

December 2014

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



OFWAT

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Overview

This appendix sets out the details of the final determination of price controls that are specific to South West Water.

An enhanced final determination

We awarded South West Water enhanced status after the completion of our risk-based review (RBR), which assessed the quality of business plans companies submitted for the 2014 price review. Enhanced status means the company produced a high-quality business plan that stood apart from the other companies. For example, in its business plan South West Water set out a Board pledge to share the benefits of success fairly between customers and investors. In line with this, it proposed an independently monitored and transparent performance-sharing framework for 2015-20 called 'WaterShare'. This framework would involve the company publishing a scorecard on an annual basis that summarises its performance and would allow for the sharing of net benefits with customers in a timely manner. It also means that we have had to make minimal changes to the company's plan to protect customer's interests and act in line with our other statutory duties.

Enhanced companies gain the reputational advantages of enhanced status and a fast track through the price review process. As we said in '[Setting price controls for 2015-20 – decisions on enhanced companies and next steps](#)' (our 'pre-qualification decision document'), these companies also receive financial benefits, through an initial financial award and access to enhanced cost performance menus, reflecting the benefits of high-quality business plans to current and future customers. South West Water chose to recover its initial reward, of £11 million, through an addition to its 2015-16 regulatory capital value (RCV), though it proposes to share up to half of this with customers through reinvestment to further improve services.

Enhanced companies also have the benefit of the 'do no harm' principle, which ensures it will not be any worse off for being categorised as enhanced. Enhanced companies also received an earlier draft determination.

We explain the 'do no harm' principle in more detail in table A4 in appendix 2 of our pre-qualification decision document. In line with the 'do no harm' principle, the company is not subject to the reduction in the allowed return. A reduction in the allowed return of 0.1 percentage points has a value of £14 million to the company. The company is also protected from changes driven by new information relevant to the wider industry framework.

Enhanced companies' draft determinations have been updated to reflect new information since the December business plan in relation to their own costs of delivering its current and future

performance commitments and for any changes in 2010-15 performance. These changes are not covered by the 'do no harm' principle.

These protections and incentives produce benefits for both the companies and customers. They form an important part of the incentive framework; encouraging companies to produce high quality business plans based on customer priorities, both at this review and in the future.

Changes since draft determination

We published '[Draft price control determination notice: company-specific appendix – South West Water](#)' (the 'draft determination' for South West Water) on 30 April 2014, which was earlier than other companies.

In June and October 2014, South West Water made technical representations on a small number of areas of its draft determination – including on the wholesale total expenditure (totex) profile. It also included additional evidence on two wholesale water special cost factor claims. We have not accepted the company's representations on all issues but we do not consider these differences to be material when taken in the round.

The customer challenge group (CCG), Environment Agency and the Consumer Council for Water (CCWater) representations were all broadly supportive of our draft determination, though they did raise some specific issues. For example, the Environment Agency commented on some of the company's performance commitments. The CCG supported the company's wholesale water special cost factor claims. And CCWater considered we should apply any reduction in the allowed return to enhanced companies. We respond to these comments in this document and in the relevant policy chapters.

We summarise our final determination for South West Water in section A1: 'Enhanced final determination – at a glance'.

About this document

The remainder of this document sets out our final determination in more detail¹ 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):

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.

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

As we explained in our final methodology statement, these separate controls are binding, confirmed through the modifications already made to the price setting elements of companies' licence conditions. This means that the companies cannot recover more revenue than allowed under each specific price control and cannot transfer costs between the controls. The revenue allowance for each price control is determined by the costs specific to that particular price control. This provides the companies with more effective incentives. It also helps to avoid distortion to the non-household market, which will be fully open to competition from 2017, as provided for in the Water Act 2014.

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

- the responses that we have received to our draft determinations and any consequential adjustments that we have made;
- the outcomes for the company to deliver and associated outcome delivery incentive (ODI);
- the efficient costs that we consider the company can achieve;
- the adjustments we are making to the wholesale water and wastewater price controls to reflect the company's performance in 2010-15;
- the allowed return for the wholesale water and wastewater controls, and the retail household and non-household net margins;
- the return on regulatory equity (RoRE) range;
- the financial ratios under the notional capital structure; and
- the uncertainty mechanisms that form part of each price control.

Where appropriate, we set out the assumptions we have made to arrive at the allowed revenue for each price control.

As set out in '[Policy chapter A1 – introduction](#)' ('policy chapter A1'), the final determination protects customers in accordance with statutory duties 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.

Implementing these price limits

South West 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 South West Water's licence and the Water Industry Act 1991. We consider that South West 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 2014 price review (PR14) reconciliation.

In [IN 14/15: '2014 price review – timetable for setting charges for 2015-16 and making menu choices'](#) we set out the requirement for companies to notify us of their menu choices by 16 January 2015. We will make any adjustment to the company's allowed revenues that result from its menu choice as part of the price review in 2019 (PR19). A company's menu choice will be influenced by our decisions in this final determination. We confirm in annex 4 of this document a commitment that the ODIs will be recalibrated in the true up calculations, based on a sharing rate that is consistent with the company's menu choice. To facilitate this, we expect the company to publish its ODIs with the cost sharing rate that is implied by its menu choice on 16 January 2015. This will allow inclusion of the recalibrated ODIs within the framework for reporting and assurance from 1 April 2015, which we will publish on 9 February 2015. We require companies' Boards to provide assurance that the recalibrated ODIs conform with the final determination and are consistent with their menu choice. Any modifications should be confined to correctly adjusting the incentive rates for the difference between the final determination assumption on the cost sharing rate and the rate associated with their final menu choice.

This price determination sets out the allowed revenues that South West Water can recover from its customers in the period 2015-20. South West 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 their charges schemes.

A1 Enhanced final determination – at a glance

This chapter provides a summary of the enhanced final determination for South West 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, RoRE and financeability ratios. We also summarise the minor changes we have made to the company's draft determination.

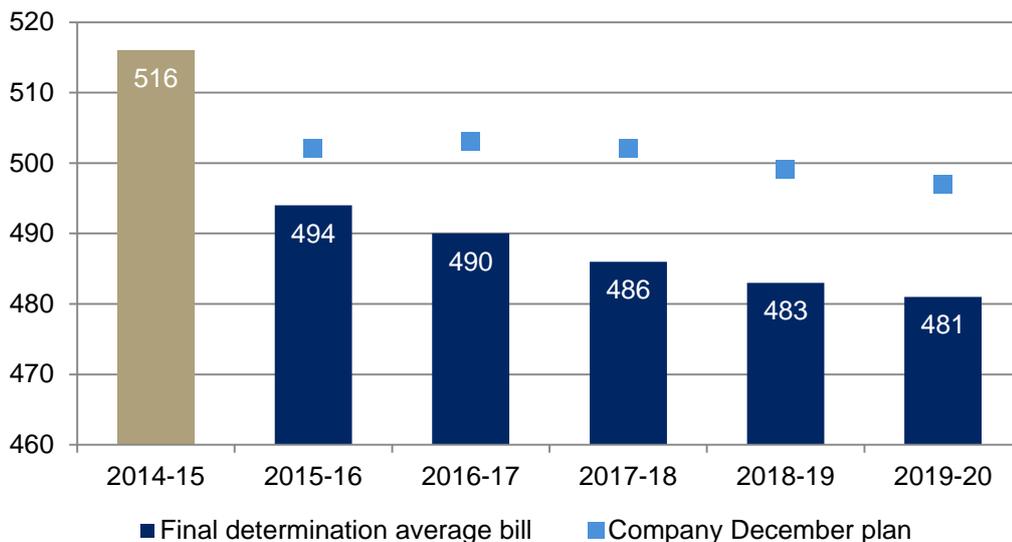
Combined average household bill (£)

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 £481, which is 7% lower than current average bill levels of £516. The difference between the company's December plan and our final determination is the result of the actions the company took to qualify as an enhanced company, including accepting [‘Setting price controls for 2015-20 – risk and reward guidance’](#) (our ‘risk and reward guidance’). This represents a cumulative saving of £69 for the average customer over the 2015-20 period.

As South West Water is an enhanced company, our final determination is based substantially on its revised plan. Consistent with the company's enhanced status, we have amended the bill profile for our final determination to target the profile proposed by the company in its June information update.

Figure A1.1 Average bills



Note:

The comparative bills from 'Company December plan' is based on the data submitted in the 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 its March business plan update.

