI tariff basket threshold originate from the company's FD09 revenue forecasts that come from the tariff basket model, which we used for PR09.	There were differences 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 50MI threshold' compared with our view of its FD09 assumptions. 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'.
Number of households billed	Our assumptions for the final determination use the data the company submitted in business plan table R3 to calculate our view of the RCM adjustment.	There were inconsistencies with the number of households billed between business plan table R3 and the company's populated RCM model. For our assumptions for the final determination, we have applied the data from table R3.

Area of intervention	What we did	Why we did it
Outturn financial year average RPI	Our assumptions for the outturn financial year average RPI at the final determination use the data that the company submitted in business plan table A9 to calculate our view of the RCM adjustment.	There were inconsistencies with the outturn financial year average RPI between table A9 and the company's populated RCM model. For our assumptions for the final determination, we have applied the data from table A9.

Change protocol (logging up, logging down and shortfalls)

Table AA3.6 and table AA3.7 below summarise Sembcorp Bournemouth 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 AA3.6 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)	-0.443	-0.443
Shortfalls (one-sided)	0.000	0.000

Note:

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 AA3.7 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	-0.020	-0.020
Shortfalls	0.000	0.000
Shortfalls for serviceability	0.000	0.000

Service standard outputs

The company did not have any service standard outputs set at PR09.

Serviceability performance

Table AA3.8 below summarises our serviceability assessments for Sembcorp Bournemouth Water and table AA3.9 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 AA3.8 Serviceability assessments for 2010-15

		2010-11	2011-12	2012-13	2013-14	2014-15
Water infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Stable	Stable	Stable	Stable	Stable
Water non-infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Marginal	Marginal	Marginal	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 AA3.9 Impact of serviceability shortfalls on the RCV (£ million)

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

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

Sembcorp Bournemouth Water did not propose any transitional investment.

CIS

Table AA3.10 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 AA3.11 sets out the profiled values of the revenue adjustments in each year 2015-20, table AA3.12 sets out the CIS components of the opening RCV adjustment, and table AA3.13 summarises our interventions in relation to Sembcorp Bournemouth Water's proposals.

There are no representations in this area from Sembcorp Bournemouth 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.

Table AA3.10 CIS true-up adjustments

		Total
Restated FD09 CIS bid ratio ¹	Company view	115.990
	Ofwat view	114.832
Out-turn CIS ratio	Company view	112.159
	Ofwat view	111.981
Incentive reward/penalty (%) ²	Company view	-3.169
	Ofwat view	-3.241

		Total
Reward/penalty (£m)	Company view	-1.380
	Ofwat view	-1.415
Adjustments to 2015-20 revenue (£m) ³	Company view	-1.463
	Ofwat view	-1.469
RCV adjustment (£m) ⁴	Company view	0.854
	Ofwat view	0.890

Notes:

1. The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol (table AA3.6)
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 AA3.12 we show how the components of this agree to those shown in table A2.7.

Table AA3.11 Profiled revenue adjustments from the CIS reconciliation (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.293	-0.293	-0.293	-0.293	-0.293	-1.465
Ofwat view	-0.316	-0.316	-0.316	-0.316	-0.316	-1.579

Table AA3.12 CIS components of the opening RCV adjustment (£ million)

	Total
Adjustment for actual expenditure 2010-15	1.333
Net adjustment from logging up and logging down	-0.443
Adjustment for shortfalls	0.000
RCV adjustment	0.890

Table AA3.13 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	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

Area of intervention	What we did	Why we did it
	<p>the revenue adjustment in the 2010-15 period.</p> <p>We have used our assumption of the cost of capital as the discount rate when profiling the revenue adjustment in 2015-20.</p>	<p>used when calculating the future value of the revenue adjustment in the 2010-15 period. This minor change has no material impact of the final revenue adjustments.</p> <p>The company used a discount rate of 0% in its CIS model for profiling the revenue adjustment in 2015-20.</p>
Change protocol adjustments	<p>In carrying out our assessment, we have:</p> <ul style="list-style-type: none"> • included our view of the applicable change protocol amounts; and • reclassified the company's shortfall claim to a log down. 	<p>We have applied Ofwat's published methodology.</p>
Data inconsistencies	<p>In carrying out our assessment, we have used the values from tables A9 and W15 of the revised business plan.</p>	<p>We identified inconsistencies between the actual capex values contained in the company's populated CIS model and the revised business plan.</p>

Other adjustments

Table AA3.14 below confirms 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 AA3.14 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	0.000	0.000

Table AA3.15 and table AA3.16 below confirm the assumptions included in this final determination with respect to other adjustments to the opening RCV.

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

Table AA3.15 Other adjustments to the opening RCV (£ million)

	Company view	Ofwat view
Land sales	0.066	0.062
2009-10 adjustment	0.000	0.484
Other adjustments	0.000	0.000

Table AA3.16 Interventions on proposed adjustments to the opening RCV

Area of intervention	What we did	Why we did it
Land sales	We calculated land sales using the business plan sales figures in our RCV midnight adjustment model.	This provided a consistent approach across all companies.
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	This provided a consistent approach across all companies.

Area of intervention	What we did	Why we did it
	<p>adjustment included in the draft determination overstated the positive impact on 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.</p>	

Annex 4 Outcomes, PCs and ODIs

We set out our methodology for PCs and ODIs in policy chapter A2.

In this annex we provide an overview of the PCs and ODIs for Sembcorp Bournemouth Water. We then set out in detail these PCs and ODIs for the company's wholesale water and household retail outcomes, presented in that order.

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 their 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 we are requiring it, in line with the methodology, to recalibrate its ODIs with the cost-sharing rate associated with that position, and provide us with the updated incentive rate calculations. The company must do this alongside its menu choice on 16 January 2015 so that the recalibrated ODIs can be included in the regulatory reporting framework for 2015-16.

We first consider the responses to our draft determinations in relation to the PCs and ODIs for Sembcorp Bournemouth Water.

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.

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 policy chapter A2. Representations that are specific to PCs and ODIs for Sembcorp Bournemouth 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 assessments 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 PCs that were proposed by companies but that have been removed as part of our final determination.
- Table AA4.5 lists PCs 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 assessments.

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
A1: Water quality contacts from customers re appearance	Following our comparative assessment, we adjusted the committed performance level from 1.25 to 1.22, the penalty collar from 2.5 to 2.47 and the penalty deadband from 1.37 to 1.22 from 2017-18 onwards so that the company is incentivised to reach upper quartile performance.		<p>We increased the penalty deadband from 1.22 to 1.29, and collar from 2.47 to 2.54 from 2017-18 onwards.</p> <p>We increased the penalty collars in 2015-16 and 2016-17 from 2.50 to 2.56 and 2.50 to 2.55.</p> <p>We increased the penalty deadbands in 2015-16 and 2016-17 from 1.25 to 1.31 and 1.25 to 1.30.</p>	<p>We intervened from 2017-18 to address natural variability as this was a penalty only incentive, in line with the intervention made as a result of the comparative assessment.</p> <p>We intervened in 2015-16 and 2016-17 because the company's current performance was better than the 2017-18 penalty deadband and therefore we did not want to penalise the company for being a strong performer.</p> <p>For further details see policy chapter A2.</p>
A2: Maintain compliance with all	Following our comparative assessment, we adjusted the CPL from 99.97% to 100.00%,	The company expressed concerns that using mean zonal compliance as the	We maintained our intervention of using mean zonal compliance as the	We consider that our interventions ensure that customers are protected from

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
water regulations	the penalty collar to 99.95% and the penalty deadband to 99.96% so that the company is incentivised to reach upper quartile performance by 2017-18.	standard industry measure increased its risk of a penalty compared with percentage compliance because it has some small distribution zones.	standard industry measure.	non-delivery and that the company has a sufficient incentive to deliver. For further details see policy chapter A2.
B3: Minimise customer disruption re: supply interruptions ≥ 3 hours	Following our comparative assessment, we adjusted the CPLs, caps and collars so that the company is incentivised to reach upper quartile performance by 2017-18.	The company proposed a CPL of 4.4 minutes and deadband of 4.8 minutes.	We accepted the company's CPL, and increased the penalty deadband to 6.4 minutes and collar to 10.3 minutes.	We intervened in line with our comparative assessment. The company is performing at better than the upper quartile level so we did not change its PC level. We set its deadband at two minutes above its PC level and maintained the company's proposed penalty range by setting the collar at 10.3 minutes. For further details see policy chapter A2.

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
B1:Reduce Leakage	We increased the penalty collar from 21MI/d to 22MI/d as we considered that the range which the company had proposed was too small in comparison to the industry.	In response to the increased penalty collar, the company sought a reduced penalty rate of half its original proposal, applied over the range 20-22MI/d (twice its original proposal) so that the maximum penalty is the same as it proposed in its business plan.	We retained the leakage CPL at 20MI/d (a reduction of only 1MI/d from current performance of 21MI/d) and the penalty collar at 22MI/d. We retained the penalty rate at the level which the company proposed in its business plan.	We reviewed all companies' leakage CPLs, deadbands, and caps/collars and concluded that the company's penalty range proposed in its representations was too small compared with the industry average. The company proposed halving its penalty rate in response to our doubling of its penalty range but we consider that this is not appropriate as its original penalty rate was correctly calibrated with totex and WTP.
B2: Minimise customer disruption	We did not intervene on the company's proposal of minimising the risk of large-scale interruptions to greater than 12,000 properties.	CCWater is concerned about a potential double reward for the company related to its PC of minimising the risk of large-scale interruption to 12,000 customers through laying a	We maintained the reward rate of £0.186 million per property for minimising the risk of large-scale interruptions to greater than	The totex required to deliver the PC will be added to the RCV as it relates to a capital scheme. The reward is for performing beyond the CPL of 12,000 properties up to a

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		<p>reinforcement main by 2020. CCWater stated that the form of penalty or reward stated in the company's draft determination is 'adjustment to revenue.' Should the company out-perform this service commitment, its customers could be required to pay both the reward under the ODI framework and the value of this new asset that will be added to the RCV.</p>	<p>12,000 properties.</p>	<p>maximum of 18,000 and it is appropriate that this is given as a revenue adjustment as this is completely separate from adding the totex to the RCV.</p>
<p>B4: Service-ability</p>	<p>We changed the penalty rate to reflect 10% of long-term capital spend, rather than 3.85% (allowed return).</p>	<p>The company considered that we should remove the drinking water quality elements from the serviceability PC as companies will be subject to a potential 'double jeopardy' of financial penalties in relation to water quality performance.</p>	<p>We removed the drinking water quality elements from this PC.</p>	<p>We accept the company's view that drinking water quality contacts and compliance could be double-counted.</p>