The outcomes committed to by South West Water

South West Water has committed to delivering outcomes that reflect its customers' views. These are supported by 42 associated performance commitments that identify the company's committed level of performance under each outcome. For 25 of these performance commitments the company is subject to associated financial ODIs whereby it will incur a penalty for performance worse than its commitments, but for some can earn a reward for performance better than its commitments during the period from 2015 to 2020.

The table below sets out the outcomes proposed by South West Water. These outcomes reflect the priorities of customers set out in research and engagement with the CCG. We have accepted these outcomes. Details of the types of incentives and level of performance commitments associated with these outcomes are set out in annex 4.

Wholesale water	Wholesale wastewater
Clean, safe and reliable supply of drinking water Available and sufficient water resources Resilience in extreme conditions Responsive to customers Protecting the environment Fair charging	Reliable wastewater service Responsive to customers Protecting the environment Benefiting the community
Retail	
Responsive to customers	

Wholesale water	Wholesale wastewater
Fair charging	

Allowed costs and revenue for South West Water

As an enhanced company, South West Water has the benefit of the ‘do no harm’ principle and so it is protected from reductions in the level of the cost of capital and the retail margins. Items related to new information since the December business plan on the company’s own costs of delivering its current and future performance commitments, as opposed to new information relevant to the wider industry framework, are not covered by the ‘do no harm’ principle, so these have been updated since the draft determination where relevant.

The table below shows the wholesale totex we have allowed over the period from 2015 to 2020. The final determination allows South West Water to receive revenues of £2,290 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 £26.9 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	Wastewater
Totex 2015-20 total (£m)	706.8	877.6
Allowed wholesale revenue 2015-20 (£m)	919.8	1,207.1
Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	143.6	
Margin (%)	1.00%	2.50%
Retail allowed revenue (£m)	163.2	26.9
Average bill per household customer – retail component only (£)	45	

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

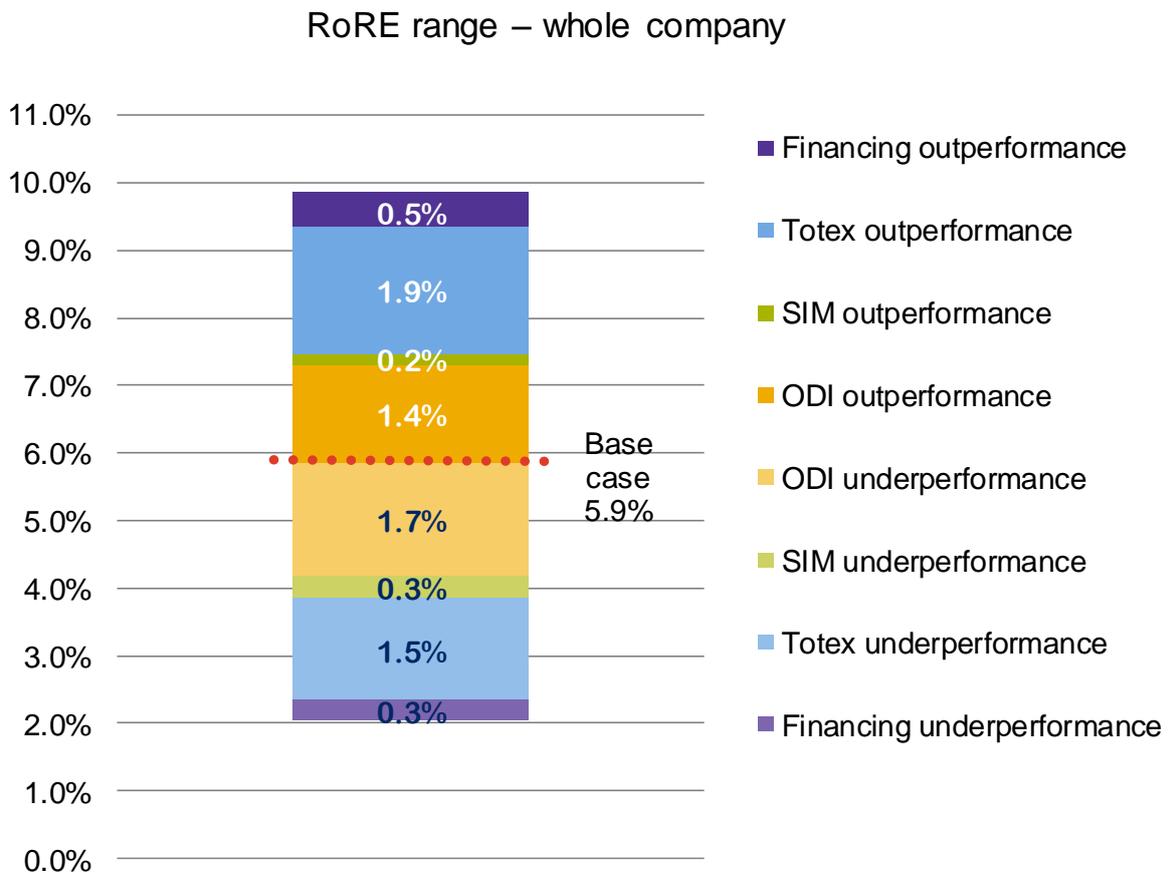
South West Water has estimated the range of RoRE that it could earn dependent on its performance and external risk factors over the price control period. The RoRE range reflects the company’s views and is based on an efficient company with the notional capital structure². We have identified the RoRE impact separately for ODIs, totex performance, financing and the

² The notional capital structure is the capital structure that reflects Ofwat’s assumption of an appropriate level of gearing to use in determining the allowed WACC.

service incentive mechanism (SIM). We note that South West 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).

The approach to calculating the RoRE range is set out in ‘Policy chapter A7 – risk and reward’ (‘policy chapter A7’).

Figure A12 RoRE range – whole company



Source: Our calculations based on information from South West Water.

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

Our calculation of notional financeability ratios

Ofwat has a statutory duty to secure that a company is able to finance the proper carrying out of its functions. We interpret this financing duty as requiring that we ensure that an efficient company with a notional capital structure is able to finance its functions. A company’s actual capital structure is a choice for the company and it bears the risk associated with its choices. An

efficient company is assumed to be able to deliver its plans based on the expenditure allowance in our final determination.

South West 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 minor updates and changes to the company's plan, are set out in section A6 and summarised on a 5-year average basis below.

We have assessed this final determination for South West Water to be financeable on a notional basis.

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover (ICR)	3.08
Adjusted cash interest cover ratio (ACICR)	1.53
Funds from operations (FFO)/debt	9.74%
Retained cash flow/debt	7.11%
Gearing	62.04%
Dividend cover (profit after tax/dividends paid)	1.43
Regulatory equity/regulated earnings for the regulated company	17.56
RCV/earnings before interest, taxes, depreciation and amortisation (EBITDA)	10.40

Summary of changes to the draft determination

In reaching our enhanced final determination, we have made only minor changes to our draft determination, which as South West Water is an enhanced company was based largely on its own business plan. In doing so, we have considered carefully the representations we have received on the draft determination and taken account of the most up-to-date information available where appropriate. We summarise the changes in the table below.

The changes we have made are consistent with the 'do no harm' principle we set out for enhanced companies in our pre-qualification decision document.

Outcomes	Wholesale costs
<ul style="list-style-type: none"> We have made three minor changes to the company's outcomes – two are to clarify performance measures but we have also made a minor adjustment to one deadband. The company is not affected by our comparative assessment of outcomes since we continue to consider that it is important to accept the enhanced companies' business plans in the round. 	<ul style="list-style-type: none"> We have reprofiled South West Water's totex and revenue to reflect its business plan profile. We have updated our view of totex to reflect revised cost allocations from the company and updates to our models. The company's proposed totex is now 8% under our final determination threshold for water, compared to 7% in the draft determination and 0.3% above it for wastewater, compared to 0.2% under in the draft determination.
Retail	Reconciling 2010-15 performance
<ul style="list-style-type: none"> We have used 2013-14 prices to set both the household and non-household retail control. We have accepted the company's updated cost allocation. We have set out a non-household retail control that has scope for review in 2015-20. We have updated our view of the industry ACTS. 	<ul style="list-style-type: none"> We have updated our assessment to reflect the latest information on 2013-14 and 2014-15 performance and to correct minor errors. Overall, we have changed the company's proposed revenue adjustment by £0.7 million (in its favour) and its proposed RCV adjustments by £4 million (also in its favour).
Risk and reward	Financeability and affordability
<ul style="list-style-type: none"> In line with the 'do no harm' principle, the company is not subject to the reduction in the allowed return. 	<ul style="list-style-type: none"> Consistent with South West Water being an enhanced company, we have adjusted its pay as you go (PAYG) rate, in line with the company's preference, so that the final determination bills match those it set out in its June information update.