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
B5: Metering-continue current strategy	We left the PC level unchanged at 17,950 meters despite disallowing the costs associated with the change of occupier metering.	<p>The company wanted to change the PC level to include optants only as it is no longer being funded for change of occupier metering.</p> <p>The Environment Agency considered that targets for intervening years could be included to enable progress towards the 2020 commitment to be managed.</p>	<p>We changed the definition of the PC to be optants only.</p> <p>We changed the PC level from 17,950 to 9,300.</p> <p>We did not intervene to set targets for 2015-16 to 2018-19.</p>	<p>We are not funding the company's change of occupier metering so its CPL should relate to optants only.</p> <p>The company proposed a target for 2019-20 with no targets in the intervening years. We consider that this is appropriate.</p>
B6: Water use – reduce average consumption	No intervention.	The company wanted to revise our CPL to 136l/person/day to reflect the decision that our change of occupier metering will not be funded.	We increased the company's CPL to 136l/person/day so the PC will now be to reduce average consumption from 142 to 136 rather than 142 to 130, that is, 50% of its original proposed reduction.	The company's original metering PC was to increase the number of meters by around 17,950 by 2020. We have not allowed its proposed funding for change of occupier metering which would have accounted for around 50% of its total metering CPL. This means it is also appropriate for us to intervene to change the company's average consumption PC level by

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
				50%.
D1: Reduce the amount of energy used to deliver water by 2020	No intervention.	The Environment Agency requested that we change the PC to be an absolute reduction in energy (kWh), not an average reduction (kWh/MI), because, if distribution input increases, this PC would result in greenhouse gases increasing.	We retained the company's original PC definition.	While the Environment Agency is correct in stating that energy use could rise if distribution input rises, we consider that the company has set an appropriate PC to reduce average energy per MI. The attainment of this target would equate to a decrease in energy use per MI/d of 9%.

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: Improve customer experience – increase SIM score.	No intervention.	The company wishes to retain SIM in its current form, with the usual rewards and penalties, plus it wants to set itself an additional non-financial ODI: ‘...to remain in a position where our score is	We retained SIM in its current form, with the usual rewards and penalties. We accepted the company's additional non-financial ODI.	The additional non-financial incentive is in its customers' interests.

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		<p>at least one standard deviation above the industry mean score when ODI outcomes are assessed at PR19. We will retain a target score of 89 or greater, but not use this specific score to assess any reward or penalty.’ (Draft determination representations document)</p>		
<p>A2: New customer relationship management (CRM) system</p>	<p>No intervention. This is a PC which we introduced after the draft determination.</p>	<p>n/a</p>	<p>We introduced a penalty-only incentive for late or non-delivery, and if the actual costs are lower than assumed in the company’s business plan.</p>	<p>To protect customers in the event that the company does not deliver, or is late in delivering, its new customer relationship management (CRM) system. Also, to protect customers in the event that the costs which the company incurs are less than those assumed in its business plan by returning half those costs to customers.</p>

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

Performance commitment	Reason for its removal
Household retail	
None	N/a

Table AA4.5 PCs excluded from the commentary tables because we received no representations to our draft determinations on them and we made no interventions at draft determination or through the comparative assessments

Wholesale water	Household retail
C1: Repair visible leaks – Percentage repaired within seven calendar days of the company is becoming aware	B1: Fair customer bills (Efficient debt management, % of average bill)
D2: Help support a natural healthy water environment	
E1: Contribute to our community	

Summary of ODIs

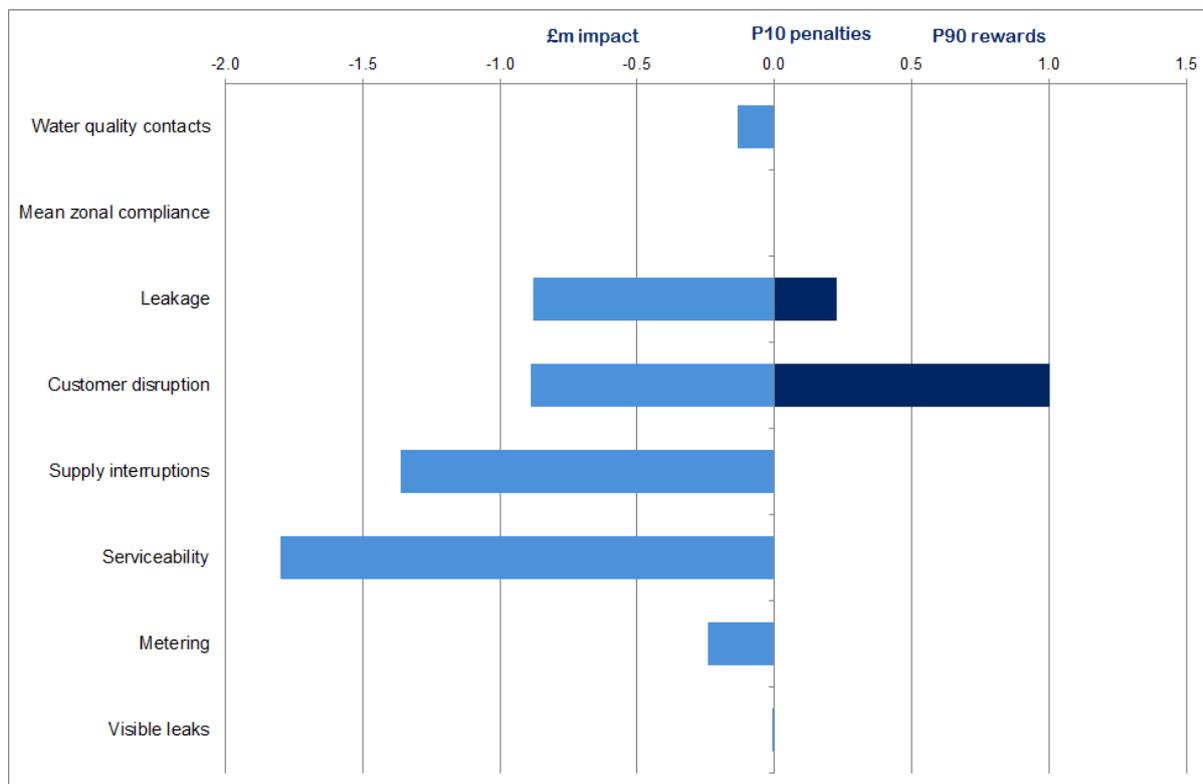
For each outcome proposed, companies were asked to identify one or more measures that would provide evidence that the outcome was being delivered. On each measure, companies had to set out the level of performance that they were committing to deliver. Companies also had to explain why they committed to the performance level chosen and explain why this represented an appropriate level of stretch (as benchmarked against an upper quartile level of performance across the sector).

Companies also had to propose ODIs. Where customers were willing to pay for higher levels of performance and companies could demonstrate that performance was at a high level relative to its peers, then the financial incentives could contain rewards for over delivery as well as penalties for under delivery. 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	2	6	4
Household retail	1	1	1
Non-household retail	0	0	0
Total	3	7	5

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 policy chapter A2, 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 policy chapter A2.

There are no specific exclusions from the cap/collar for Sembcorp Bournemouth Water.

In the remainder of this chapter, we provide the following information on each PC we are confirming as part of this final determination:

- the name and detailed definition of the PC;
- the type of incentive;
- the PC level;
- for financial incentives:
 - the limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable³; and

³ 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

- 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.

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.

PCs and ODIs in detail

Wholesale water outcome A: Safe and wholesome water

PC A1: Customer contacts: taste and appearance

Detailed definition of performance measure: Customer contacts with Sembcorp Bournemouth Water regarding appearance, taste and odour contacts per one thousand of the population served

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	Contacts/ 1,000 population	1.25	1.25	1.24	1.23	1.23	1.23
Penalty collar	Contacts/ 1,000 population		2.56	2.55	2.54	2.54	2.54
Penalty deadband	Contacts/ 1,000 population		1.31	1.30	1.29	1.29	1.29

Incentive rates

Incentive type	Incentive rate (£ million/1.00 contacts/1,000 population/year)
Penalty	-0.040

Additional details

Necessary detail on measurement units	Measured on a calendar year basis and reported internally each month. Set against the company's total population of approximately 436,000.
Frequency of PC measurement and any use of averaging	Annual
Timing and frequency of rewards/penalties	Measured on a calendar year basis and reported internally each month
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	<p>PC is to be within lower and upper performance level range regarding the company's stated measure, that is, between 2.50 and 1.23 contacts per 1,000 head of population, targeting 1.23.</p> <p>Deadband set at 1.25, reducing to 1.23 from 2017-18.</p> <p>£50,000 maximum/year scaled per 1.00 contacts implies an incentive rate of £40,000/1.00 contacts/1,000 population/year, as the range over which the penalty applies in every year is 1.25 contacts/1,000 population.</p>

PC A2: WS (WQ) regulation compliance – mean zonal compliance

Detailed definition of performance measure: Compliance with the Drinking Water Inspectorate (DWI) regulations as measured by Mean Zonal Compliance (MZC)

Incentive type: Financial – penalty only

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	99.95	99.97	99.97	100.00	100.00	100.00

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty collar	%		99.94	99.94	99.94	99.94	99.94
Penalty deadband	%		99.95	99.95	99.95	99.95	99.95

Incentive rates

Incentive type	Incentive rate (£ million/0.01%)
Penalty	0.284

Additional details

Necessary detail on measurement units	Compliance with all regulatory parameters required under the Water Supply (Water Quality) regulations (% overall compliance). This is the Drinking Water Inspectorate's measure of mean zonal compliance.
Frequency of PC measurement and any use of averaging	Monthly
Any other information or clarifications relevant to correct application of incentive	To be within the lower and upper performance levels regarding the company's stated measure and maintain the company's upper quartile position in the industry. Target compliance level set at 100.00%. Lower performance level set at 99.94%. Upper performance level set at 100.00%.

Wholesale water outcome B: Reliable water supply

PC B1: Reduce leakage

Detailed definition of performance measure: Reduction in leakage to less than or equal to 20.00 MI/d by 2020

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	21.47					20.00
Penalty collar	MI/d						22.00
Penalty deadband	MI/d						20.10
Reward deadband	MI/d						19.90
Reward cap	MI/d						17.00

Incentive rates

Incentive type	Incentive rate (£ million /0.1MI/d/year)
Penalty	-0.1154
Reward	0.0389

Additional details

Necessary detail on measurement units	The total level of leakage, including customer supply-pipe leakage, expressed in megalitres per day (MI/day). The company will round the measurement of leakage to the nearest 0.1MI/d.
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target.