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.
- [‘Policy chapter A8 – financeability and affordability’](#) (‘policy chapter A8’).

Table A2.1 lists the representations we have received that are specific to South West 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 South West Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	South West Water Environment Agency CCWater	Section A2.2.1 and annex 4
Outcome delivery and reporting	None	Section A2.2.2 and annex 4

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Calculating allowed wholesale water expenditure	South West Water CCG	Section A2.3.1 and Annex 1
Calculation of revenues: PAYG and RCV run-off	None	Section A2.3.2 and A6.5
Cost of capital	CCWater	Section A2.3.3
Reconciling 2010-15 performance	South West Water CCWater	Annex 3
Uncertainty mechanisms	None	Section A2.4

A2.2 Company outcomes, performance commitments and delivery incentives

A2.2.1 Outcomes, performance commitments and incentives

We summarise the outcomes, performance commitments and ODIs for the wholesale water control for South West Water in table A2.2 below.

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

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
Clean, safe and reliable supply of drinking water	Compliance with water quality standard (%)	Financial – penalty only	None
	Taste, smell and colour contacts (number/1,000 population)	Financial – reward and penalty	None

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
	Asset reliability (pipes)	Financial – penalty only	None
	Asset reliability (process)	Financial – penalty only	None
	Duration of interruptions in supply (hours/property)	Financial – reward and penalty	None
Available and sufficient water resources	Water restrictions placed on customers (number)	Financial – reward and penalty	None
	Ability to move water around the network	Future measure	None
	Leakage levels (megalitres a day, Ml/d)	Financial – reward and penalty	None
	Time taken to fix significant leaks (days)	Reputational	None
	Security of supply index	Reputational	None
Resilience in extreme conditions ¹	Supplies interrupted due to flooded company sites (number/year > 24 hours)	Financial – reward and penalty	None
Responsive to customers	Operational customer contacts resolved first time (%)	Financial – reward and penalty	None

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
Protecting the environment	Sustainable abstractions (EA/WFD classification)	Reputational	We require South West Water to adopt the Environment Agency’s new water scarcity definitions or to provide a reconciliation between the definition used for the incentive and any subsequent definitions the Environment Agency introduces.
	Sustainable abstractions (EA water stress status)	Financial – penalty only	None
	Catchment management (acres)	Reputational	None
	Catchment management (number of farms)	Reputational	None
	Pollution incidents – category 1 and 2 (number)	Financial – penalty only	None
	Pollution incidents – category 3 and 4 (number)	Financial – penalty only	None
	Operational carbon emissions (ktCO ₂ e)	Reputational	None
	Energy from renewable sources (%)	Reputational	None
Fair charging	Customers paying a metered bill	Financial – penalty only	None

Note:

1. The company will also track its performance against this outcome through measures of service reliability and interruption used for other outcomes, including those applying to other controls.

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

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

As South West Water is an enhanced company, the outcomes that it proposed are those which it will need to deliver over the next 5 years. We have made only a minor change for our final determination and this is summarised in table A2.2 above.

For the enhanced companies following the RBR we had relatively high confidence in the business plans and the proposed outcomes and performance commitments (PCs) and outcome delivery incentives (ODIs). On this basis, we have accepted the proposals with relatively minor adjustments after draft determinations to reflect feedback from stakeholders such as the Environment Agency. The determinations have not been changed to reflect the comparative analysis applied to non-enhanced companies, since we continue to consider that it is appropriate to accept the enhanced companies' business plans in the round. However, South West Water has recognised that even though its financial incentives are not being changed, it faces significant reputational incentives to improve its performance in areas where it is not yet delivering upper quartile performance, especially in the latter years of the price control.

While we have not intervened in relation to our comparative assessment of outcomes, South West Water has indicated that it will have regard to upper quartile performance in anticipation of its 2019 price determination.

As an enhanced company, South West Water gained its draft determination earlier than all non-enhanced companies, giving it additional certainty and allowing it to focus on delivery of these outcomes for its customers.

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

A2.2.2 Outcome delivery and reporting

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

A2.2.3 Licence modification

Following our draft determinations in August, South West Water expressed a desire for price controls to be adjusted within the control period to take account of rewards or penalties for selected performance commitments. Under the current licence the adjustment for companies will occur at the end of the price control period (either as an RCV or revenue adjustment to future price controls).

Anglian Water and Severn Trent Water also requested the possibility of in-period changes to price controls to take account of rewards or penalties for some of their performance commitments. The three companies were only seeking in-period changes for ODIs which would result in a revenue adjustment, as opposed to an RCV adjustment.

Following dialogue with South West Water, Anglian Water and Severn Trent Water, we are proposing a draft licence modification that would allow in-period adjustments to the level of price controls in relation to selected performance commitments.

Our proposed licence modification for these three companies is set out in ['Consultation under section 13 of the Water Industry Act 1991 on proposed modification to condition B of Anglian Water Services', Severn Trent Water's and South West Water's licences'](#) (our 'section 13 consultation').

The wholesale water performance commitments that would be covered by the licence modification are those notified to South West Water in this document as being eligible for in-period changes. These are as follows:

- compliance with water quality standard;
- taste, smell and odour contacts;
- water restrictions placed on customers (penalty payments only);
- leakage levels;
- operational customer contacts resolved first time;
- pollution incidents (category 1 and 2); and
- pollution incidents (category 3 and 4).

We set out the wholesale wastewater performance commitments that would be covered by licence modification in section A3.2.1.

South West Water's business plan contained a Board pledge to share the benefits of success fairly between customers and investors. In line with this, it proposed an independently monitored and transparent performance sharing framework for 2015-20 called 'WaterShare' that allows for the sharing of net benefits with customers in a timely manner. The company's framework operates at the appointee level and takes account of the company's overall position in relation to gains and losses against the final determination before returning benefits to customers. Its business plan also contained a Board pledge that price rises would be below inflation to 2020.

The proposed licence modification for South West Water will operate within this context. This means that any in-period outcome delivery rewards (which could increase customers' bills) and any outcome delivery penalties (which could decrease customers' bills) should be considered in the context of the net gains or losses between customers and investors and the upward impact on customers' bills.

The company will only be able to increase customers' bills above the price controls we have set for 2015-20 to claim outcome delivery rewards if it accepts our proposed modification.

A2.3 Calculating the wholesale water price control

A2.3.1 Calculating allowed wholesale water expenditure

The cost of delivering wholesale water and wastewater services is a major driver of customer bills, comprising more than 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.

In its business plan, South West Water proposed a level of wholesale water totex that was below our view of costs and which we consider to be efficient. There are mechanisms to share out- or under-performance with customers in relation to wholesale costs, including the use of a menu. One of the financial benefits of being an enhanced company is access to an enhanced menu with enhanced cost sharing rates. This incentivises companies to deliver efficiently-costed business plans, which in turn benefits customers.

Our approach to determining efficient wholesale expenditure is set out in policy chapter A3. This includes information on the enhanced menu and sharing rate that applies to South West Water as an enhanced company.

The company proposed wholesale water totex of £684 million over 2015-20 (versus the £686 million proposed ahead of its draft determination). This is 8% below the final determination threshold (post additions) of £741 million. Table A2.3 below notes the comments that we have received that are specific to this aspect of the wholesale water control of South West Water and our response.

Table A2.3 Representations specific to the wholesale water totex for South West Water

Respondent	Summary of comment	Ofwat response
South West Water	The company provided further evidence on its special cost factor claims for its catchment management programme 'Upstream Thinking' (which we assessed within Nation Environment Programme (NEP) drinking water protected areas) and raw water deterioration.	We have not made an adjustment for these schemes, though we consider our cost thresholds should be sufficient for the company to carry out efficient activity in these areas. We did not make an adjustment, as the company did not demonstrate the scheme was cost beneficial (raw water deterioration), or that the costs were robust (NEP drinking water protected areas).
South West Water	The company suggested adjusting the application of efficiencies to pension deficit costs.	We have corrected for the minor error in the application of efficiencies. Consistent with IN 13/17, we have continued to apply the level of efficiencies as at the 2009 price review (PR09).
South West Water	The company suggested we should retain the totex profile from its business plan.	Consistent with our default approach to other companies, we have reprofiled the company's totex and revenue to reflect its business plan profile.
CCG	The CCG supported the reprofiling of the company's totex expenditure and adjusting our view of costs for the 'Upstream Thinking' scheme.	See responses set out above.

The wholesale water allowed expenditure for South West 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](#).

We have adapted our final determination threshold by using the projections of explanatory variables for the water wholesale service provided in the company plan as inputs to our cost models. This is on the basis that the two enhanced companies submitted high quality business plans and so we have relatively high confidence that these cost driver projections are aligned with the companies' delivery to customers.

In South West Water's draft determination we used our own profile of the company's wholesale water totex. In line with the 'do no harm' principle, and consistent with the default approach to all other companies, for the final determination we have used the company's totex profile.

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						741.3
Costs excluded from menu	9.6	9.5	9.5	9.5	9.5	47.8
Menu cost baseline ¹	140.2	147.6	148.0	132.1	125.6	693.5
Company's view of menu costs ²						634.8
Implied menu choice						91.5
Allowed expenditure from menu	137.2	144.4	144.8	129.3	123.0	678.8
Costs excluded from menu	9.6	9.5	9.5	9.5	9.5	47.8
Total allowed expenditure ³	146.9	154.0	154.4	138.9	132.5	726.6
Less pension deficit repair allowance	4.0	4.0	4.0	4.0	4.0	19.8

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Totex for input to PAYG	142.9	150.0	150.4	134.9	128.5	706.8

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 A6.5, we discuss financeability at an appointee (whole regulated company) level. In this section, we also discuss any representations that we have received that are specific to South West Water's PAYG, RCV run-off and financeability and our response to those representations.

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 enhanced final determination. It reflects adjustments we have made to the PAYG rates, with the company's agreement, to smooth out the impact of the minor changes from the draft determination and ensure that the 2015-20 final determination bills match those proposed by the company. This is consistent with South West Water being an enhanced company.

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 South West Water's wholesale water PAYG rates

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	142.9	150.0	150.4	134.9	128.5	706.8
PAYG (%)	62.4%	57.6%	54.3%	59.4%	62.2%	59.2%
Resulting PAYG (£m)	89.1	86.5	81.6	80.2	80.0	417.4

Note:

The figures in this table reflect our change in PAYG rates as described in section A6.5 on financeability.

Table A2.6 South West Water’s wholesale water RCV run-off (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	44.4	42.7	41.1	39.6	38.1	206.0
RCV run-off of totex additions	1.0	3.3	5.8	8.2	10.2	28.6
Total RCV run-off	45.4	46.0	47.0	47.8	48.4	234.6

Note:

The figures in this table reflect a run-off rate of 3.72% for the RCV as at 31 March 2015 and 26 years for the totex additions to the RCV over 2015-20. We have arrived at this figure by averaging the company’s annual asset life figures.

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 weighted average cost of capital (WACC) 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 allowed return for both wholesale water and wastewater services based on market evidence, which at the time was of 3.7%. The company accepted this guidance as a condition of its enhanced categorisation. As set out in policy chapter A7, based on the latest market evidence for the cost of new debt we have set the wholesale allowed return at 3.6% for non-enhanced companies.

As South West Water is an enhanced company, it is protected against downward adjustments to the cost of capital by the ‘do no harm’ principle. This protection is an important part of the incentive framework; encouraging companies to produce high quality business plans. A reduction in the allowed return of 0.1% has a value of £14 million to the company. However, we note that the company’s customers could share in any benefit from a reduction in the cost of new debt we have assumed in the final determination through its voluntary WaterShare mechanism.

South West Water’s wholesale allowed return is therefore 3.70%. This results in a return on capital of £227 million over 2015-20.

CCWater considered in its representation that we should apply any reduction in the allowed return from 3.7% to enhanced companies. As set out above, in line with our

do no harm principle we have not applied the reduction in the allowed return to enhanced companies. However, we note that the company's customers could share in any benefit from a reduction in the cost of new debt through its voluntary WaterShare mechanism.

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. It also sets out the wholesale water element of the initial reward to the company as a result of it achieving enhanced status. In April, the company chose to receive the reward through an addition to its 2015-16 RCV. The company proposed to share up to half of the award with customers through re-investment to further improve services.

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 South West Water's wholesale water opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	1,208.4
Land sales ¹	-1.2
Adjustment for actual expenditure 2009-10 ²	10.4
Adjustment for actual expenditure 2010-15 ³	-29.9
Net adjustment from logging up and logging down ^{3,4}	0.0
Adjustment for shortfalls ^{3,4}	0.0
Adjustment for serviceability shortfalls ⁵	0.0
Enhanced reward ⁶	5.2
Other adjustments ⁷	0.0
Opening RCV 1 April 2015	1,192.9

Notes:

1. Land sales adjustment is set out in table AA3.17.
2. 2009-10 actual expenditure adjustment is set out in table AA3.17.
3. A component of the capital expenditure incentive (CIS) adjustment as set out in table AA3.15.
4. The net adjustment from the change protocol is set out in table AA3.8.
5. The serviceability shortfall assessment is set out in table AA3.15.
6. The sum of the wholesale water and wastewater enhanced rewards in table AA3.17 does not match the £11m set out in the overview or draft determination as that figure was in 2012-13 year end prices rather than 2012-13 year average prices
7. Other RCV adjustments are set out in table AA3.17.

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

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	1,192.9	1,201.3	1,218.8	1,240.6	1,247.5
RCV additions (from totex)	53.8	63.6	68.8	54.8	48.5
Less RCV run-off	45.4	46.0	47.0	47.8	48.4
Closing RCV	1,201.3	1,218.8	1,240.6	1,247.5	1,247.7
Average RCV (year average)	1,197.1	1,210.1	1,229.7	1,244.1	1,247.6
Return on capital	44.3	44.8	45.5	46.0	46.2

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 the final determinations in 2009 we have made adjustments at this price review (PR14) to 2015 to 2020 revenues and the RCV to take account of company performance in the 2010 to 2015 period.

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

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale water services to reconcile performance in 2010-15 in December 2013. We and the company have made slight adjustments to these based on the identification of minor errors and on updated information for 2013-15 not available when we made our draft determination in April. As a result, the revenue adjustments for wholesale water have changed from -£0.9 million to -£0.6 million. We summarise these adjustments 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 changes in this area further in annex 3.

The changes we have made in the final determination in reconciling the company’s 2010-15 performance result from including updated actuals for 2013-14 and forecasts for 2014-15.

When making this final determination we do not have the full information on companies’ performance in 2014-15. We set out in [‘Setting price controls for 2015-20](#)

– [further information on reconciling 2010-15 performance](#)’ that we would reconcile for the revenue correction mechanism (RCM), change protocol and serviceability in 2015, and in 2016 for the capital expenditure incentive scheme, when we have the company’s actual performance for 2014-15. In carrying out this reconciliation we will take a proportionate approach (for example, applying materiality thresholds where appropriate) to making adjustments for company’s actual performance and implement these changes at the next wholesale price control review in 2019.

Table A2.9 South West Water’s wholesale water revenue adjustments to reflect 2010-15 performance (£ million)

Area	Change to draft determination	Total adjustment 2010-15 (post updates)		
		Company view	Draft determination	Final determination
SIM	We have updated the calculation with the company’s latest predicted turnover for 2014-15.	-5.6	-5.6	-5.4
RCM	Our final determination reflects the company’s updated RCM adjustments following updates to 2013-14 actuals and 2014-15 forecasts. We have included our view of the final determination 2009 (FD09) assumptions and used the out-turn financial year average RPI and number of households billed as submitted in the company’s business plan instead of what the company has submitted in its RCM calculations. Combined, the value of our adjustment is less than £0.1 million of revenue compared to the company’s proposal.	5.8	7.3	5.8
Opex incentive allowance (OIA)	We have accepted the company’s revised view of its OIA, which includes updated actuals for 2013-14, and an updated view of its pension adjustments.	3.7	1.5	3.7
Capital expenditure incentive scheme (CIS)	In carrying out the CIS assessment for the final determination, we have used the updated information on 2013-14 and 2014-15.	-4.8	-6.6	-4.8

Area	Change to draft determination	Total adjustment 2010-15 (post updates)		
		Company view	Draft determination	Final determination
	<p>As for all companies, we have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period.</p> <p>Combined these updates increased revenue further by less than £0.1 million compared to the company's proposal.</p>			
Other adjustments	There are no changes 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 South West Water's wholesale water control in Table A2.10.

Overall, the company's wholesale water revenue allowance will be £188.2 million in 2015-16, decreasing by 3.5% to £181.6 million in 2019-20.