Timing and frequency of rewards/penalties	A £0.1154 million penalty applies for every 0.1MI/d missed from the target of 20.0MI/d, up to a maximum of 22.0MI/d. A £0.0389 million reward applies for every 0.1MI/d achieved beyond the target of 20.0MI/d, up to a maximum of 17.0MI/d.
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	Reduce leakage from current performance to 20.00 MI/d by 2020. Lower performance level set at 22.00 MI/d by 2020. Upper performance level set at 17.00 MI/d by 2020. The company will monitor progress towards the target on an annual basis.

PC B2: Large scale interruptions

Detailed definition of performance measure: Minimise risk of large scale interruption to 12,000 properties

Incentive type: Financial – reward and penalty

Performance commitments

	Unit	Starting level	Committed performance levels				
			2014-15	2015-16	2016-17	2017-18	2018-19
PC	Props						12.0
Penalty collar	Props						0.0
Penalty deadband	Props						11.5
Reward deadband	Props						12.5
Reward cap	Props						18.0

Incentive rates

Incentive type	Incentive rate (£ million/1,000 properties)
Penalty	-0.082
Reward	0.186

Additional details

Necessary detail on measurement units	<p>Minimise risk of large-scale interruptions to 12,000 properties by March 2020 so that there is no greater risk of interruption than other properties.</p> <p>12,000 properties to benefit from the laying of a reinforcement main by 2020.</p> <p>Penalties are in place for every 1,000 properties of the 12,000 population not benefitting from this scheme.</p> <p>There are also rewards in place for over-performance set at 1,000 property intervals over the target of 12,000 up to 18,000.</p> <p>The company will monitor progress towards the target on an annual basis.</p>
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target.
Timing and frequency of rewards/penalties	<p>A £0.082 million penalty applies for every 1,000 properties not benefitting.</p> <p>A £0.186 million reward applies for every 1,000 properties benefitting over 12,000.</p>
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	The reward and penalty are broadly symmetrical in total because the penalty is spread over a greater number of properties. The reward has been smoothed to ensure that there is a consistent incentive for Sembcorp Bournemouth Water to stretch its performance. An unsmoothed incentive results in a higher incentive for lower performance levels.

PC B3: Decreasing average interruptions >3 hours

Detailed definition of performance measure: Water supply interruptions >3 hours. Calculated as minutes lost per property served. (This is the calculation used for the KPI in the Annual Return)

Incentive type: Financial – penalty only

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Min/prop	4.4	4.4	4.4	4.4	4.4	4.4
Penalty collar	Min/prop		10.3	10.3	10.3	10.3	10.3
Penalty deadband	Min/prop		6.4	6.4	6.4	6.4	6.4

Incentive rates

Incentive type	Incentive rate (£ million/minute/property)
Penalty	0.075

Additional details

Necessary detail on measurement units

Number of hours lost per property served in the year with supply interruptions greater than three hours (irrespective of whether it was planned, unplanned or caused by a third party), expressed as minutes lost per property served.

The minutes lost per property served target and associated collar and deadband have been calculated on the data for the period 2000 to 2014 using the hours of interruption > 3 hours divided by the number of properties served, expressed as minutes lost per property served.

Properties served means the number of connected properties (domestic and non-domestic) for water

	<p>supply. This includes properties that are connected but not billed (for example, temporarily unoccupied) but excludes properties that have been permanently disconnected.</p> <p>A group of properties supplied by a single connection but separately billed should be counted as multiple properties.</p>
Frequency of PC measurement and any use of averaging	Annual review of performance against target.
Any other information or clarifications relevant to correct application of incentive	<p>Penalty deadband set at 6.4.</p> <p>Penalty collar set at 10.3.</p> <p>Penalty rate set at £75,000/minute/property.</p> <p>Current performance (2013-14) is 2.0.</p> <p>The company will monitor progress towards the target on an annual basis.</p> <p>'Enhanced GSS compensation' will apply approximately £0.070 million for 2015-20.</p>

PC B4: Maintain serviceable assets

Detailed definition of performance measure: Assessment of the recent historical trend in serviceability to customers, as measured by movements in service and asset performance indicators (Ofwat methodology).

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	Serviceability category	Stable	Stable	Stable	Stable	Stable	Stable
Penalty collar	Serviceability category		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating

Penalty deadband	Serviceability category	Marginal	Marginal	Marginal	Marginal	Marginal
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Incentive rates

Incentive type	Incentive rate (£ million/category/year)
Penalty	0.225

Additional details

Necessary detail on measurement units	<p>The company's target is to remain at Stable serviceability status for customers and the environment by managing and maintaining assets such that all indicator values remain well within the control limits and oscillate around the reference level year on year.</p> <p>Ofwat KPI indicators:</p> <p>Green = Overall Improving or Stable status.</p> <p>Amber = Overall Marginal status.</p> <p>Red = Overall Deteriorating status.</p>
Frequency of PC measurement and any use of averaging	The company will monitor progress towards the target on an annual basis.
Timing and frequency of rewards/penalties	<p>The company will assess, supported by independent technical review, the overall serviceability in each sub-service and update the serviceability status as one of the following:</p> <ul style="list-style-type: none"> • Improving • Stable • Marginal • Deteriorating <p>When making the assessments the company will use Ofwat's serviceability assessment toolkit and the 2009 price review final determination, which states the reference level and control limits for each indicator.</p>
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	<p>At Deteriorating a penalty of £0.225 million applies per year per sub-service.</p> <p>The metric for the PC is designed so that a second</p>

year of Marginal would lead to a Deteriorating assessment and therefore a penalty would apply.