Table A2.10 South West Water's wholesale water allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	142.9	150.0	150.4	134.9	128.5	706.8
PAYG rate (%)	62.4%	57.6%	54.3%	59.4%	62.2%	
Totex additions to the RCV	53.8	63.6	68.8	54.8	48.5	289.4
RCV (year average)	1,197.1	1,210.1	1,229.7	1,244.1	1,247.6	
Wholesale allowed revenue build up:						
PAYG ¹	93.1	90.4	85.6	84.1	84.0	437.2
Return on capital	44.3	44.8	45.5	46.0	46.2	226.8
RCV run-off	45.4	46.0	47.0	47.8	48.4	234.6
Tax ²	7.2	6.2	4.8	4.3	4.3	26.7
Income from other sources ^{3,4}	-5.5	-5.5	-5.5	-5.5	-5.5	-27.6
Reconciling 2010-15 performance	-0.5	-0.6	0.3	0.1	0.1	-0.6
Ex ante additional menu income	1.6	1.7	1.7	1.5	1.4	7.8
Wholesale allowed revenue adjustments:						
Capital contributions from connection charges and revenue from infrastructure	2.7	2.8	3.2	3.2	2.9	14.8

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
charges						
Final allowed revenues	188.2	185.8	182.6	181.5	181.6	919.8

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 section A3.3 of 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 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 South West Water’s proposed wholesale water uncertainty mechanisms and our final assessment of these proposals.

Table A2.11 South West Water’s proposals for wholesale water uncertainty mechanisms

Assessment at draft determination	Our final assessment
In the draft determination, we accepted South West Water’s proposed uncertainty mechanism for water business rates with the proposed sharing rate of 80:20 (customer:company). We accepted a non-standard sharing rate in conjunction with the ‘WaterShare’ gain sharing mechanism.	For our final determination we confirm the uncertainty mechanism included in our draft determination. The specific text of this Notified Item is in the annex to the final determination letter. The rationale for its inclusion in the final determination is set out in policy chapter A7.

A3 Wholesale wastewater

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 wholesale wastewater 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 A3.
- Policy chapter A4.
- Policy chapter A7.
- Policy chapter A8.

Table A3.1 lists the representations we have received that are specific to South West Water’s wholesale wastewater control and sets out where to find more information on our responses in this document.

Table A3.1 Representations specific to the wholesale wastewater control of South West Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	South West Water Environment Agency CCWater	Section A3.2 and annex 4
Outcome delivery and reporting	None	Annex 4
Calculating allowed wholesale wastewater expenditure	South West Water CCG	Section A3.3.1 and Annex 1

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Calculation of revenues: PAYG and RCV run-off	None	Section A3.3.2 and A6.5
Cost of capital	CCWater	Section A3.3.3
Reconciling 2010-15 performance	South West Water CCWater	Annex 3
Uncertainty mechanisms	None	Section A3.4

A3.2 Outcomes, performance commitments and incentives

We summarise the outcomes, performance commitments and ODIs for the wholesale wastewater control for South West Water in table A3.2 below.

Table A3.2 Wholesale wastewater outcomes, performance commitments and incentives

Outcome	Company proposal		Update to draft determination
	Performance commitment	Incentive type	
Reliable wastewater service	Internal sewer flooding incidents (number)	Financial – reward and penalty	None
	External sewer flooding incidents (number)	Financial – reward and penalty	None
	Odour contacts – WWTWs (number)	Financial – reward and penalty	None
	Asset reliability – pipes	Financial – penalty only	None
	Asset reliability – processes	Financial – penalty only	None
	Compliance with sludge standard (%)	Reputational	None

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
Responsive to customers	Operational customer contacts resolved first time (%)	Financial – reward and penalty	None
Protecting the environment	WWTW numeric compliance (%)	Financial – penalty only	We have set non-financial interim performance commitments for 2015-16 and 2017-18.
	WWTW pop. equiv. sanitary compliance (%)	Reputational	None
	WWTW descriptive permit compliance (%)	Financial – penalty only	We are raising the penalty deadband to 95% compliance for each year in 2015-20.
	Pollution incidents – category 1 and 2 (number)	Financial – penalty only	None
	Pollution incidents – category 3 and 4 (number)	Financial – penalty only	None
	Operational carbon emissions (ktCO ₂ e)	Reputational	None
	Energy from renewable sources (%)	Reputational	None
	Benefiting the community	Bathing water quality (%)	Financial – reward and penalty
Combined sewer overflow spills (number)		Future measure	None

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
	River water quality standard (km)	Reputational	None

In policy chapter A2 we discuss our approach to outcomes for the wholesale and retail controls. South West 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.

As South West Water is an enhanced company, the outcomes that it proposed are those which it will need to deliver over the next 5 years. We have made only minor changes for our final determination and these are summarised in table A3.2 above.

For the enhanced companies following the RBR we had relatively high confidence in the business plans and the proposed outcomes and PCs and ODIs. On this basis, we have accepted the proposals with relatively minor adjustments after draft determinations to reflect feedback from stakeholders such as the Environment Agency. The determinations have not been changed to reflect the comparative analysis applied to non-enhanced companies, since we continue to consider that it is appropriate to accept the enhanced companies' business plans in the round. However, South West Water has recognised that even though its financial incentives are not being changed, it faces significant reputational incentives to improve its performance in areas where it is not yet delivering upper quartile performance, especially in the latter years of the price control.

While we have not intervened in relation to our comparative assessment of outcomes, South West Water has indicated that it will have regard to upper quartile performance in anticipation of its 2019 price determination.

As an enhanced company, South West Water gained its draft determination earlier than all non-enhanced companies, giving it additional certainty and allowing it to focus on delivery of these outcomes for its customers.

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

A3.2.1 Licence modification

As outlined in section A2.2.3 for wholesale water, our proposed licence modification for South West Water, Anglian Water and Severn Trent Water is set out in our section 13 consultation. The wholesale wastewater performance commitments that would be covered by the licence modification are those notified to South West Water in this document as being eligible for in-period changes. These are as follows:

- operational customer contacts resolved first time;
- wastewater descriptive works permit compliance;
- pollution incidents (category 1 and 2); and
- pollution incidents (category 3 and 4).

As set out in section A2.2.3, the proposed licence modification, and the claiming or application of rewards and penalties, will operate within the context of the company's WaterShare framework and its Board pledge of below inflation bill increases to 2020.

A3.3 Calculating the wholesale wastewater price control

A3.3.1 Calculating allowed wholesale wastewater expenditure

Our approach to calculating allowed wholesale expenditure is set out in policy chapter A3. This includes information on the enhanced menu and sharing rate that applies to South West Water as an enhanced company.

In its business plan, South West Water proposed a level of wholesale wastewater totex that was very close to our view of costs and which we consider to be efficient. There are mechanisms to share out- or under-performance with customers in relation to wholesale costs, including the use of a menu. One of the financial benefits of being an enhanced company is access to an enhanced menu with enhanced cost sharing rates. This incentivises companies to deliver efficiently costed business plans, which in turn benefits customers.

The company proposed wholesale wastewater totex of £898 million over 2015-20 (the same as it proposed ahead of its draft determination). This is 0.3% above the final determination threshold (post additions) of £895 million. Table A3.3 below notes the comments that we have received that are specific to this aspect of the wholesale wastewater control of South West Water and our response.

Table A3.3 Representations specific to the wholesale wastewater totex for South West Water

Respondent	Summary of comment	Ofwat response
South West Water	The company proposed a neutral adjustment to our final determination threshold in relation to Bathing Water Schemes carried out in 2010-15 that left our threshold for the wholesale wastewater control unchanged from the draft determination.	We have made a £7.6 million reduction to our threshold, to correct for the inclusion of Bathing Water Schemes in 2015-20 expenditure that the company delivered in 2010-15 (and which we have reflected in our reconciliation of 2010-15 performance). This reduction is partially offset by a £2.8 million increase to our threshold as a result of updating our private sewers model.
South West Water	As with wholesale water, the company suggested adjusting the application of efficiencies to pension deficit costs.	We have corrected for the minor error in the application of efficiencies. Consistent with IN 13/17, we have continued to apply the level of efficiencies as at PR09.
South West Water	As with wholesale water, the company suggested we should retain the totex profile from its business plan.	As with wholesale water, consistent with our default approach to other companies, we have reprofiled the company's totex and revenue to reflect its business plan profile.
CCG	As with wholesale water, the CCG supported the reprofiling of the company's totex expenditure.	See responses set out above.

The wholesale wastewater allowed expenditure for South West Water is detailed in Table A3.4 below. A further breakdown of some of the calculations is provided 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.

In South West Water's draft determination we used our own profile of the company's wholesale wastewater totex. In line with the 'do no harm' principle, and consistent with the default approach to all other companies, for the final determination we have used the company's totex profile.

Table A3.4 Wholesale wastewater allowed expenditure (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Final determination cost threshold						894.9
Costs excluded from menu	3.9	3.8	3.8	3.8	3.8	19.0
Menu cost baseline ¹	191.7	193.1	176.7	158.7	155.7	875.9
Company's view of menu costs ²						877.4
Implied menu choice						100.2
Allowed expenditure from menu	191.8	193.2	176.8	158.7	155.8	876.3
Costs excluded from menu	3.9	3.8	3.8	3.8	3.8	19.0
Total allowed expenditure ³	195.7	197.0	180.6	162.5	159.6	895.3
Less pension deficit repair allowance	3.5	3.5	3.5	3.5	3.5	17.7
Totex for input to PAYG	192.1	193.5	177.0	159.0	156.0	877.6

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.

A3.3.2 Calculation of Revenues: PAYG and RCV run-off

In section A6.5, we discuss financeability at an appointee (whole regulated company) level. In this section, we also discuss any representations that we have received that are specific to South West Water's PAYG, RCV run-off and financeability and our response to those representations.

Table A3.5 shows the PAYG rates and the associated totex recovered for wholesale wastewater, which we have used as the basis for this final determination. It reflects adjustments we have made to the PAYG rates, with the company's agreement, to

smooth out the impact of the minor changes from the draft determination and ensure that the 2015-20 final determination bills match those proposed the company. This is consistent with South West Water being an enhanced company.

The 'Resulting PAYG (£m)' is the amount of money recovered from customers in the short term. Table A3.6 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 A3.5 South West Water's wholesale wastewater PAYG rates

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	192.1	193.5	177.0	159.0	156.0	877.6
PAYG (%)	49.7%	49.9%	52.6%	59.2%	60.8%	54.4%
Resulting PAYG (£m)	95.4	96.5	93.1	94.1	94.9	474.0

Note:

The figures in this table reflect our change in PAYG rates as described in section A6.5 on financeability.

Table A3.6 South West Water's wholesale wastewater RCV run-off (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	74.8	71.3	67.9	64.7	61.7	340.4
RCV run-off of totex additions	2.4	7.3	11.8	15.5	18.6	55.6
Total RCV run-off	77.2	78.5	79.7	80.2	80.3	395.9

Note:

The figures in this table reflect a run-off rate of 4.71% for the RCV as at 31 March 2015 and 20 years for the totex additions to the RCV over 2015-20. We have arrived at this figure by averaging the company's annual asset life figures.

A3.3.3 Return on the RCV

As discussed in section A2.3.3, we have used an allowed return of 3.6% in these final determinations for non-enhanced companies.

As South West Water is an enhanced company, it is protected against downward adjustments to the cost of capital by the 'do no harm' principle. This protection is an important part of the incentive framework; encouraging companies to produce high

quality business plans. A reduction in the allowed return of 0.1 percentage points has a value of £14 million to the company.

South West Water's wholesale allowed return is therefore 3.70%. This results in a return on capital of £299 million over 2015-20.

CCWater considered in its representation that we should apply any reduction in the allowed return from 3.7% to enhanced companies. As set out above, in line with our do no harm principle we have not applied the reduction in the allowed return to enhanced companies. However, we note that the company's customers could share in any benefit from a reduction in the cost of new debt we have assumed in the final determination through its voluntary WaterShare mechanism.

Table A3.7 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A3.2.4 below. It also sets out the wholesale wastewater element of the initial reward to the company as a result of it achieving enhanced status. In April, the company chose to receive the reward through an addition to its 2015-16 RCV. The company proposed to share up to half of the award with customers through re-investment to further improve services.

The average RCV, set out in table A3.8 below 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 A3.5 and table A3.6 above.

Table A3.7 South West Water's wholesale wastewater opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	1,578.1
Land sales ¹	-1.5
Adjustment for actual expenditure 2009-10 ²	-6.3
Adjustment for actual expenditure 2010-15 ³	-23.8
Net adjustment from logging up and logging down ^{3,4}	36.4
Adjustment for shortfalls ^{3,4}	0.0
Adjustment for serviceability shortfalls ⁵	0.0
Enhanced reward ⁶	5.2
Other adjustments ⁷	0.0

	2015-16
Opening RCV 1 April 2015	1,588.0

Notes:

1. Land sales adjustment is set out in table AA3.17.
2. 2009-10 actual expenditure adjustment is set out in table AA3.17.
3. A component of the CIS adjustment as set out in table AA3.15.
4. The net adjustment from the change protocol is set out in table AA3.8.
5. The serviceability shortfall assessment is set out in table AA3.15.
- 6 The sum of the wholesale water and wastewater enhanced rewards set out in table AA3.17 does not match the £11m set out in the overview or draft determination as that figure was in 2012-13 year end prices rather than 2012-13 year average prices
7. Other RCV adjustments are set out in table AA3.17.

Table A3.8 South West Water's wholesale wastewater return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	1,588.0	1,607.5	1,625.9	1,630.1	1,614.9
RCV additions (from totex)	96.7	97.0	83.9	64.9	61.2
Less RCV run-off	77.2	78.5	79.7	80.2	80.3
Closing RCV	1,607.5	1,625.9	1,630.1	1,614.9	1,595.7
Average RCV (year average)	1,597.7	1,616.7	1,628.0	1,622.5	1,605.3
Return on capital	59.1	59.8	60.2	60.0	59.4

A3.3.4 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 the final determinations in 2009 we have made adjustments at this price review (PR14) to 2015 to 2020 revenues and the RCV to take account of company performance in the 2010 to 2015 period.

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

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale wastewater services to reconcile performance in 2010-15 in its December plan. We and the company have made slight adjustments to these based on the identification of minor errors and on updated information for 2013-15 not available when we made our draft determination in April. As a result, the revenue

adjustments for wholesale wastewater have changed from -£26.9 million to -£26.4 million. We summarise these adjustments in Table A3.9 below, and quantify the resulting adjustments within this final determination. The impact on the opening RCV of 2010-15 adjustments is shown in Table A3.7 and we discuss our changes in this area further in annex 3.

The changes we have made in the final determination in reconciling the company's 2010-15 performance result from including updated actuals for 2013-14 and forecasts for 2014-15.

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 RCM, change protocol and serviceability in 2015, and in 2016 for the capital expenditure incentive scheme, when we have the company's actual performance for 2014-15. In carrying out this reconciliation we will take a proportionate approach (for example, applying materiality thresholds where appropriate) to making adjustments for company's actual performance and implement these changes at the next wholesale price control review in 2019.

Table A3.9 South West Water’s wholesale wastewater revenue adjustments to reflect 2010-15 performance (£ million)

Area	Change to draft determination	Total adjustment 2010-15 (post updates)		
		Company view	Draft determination	Final determination
SIM	We have updated the calculation with the company’s latest predicted turnover for 2014-15.	-6.7	-6.8	-6.5
RCM	Our final determination reflects the company’s updated RCM adjustments following updates to 2013-14 actuals and 2014-15 forecasts. We have included our view of the FD09 assumptions and used the out-turn financial year average RPI and number of households billed as submitted in the company’s business plan instead of what the company has submitted in its RCM calculations. Combined, the value of our adjustment is less than £0.1 million of revenue compared to the company’s proposal.	-11.8	-10.6	-11.7
OIA	There are no changes in this area.	0.0	0.0	0.0
CIS	In carrying out the CIS assessment for the final determination, we have used the updated information on 2013-14 and 2014-15. As for all companies, we have used the post-tax	-8.4	-8.1	-8.2

Area	Change to draft determination	Company view	Total adjustment 2010-15 (post updates)	
			Draft determination	Final determination
	basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period. Combined these updates increased revenue by a further £0.2 million compared to the company's proposal.			
Other adjustments	There are no changes in this area.	0.0	0.0	0.0

A3.3.5 Calculation of allowed revenue

The calculation of the allowed revenue for South West Water's wholesale wastewater control is shown in table A3.10.

Overall, South West Water's wholesale wastewater revenue allowance will be £238.4 million in 2015-16, increasing by 2.2% to £243.6 million in 2019-20.