Potential maximum penalty over the AMP is £0.225 million x 2 (sub-services) x 5 (years) = £2.25 million. This would occur in the event that performance was Marginal or Deteriorating in 2014-15, and then Marginal or Deteriorating in each year between 2015-16 and 2019-20.

Infrastructure serviceability – reference levels and control limits

Composite index					Committed performance levels				
Sub measure	Unit	2014-15	Limits	AMP5	2015-16	2016-17	2017-18	2018-19	2019-20
					Stable	Stable	Stable	Stable	Stable
Total bursts	Nr		Ref	350	350	350	350	350	350
			High	435	435	435	435	435	435
			Low	265	265	265	265	265	265
Interruptions >12h	Nr		Ref	6	6	6	6	6	6
			High	15	15	15	15	15	15
			Low	0	0	0	0	0	0
Iron non-compliance (as 100-Mean Zonal Compliance)	%		Ref	0.19	0.19	0.19	0.19	0.19	0.19
			High	0.47	0.47	0.47	0.47	0.47	0.47
			Low	0.00	0.00	0.00	0.00	0.00	0.00
DG2 pressure	Nr		Ref	0	0	0	0	0	0
			High	19	19	19	19	19	19
			Low	0	0	0	0	0	0
Customer contacts – discolouration (nr/ 1000 population)	Nr		Ref	0.23	0.23	0.23	0.23	0.23	0.23
			High	0.46	0.46	0.46	0.46	0.46	0.46
			Low	0.00	0.00	0.00	0.00	0.00	0.00

Non-infrastructure serviceability – reference levels and control limits

Composite index					Committed performance levels				
Sub measure	Unit	2014-15	Limits	AMP5	2015-16	2016-17	2017-18	2018-19	2019-20
					Stable	Stable	Stable	Stable	Stable
Water treatment works Coliforms non-compliance (%)	%		Ref	0.07	0.07	0.07	0.07	0.07	0.07
			High	0.14	0.14	0.14	0.14	0.14	0.14
			Low	0.00	0.00	0.00	0.00	0.00	0.00
Service reservoir Coliforms non-compliance (%)*	%		Ref	0.00	0.00	0.00	0.00	0.00	0.00
			High	5.00	5.00	5.00	5.00	5.00	5.00
			Low	0.00	0.00	0.00	0.00	0.00	0.00
Turbidity (nr)	Nr		Ref	1	1	1	1	1	1
			High	2	2	2	2	2	2
			Low	0	0	0	0	0	0
Enforcement (incidents number)	Nr		Ref	0	0	0	0	0	0
			High	1	1	1	1	1	1
			Low	0	0	0	0	0	0
Unplanned maintenance (nr)	Nr		Ref	900	900	900	900	900	900
			High	1100	1100	1100	1100	1100	1100
			Low	700	700	700	700	700	700

PC B5: Metering – continue current strategy

Detailed definition of performance measure: Install 9,300 meters by 2020

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	Meters						9,300
Penalty collar	Meters						0
Penalty deadband	Meters						9,200

Incentive rates

Incentive type	Incentive rate (£/meter)
Penalty	-26.60

Additional details

Necessary detail on measurement units	The target is to continue with the company's metering strategy of installing optional meters and to have installed an additional 9,300 meters by March 2020.
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target.
Timing and frequency of rewards/penalties	One-off penalty applied at the end of the period.
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	<p>To be at the target of 9,300 by 2020.</p> <p>Penalty will be applied to every meter the company does not install out of its target of 9,300. The penalty is equal to that in the 2014 final determination cost modelling plus 10% = £26.60 per meter.</p> <p>The company will monitor progress towards the target on an annual basis.</p>

PC B6: Reducing per capita consumption

Detailed definition of performance measure: Reduce the per capita consumption (PCC) to 136 litres/head/day by March 2020

Incentive type: Reputational

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/h/d	142	142				136

Additional details

Necessary detail on measurement units	Target is to reduce the per capita consumption (PCC) to 136 litres/head/day by March 2020. 2014-15 performance is 142 litres/head/day.
Frequency of PC measurement and any use of averaging	Annual review of performance against target.
Any other information or clarifications relevant to correct application of incentive	<p>The company will evaluate its performance based on a five-year rolling average downward trend to counteract weather volatility. It will report this for independent scrutiny. By 2020 it will target the absolute number of 136 litres/head/day.</p> <p>The company will not return funds to the customers if it fails to meet the company's target as it consider that this will incentivise them to be less efficient regarding consumption. However, it will engage the Customer View group to decide on the activity required to get back on track.</p> <p>The weighted average per capita consumption will be calculated in line with Ofwat's June Return calculation which is the measure of average water use per person in an appointed water company's area.</p>

Wholesale water outcome C: Provide an excellent customer experience

PC C1: Repair visible leaks

Detailed definition of performance measure: Percentage of visible leaks being repaired within seven calendar days of Sembcorp Bournemouth Water becoming aware

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	%	77.0					85.0
Penalty collar	%						77.0
Penalty deadband	%						84.5