Table A3.10 South West Water's wholesale wastewater allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	192.1	193.5	177.0	159.0	156.0	877.6
PAYG rate	49.7%	49.9%	52.6%	59.2%	60.8%	
Totex additions to the RCV	96.7	97.0	83.9	64.9	61.2	403.6
RCV (year average)	1,597.7	1,616.7	1,628.0	1,622.5	1,605.3	
Wholesale allowed revenue build up:						
PAYG ¹	99.0	100.0	96.7	97.6	98.4	491.7
Return on capital	59.1	59.8	60.2	60.0	59.4	298.6
RCV run-off	77.2	78.5	79.7	80.2	80.3	395.9
Tax ²	8.1	6.6	6.4	6.5	6.7	34.3
Income from other sources ^{3,4}	-0.5	-0.5	-0.5	-0.5	-0.5	-2.5
Reconciling 2010-15 performance	-7.7	-7.8	-3.6	-3.6	-3.6	-26.4
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	3.2	3.2	3.1	3.2	3.0	15.7

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
charges						
Final allowed revenues	238.4	239.8	241.9	243.4	243.6	1,207.1

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 section A3.3 of policy chapter A3.

A3.4 Uncertainty mechanisms

We have set the company’s allowed revenues for the 2015-20 period. All companies face uncertainty about future costs and revenues 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.

For the wholesale wastewater control, we are not allowing additional uncertainty mechanisms within this framework.

In table A3.11 below, we set out South West Water’s proposed wholesale wastewater uncertainty mechanisms and our assessment of these proposals.

Table A3.11 South West Water’s proposals for wholesale wastewater uncertainty mechanisms

Assessment at draft determination	Our assessment
No uncertainty mechanisms for wholesale wastewater were included in our draft determination and South West Water did not propose any beyond those that will already form part of the regulatory framework for 2015-20.	South West Water has not objected to our approach in the draft determination. We have not included any additional uncertainty mechanisms for South West Water.

A4 Household retail

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

Table A4.1 Representations specific to the household retail control of South West Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	CCWater	Annex 4
Outcome delivery and reporting	None	Annex 4
Allocation of costs	South West Water	Section A4.3.1
Adjustments	CCWater	Section A4.3.2 and Annex 2
New costs	None	Section A4.3.3

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Uncertainty mechanisms	None	Section A4.5

A4.2 Outcomes, performance commitments and incentives

We summarise the outcomes, performance commitments and ODIs for the household retail control for South West Water in table A4.2 below.

Table A4.2 Household retail outcomes, performance commitments and incentives

Outcome	Company proposal		Update to draft determination
	Performance commitment	Incentive type	
Responsive to customers	Customer overall satisfaction (%)	Reputational	None
	SIM ¹	Financial – reward and penalty	None
	Customers' satisfaction with value for money (%)	Reputational	None
Fair charging	Customers assisted by water poverty initiatives	Reputational	None

Notes:

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

In policy chapter A2 we discuss our approach to outcomes for the wholesale and retail controls. South West 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.

As South West Water is an enhanced company, the outcomes that it proposed are those which it will need to deliver over the next 5 years.

As an enhanced company, South West Water gained its draft determination earlier than all non-enhanced companies, giving it additional certainty and allowing it to focus on delivery of these outcomes for its customers.

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

A4.3 Costs

Our assessment of South West Water’s retail costs and the impacts these have on its allowed revenues has changed since our draft determination. The change reflects the retail cost information we have received from South West Water, along with other companies, and our assessment of those costs. It also reflects changes following representations by all companies. We have updated our view for enhanced companies because changes in their retail costs are not covered by the ‘do no harm’ principle.

Our approach to the household retail control is set out in policy chapter A5. As set out in policy chapter A5, we have adjusted companies’ costs to align to the 2013-14 base year – this is consistent with the position the company proposed in its representation. 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.

A4.3.1 Allocation of costs

In table A4.3 below, we summarise our assessment of South West Water’s cost allocation methodology.

Table A4.3 Our assessment of South West Water’s cost allocation methodology

Area assessed	Assessment
No potential material misallocations	Pass
Adequate assurance provided	Pass

Area assessed	Assessment
Reconciliation to regulatory accounts and December business plan provided	Pass

We wrote to the company on 29 August 2014 to notify it of the outstanding cost allocation action following our review of its June cost allocation submission. We required the company to address this action by 3 October 2014. We are satisfied that the company has addressed this action. Therefore we have used the company's cost allocation between retail and wholesale and between household and non-household retail to set our final determination.

In its representations on our draft determination the company argued, in relation to cost allocation, that our treatment of legacy depreciation would make its household retail business appear unprofitable in the regulatory accounts. We address this issue in policy chapter A5.

A4.3.2 Adjustments

In its business plan, South West Water sought adjustments to the ACTS for:

- pension deficit repair costs; and
- doubtful debt.

Pension deficit repair costs

In the final determination, we have included an adjustment to the ACTS 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](#).

Doubtful debt

In the final determination for South West Water, we have included an adjustment to the ACTS for doubtful debt. Our final assessment is unchanged from the draft determination.

Table A4.4 outlines our assessment of South West Water's proposed ACTS adjustments. The value of the adjustments we have accepted in our final determination is summarised in table A4.5. Further details on our assessment, and our response to representations we received on our draft determination that are specific to this aspect of the company's household retail control determination, are set out in annex 2.

Table A4.4 South West’s proposals for ACTS adjustments

		Adjustment assessment criteria			
Adjustment	Value (£m over 2015-20)	Materiality	Beyond efficient management control	Impact company in materially different way	Value of adjustment appropriate
Doubtful debt	34.7	Pass	Pass	Pass	Pass

Note:

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

Table A4.5 Household retail adjustments (£ million, nominal prices)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in final determination						
Doubtful Debt	6.934	6.934	6.934	6.934	6.934	34.672
Pension deficit repair costs	0.721	0.721	0.721	0.721	0.721	3.604
Outcome B1: Customers assisted by water poverty measures	Not included as adjustment – forms part of new cost					
Adjustments included in final determination	7.655	7.655	7.655	7.655	7.655	38.276

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

A4.3.3 New costs

South West included new costs for vulnerable customer schemes in its business plan that could result in a modification being made to its allowed revenues. We support schemes of this type. However, as the company has a falling cost profile, overall the new costs are offset and so we have not made a modification for new costs. Because of the falling cost profile, South West Water has no material new costs.

Table A4.6 New household retail costs (£/customer)

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

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

A4.4 Calculating the allowed revenues

As set out in policy chapter A5, total allowed household retail revenues are calculated taking account of our assessment of the cost to serve per customer (after the impact of our efficiency challenge), the projected customer numbers in the company's revised business plan and the household retail net margin.

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

Table A4.7 below shows the household retail net margin over 2015-20.

Table A4.7 Household retail net margins (%)

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

Table A4.8 below sets out the components of the allowed household retail revenue.

Table A4.8 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	26.2					
Unmetered water and wastewater customers	34.0					
Metered water only	29.1					

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
customers						
Metered wastewater only customers	26.2					
Metered water and wastewater customers	37.1					
Industry ACTS (£/customer)						
Unmetered single service customers	21.47					
Unmetered water and wastewater customers	27.91					
Metered water only customers	27.26					
Metered wastewater only customers	25.54					
Metered water and wastewater customers	34.26					
Allowed cost to serve¹ (£/customer)						
Unmetered single service customers		28.5	28.7	28.7	28.5	28.7
Unmetered water and wastewater customers		37.1	37.3	37.4	37.0	37.3
Metered water only customers		31.3	31.4	31.5	31.3	31.3
Metered wastewater only customers		28.5	28.7	28.7	28.5	28.7
Metered water and wastewater customers		40.0	40.2	40.3	40.0	40.2
Total allowed (£m)						

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Cost to serve (excluding net margin)		28.1	28.5	28.8	28.9	29.3
Forecast household wholesale charge (including forecast RPI ²) ³		368.5	380.0	392.2	404.9	418.2
Household retail revenue (including an allowance for the net margin) ⁴		31.8	32.3	32.8	32.9	33.5

Notes:

There will be no automatic indexation for retail price controls to RPI. However, the wholesale price controls are index 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.

A4.5 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in the policy chapter A7. South West Water did not propose any household retail uncertainty mechanisms beyond those that will already form part of the regulatory framework for 2015-20.

A5 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 provide details of South West Water’s non-household retail price control.

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

Table A5.1 lists the representations we have received that are specific to South West Water’s non-household retail control and sets out where to find more information on our responses in this document.