Incentive rates

Incentive type	Incentive rate (£ million/%)
Penalty	-0.0010

Additional details

Necessary detail on measurement units	<p>The measure is the percentage of visible leaks being repaired within seven calendar days of Sembcorp Bournemouth Water becoming aware.</p> <p>The company's target is 85% or more by March 2020.</p> <p>Penalty collar set at 77%.</p> <p>Penalty deadband set at 84.5%.</p>
Frequency of PC measurement	Annual review of progress towards March 2020 target.

and any use of averaging	The company aims to be within lower and upper performance levels (collar and deadband) by 2020. It will monitor progress towards the target on an annual basis.
Timing and frequency of rewards/penalties	85% of visible leaks that Sembcorp Bournemouth Water is made aware of should be repaired within seven working days from the time of notification to Sembcorp Bournemouth Water.
Form of reward/penalty	Revenue adjustment.
Any other information or clarifications relevant to correct application of incentive	Maximum financial penalty for 2015-20 set at £0.008 million.

Wholesale water outcome D: Environmentally sustainable operations

PC D1: Reduce energy used in water delivery

Detailed definition of performance measure: Reduce the amount of energy used to deliver water by 2020

Incentive type: Reputational

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	kWh/MI	580					530

Additional details

Necessary detail on measurement units	Reduce the amount of energy used to deliver water by 2020
Frequency of PC measurement and any use of averaging	<p>Annual review of performance towards March 2020 target.</p> <p>The company's target is to reduce the kWh used per megalitre (MI) of water delivered to 530 by March 2020. Current performance is 580. Lower performance level is 535. Upper performance level is 530.</p> <p>Target is to be within the lower and upper performance levels of 535 and 530 kWh used per MI of water delivered by 2020.</p> <p>The company will monitor progress towards the target on an annual basis.</p>
Any other information or clarifications relevant to correct application of incentive	<p>The penalty is included in the cost of power and in the carbon levy. If the target is not met there is a cumulative cost to Sembcorp Bournemouth Water on power. The cost in the final year would be approximately £0.268 million (2012-13 prices). Therefore, the total potential penalty could be around £1 million.</p>

PC D2: Help support a natural healthy water environment

Detailed definition of performance measure: Increase work to support the environment in addition to the NEP statutory obligation work

Incentive type: Reputational

Performance commitments

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

Additional details

Necessary detail on measurement units	Increase work to support the environment in addition to the NEP statutory obligation work. Include annual review.
Frequency of PC measurement and any use of averaging	There will be an annual review with the Environment Agency and Natural England in place alongside increased work supporting the environment and statutory NEP work. The company will monitor progress towards the target on an annual basis.
Any other information or clarifications relevant to correct application of incentive	

Wholesale water outcome E: Engage well with our community and customers

PC E1: Contribute to our community

Detailed definition of performance measure: Increase educational visits to schools, and working days for volunteer and charity work

Incentive type: Reputational

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Days	84					175

Additional details

Necessary detail on measurement units	Increase educational visits to schools and working days for volunteer and charity work
Frequency of PC measurement and any use of averaging	The company's target is to increase the working days spent on educational visits to schools and volunteer and charity work to 175 by March 2020. Current performance is 84 working days. The company will monitor progress towards the target on an annual basis.
Any other information or clarifications relevant to correct application of incentive	The company will pay £100/day (indexed annually with RPI) to a local charity of the Customer View group's choice for the number of days fewer than the company's target.

Household retail outcome A: Provide an excellent customer experience

PC A1: Service incentive mechanism (SIM)

Detailed definition of performance measure: Improve our customers' experience measured through the service incentive mechanism score. Our target is to maintain our position of >1 standard deviation above the industry average

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	Average SIM score	87					89

Additional details

Necessary detail on measurement units	Increase service incentive mechanism score to an average greater than or equal to 89 by 2020 in order to maintain a position greater than one standard deviation above the industry average.
Frequency of PC measurement and any use of averaging	<p>Average SIM score greater than or equal to 89 by 2020. The company will monitor progress towards the target on an annual basis.</p> <p>The company will measure performance using Ofwat's confirmed methodology with effect from 1 April 2015. The company expects this to be:</p> $\{(S - LS) / (HS - LS)\} \times WS + \{[1 - ((C - CL) / (CH - CL))]\} \times WC$ <p>where:</p> <p>S = satisfaction score achieved (qualitative survey); LS = satisfaction minimum (1); HS = satisfaction maximum (5); WS = survey weighting (75); C = quantitative composite measure;</p>

	<p>CL = composite measure minimum (0); CH = composite measure maximum (600); and WC = quantitative composite measure weighting (25). Quantitative composite measure $((\text{All unwanted contacts}) + (\text{written complaints} * 5) + (\text{escalated written complaints} * 100) + (\text{CCWater investigated complaints} * 1,000)) / (\text{connected household properties} / 1,000)$</p>
Any other information or clarifications relevant to correct application of incentive	<p>There is a penalty of up to 1% of turnover. There is a reward of up to 0.5% of turnover.</p>

PC A2: New customer relationship management (CRM) system

Detailed definition of performance measure: Delivery of our new customer relationship management (CRM) system

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	£ million cumulative depreciation	0	N/a	N/a	N/a	N/a	1.18
		Delivery	Delivery	Delivery	Delivery	Delivery	Delivery
Penalty 1 collar	£ million cumulative depreciation		N/a	N/a	N/a	N/a	0.00
Penalty 1 deadband	£ million cumulative depreciation		N/a	N/a	N/a	N/a	1.10

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty 2 collar			Non-delivery	Non-delivery	Non-delivery	Non-delivery	Non-delivery
Penalty 2 deadband			Non-delivery	Non-delivery	Non-delivery	Non-delivery	Non-delivery

Incentive rates

Incentive type	Performance levels		Incentive rate
	Lower	Upper	
Penalty 1 – cost differences	0		£0.50 per £1 of cumulative depreciation
Penalty 2 – late or non-delivery	Non-delivery in 2015-16, 2016-17, 2017-18, 2018-19 or 2019-20	Non-delivery in 2015-16, 2016-17, 2017-18, 2018-19 or 2019-20	£0.17 million per year of non-delivery

Additional details

Necessary detail on measurement units	<p>Under the ACTS methodology the company will recover the forecast depreciation on its new Customer Relationship Management (CRM) system based on the projected spend in our business plan. This ODI protects customers by returning half of any funding for this scheme (via payments for depreciation) back to customers if the out-turn costs of the programme are lower than assumed in our business plan. It allows the company to retain half of any excess funding so that there is an incentive for it to make cost savings on the CRM system and to share them with customers.</p> <p>This ODI also penalises the company for not delivering the CRM system on time by 31 January 2015.</p> <p>The calculation of the performance measure is the cumulative depreciation charge allowed for in price limits for the delivery of the company’s new CRM system.</p> <p>“Delivery” is defined as 75% or more of Sembcorp Bournemouth Water’s customers being handled through the new CRM system.</p>
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	The company will include this specific ODI to be reported in line with its other ODIs to our Customer View Group for challenge at least on an annual basis.
Frequency of PC measurement and any use of averaging	Annual review of performance against target.
Timing and frequency of rewards/penalties	<p>Assessment of penalty 1 made on 2019-20 performance.</p> <p>Assessment of penalty 2 will be made annually from 2015-16 onwards.</p> <p>The measurement of non-delivery for 2015-16 will commence from 1 April 2015 on a pro-rata basis, that is relating to the portion of the year not delivered. Penalties are payable during the 2020-25 price control period.</p>
Form of reward/penalty	Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	<p>Penalty rate 1 applies at the end of 2019-20. Penalty rate 1 returns half of any funding for the CRM system (via payments for depreciation) back to customers if the out-turn costs of the programme are lower than assumed in the company's business plan.</p> <p>Penalty rate 2 applies cumulatively, that is if the improved CRM system is not delivered until 1 June 2018 a penalty of £0.17 million applies three times for non-delivery in each of 2015-16, 2016-17 and 2017-18 and pro rata for 1 April 2018 to 1 June 2018.</p> <p>Both Penalty rate 1 and Penalty rate 2 can apply at the same time. For example, if the company did not spend anything to implement the new CRM system in 2015-16 to 2019-20 the company would be required to pay all the funding in price limits for cumulative depreciation back to customers (Penalty 1) and the company would be required to pay five times Penalty rate 2 to customers for non-delivery.</p>

Household retail outcome B: A financially sustainable business

PC B1: Fair customer bills

Detailed definition of performance measure: Efficient debt management: % of average bill

Incentive type: Reputational

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%						Between 3.00% and 3.75%

Additional details

Necessary detail on measurement units	Fair customer bills (efficient debt management: % of average bill)
Frequency of PC measurement and any use of averaging	<p>The company's target is to maintain debt management costs at an average percentage of between 3.00% and 3.75% over 2015-20. The company will monitor progress towards the target on an annual basis.</p> <p>Calculation = [Household outstanding revenue collection opex + household revenue written off + (household revenue outstanding x 5% bank base rate)] / Number of households billed.</p> <p>Expressed as a percentage of the average bill.</p>
Any other information or clarifications relevant to correct application of incentive	Customer View Group to review and impose sanctions if deemed appropriate.

Outcome delivery and reporting

In policy chapter A2, we outline a framework against which we have assessed Sembcorp Bournemouth Water’s proposals in relation to outcome delivery and reporting.

The table AA4.7 below summarises Sembcorp Bournemouth Water’s proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach.

Table AA4.7 Sembcorp Bournemouth Water’s proposals for outcome delivery and reporting

Sembcorp Bournemouth Water’s proposals	Our assessment
<p>Taken from page 2 onwards of data definitions for outcomes and PCs:</p> <p>‘To hold us to account, in discussion with our Customer Challenge Group, we are creating an independent review body which we refer to as the Customer View group. Following the structure laid out here this group will review actual performance against targets and recommend to the Board what pain, or gain if appropriate, should be shared with the customers, as well as when and how. At least once every year we will report our performance against agreed PCs to the Customer View group. The group will review the performance and make any recommendations to our Board through the independent non-executive director that sits on the group.</p> <p>The PCs will be reported on each year, published on our website and in our ‘How we’re doing’ document, and be part of the Customer View group’s review process.’</p>	<p>In our methodology statement, we set out our expectation that companies should demonstrate that their proposed PCs can be measured and recorded consistently and that they will have the appropriate governance and quality assurance processes in place to achieve this. We also expect companies to be transparent with customers about their performance against their outcomes and commitments.</p> <p>Sembcorp Bournemouth 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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