We did not formally make our draft determination of South West Water’s non-household control until August. We therefore received the representations on this element of the company’s draft determination in October, at the same time as non-enhanced companies. These included representations on the form of the non-household control, an issue we invited views on after we made our April draft determination.

Table A5.1 Representations specific to the non-household retail control of South West Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Net margins	None	Section A5.3
Cost proposals	South West Water	Section A5.4
Form of control	South West Water	Section A5.5

A5.2 Indicative non-household retail total revenue

Table A5.2 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 A5.2 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	5.2	5.3	5.4	5.5	5.6

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

A5.3 Net margins

The company 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. We have therefore accepted the company's proposals.

A5.4 Cost proposals

As requested in our draft determination, the company provided further information as to why its 2013-14 costs appeared significantly higher than in previous years. We have assessed this evidence and consider the costs have no effect on the 2015-20 allowance and so we do not need to make any adjustment.

The company also represented on Ofwat deflating retail costs by the difference in RPI between 2012-13 and 2013-14. We agree that deflating companies' costs would not be appropriate for a final determination, as it would effectively be embedding an

additional efficiency challenge due to the controls being set on a nominal basis. We have therefore set the retail controls based on companies' non-deflated 2013-14 costs (prior to any subsequent adjustments). For further details, see policy chapter A6.

As set out in the 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. All cost figures (unless otherwise specified) are five-year totals. As set out in policy chapter A6 we expect our decisions on the total level of non-household retail costs 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 IN 13/17: 'Treatment of companies' pension deficit repair costs at the 2014 price review' we explained how we would treat the costs associated with water companies reducing the deficits in their defined benefit pension schemes at the 2014 price review. Where companies' proposals have differed from our calculations we have over-written their proposals in line with our overall approach. This resulted in the company's proposals being adjusted from £0.725 million over the control period, to £0.578 million.

In total, this resulted in the company's proposed costs being adjusted from £10.488 million over the control period to £10.341 million.

A5.5 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.

A5.6 Average revenue controls

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

The average retail revenue per customer – £ (r) – has also been 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 A5.3 Non-household retail average controls per customer

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Standard Unmeasured Water	£	13.69	13.31	13.47	13.27	13.05
	%	2.0%	2.0%	1.9%	1.9%	1.9%
	£ (r)	28.16	28.12	28.38	28.67	28.76
Standard Unmeasured Sewerage	£	15.17	14.81	15.07	15.02	14.64
	%	2.0%	2.0%	1.9%	1.9%	1.9%
	£ (r)	47.94	48.26	49.66	50.44	50.75
Standard Measured Water	£	16.83	16.53	16.51	16.45	16.20
	%	2.7%	2.7%	2.7%	2.7%	2.7%
	£ (r)	35.84	35.72	35.82	36.09	36.21
Standard Measured Sewerage	£	15.47	15.27	15.38	15.39	15.26
	%	2.7%	2.6%	2.6%	2.6%	2.6%
	£ (r)	44.32	44.58	45.36	46.31	46.97
Large and Special User 50-100ML Water	£	758.51	758.38	758.45	758.46	758.36
	%	1.6%	1.8%	1.8%	1.9%	1.9%
	£ (r)	2,384.42	2,621.43	2,733.02	2,823.48	2,912.32
Large and Special User 50-100ML Sewerage	£	717.13	717.01	717.08	717.09	717.00
	%	1.5%	1.7%	1.8%	1.8%	1.8%
	£ (r)	2,368.64	2,642.34	2,824.93	2,977.57	3,104.57
Large and Special User 100-250ML Water	£	1,205.18	1,204.98	1,205.09	1,205.12	1,150.18
	%	1.5%	1.7%	1.8%	1.9%	1.9%
	£ (r)	4,946.10	5,504.70	5,755.35	5,967.13	6,202.51
Large and Special User	£	704.33	704.21	704.27	704.29	704.19

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
100-250ML Sewerage	%	1.5%	1.7%	1.8%	1.8%	1.8%
	£ (r)	2,288.29	2,551.33	2,721.90	2,868.93	2,992.42
Large and Special User 250+ML Water	£	1,972.11	1,971.78	1,971.97	1,972.01	1,971.74
	%	1.6%	1.8%	1.9%	1.9%	1.9%
	£ (r)	10,899.1 1	12,207.2 0	12,790.6 1	13,306.6 3	13,781.8 4
Large and Special User 250+ML Sewerage	£	2,958.17	2,957.67	3,450.94	3,451.01	2,957.61
	%	1.6%	1.7%	1.7%	1.8%	1.9%
	£ (r)	16,762.5 4	19,034.4 6	20,429.4 6	21,659.1 7	22,845.3 2
Large and Special User Special Agreements Water	£	580.03	579.94	579.99	580.00	579.92
	%	2.1%	2.1%	2.2%	2.2%	2.2%
	£ (r)	717.40	721.89	724.51	727.96	731.55
Large and Special User Special Agreements Sewerage	£	484.67	484.59	484.64	484.65	484.58
	%	2.4%	2.4%	2.4%	2.4%	2.4%
	£ (r)	1,529.24	1,573.26	1,615.56	1,667.00	1,712.39
Trade Effluent	£	87.96	87.94	87.95	87.95	87.94
	%	2.4%	2.5%	2.5%	2.5%	2.5%
	£ (r)	467.97	482.29	493.34	506.41	518.10

A6 Appointee financeability and affordability

In this section, we discuss at an appointee level:

- bills and K factors;
- RoRE;
- financeability; and
- affordability.

However, we first consider the responses to our draft determinations that are specific to South West Water’s in these areas.

A6.1 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 A6.1 lists the representations we have received that are specific to South West Water at an appointee level and sets out where to find more information on our responses in this document.

Table A6.1 Representations specific to issues at an appointee level for South West Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Bills and K factors	None	Section A6.2

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Appointee level uncertainty and gain share mechanisms	None	Section A6.3
RoRE range	None	Section A6.4
Financeability	South West Water	Section A6.5
Affordability	CCWater	Section A6.6
Financial modelling	South West Water	Section A6.7

A6.2 Bills and K factors

Table A6.2 below sets out the allowed revenues we have assumed in our final determination for South West Water to deliver for its customers on its:

- statutory duties; and
- associated performance commitments.

It also sets out the average customer bills on the basis of the final determination. These figures reflect the changes we made to PAYG rates to target the company's desired final determination revenue and bills.

Table A6.2 South West Water's enhanced 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	188.2	185.8	182.6	181.5	181.6	919.8
Wholesale water – K (%)	0.0%	-0.7%	-1.6%	-0.8%	-0.2%	-
Wholesale wastewater – allowed revenues (£m) ²	238.4	239.8	241.9	243.4	243.6	1,207.1
Wholesale wastewater – K (%)	0.0%	1.2%	1.0%	0.4%	-0.1%	-

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Retail household allowed revenue (£m)	31.8	32.3	32.8	32.9	33.5	163.2
Retail non-household expected revenue (£m)	5.2	5.3	5.4	5.5	5.6	26.9
Average household bill – water (£)	218	215	211	209	209	-
Average household bill – wastewater (£)	300	300	300	299	297	-
Average household bill – combined (£) ^{3, 4}	494	490	486	483	481	-

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 South West 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. The average combined household bill is not equal to the sum of the average household water bill and the average household wastewater bill due to the use of the economies of scope factor in the household retail price control.
4. 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 South West Water's household and non-household customer base. In practice, this will depend upon the structure of wholesale charges implemented by South West Water.

As discussed in policy chapter A3, K is set to zero for 2015-16 for wholesale water and wastewater 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 South West Water in the table below.

Table A6.3 South West Water's allowed wholesale revenue for 2014-15

South West Water	Wholesale Water	Wholesale Wastewater
Allowed wholesale revenue 2014-15 (£ million)	198.6	251.6

A6.3 Uncertainty and gain share mechanisms

We outline our approach to uncertainty mechanisms and ‘pain and gain share’ in policy chapter A7. In table A6.4 below, we set out South West Water’s proposed appointee level uncertainty mechanisms and our assessment of these proposals.

Table A6.4 South West Water proposals for appointee level uncertainty and gain share mechanisms

South West Water proposals	Our assessment
South West Water included WaterShare a gain sharing mechanism that provides independently monitored performance tracking and gains typically shared 50:50 with customers.	Consistent with our draft determination we have not intervened in the company’s plan.

A6.4 RoRE range

South West 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 structure³. We have identified the RoRE impact separately for ODIs, totex performance, financing and the SIM. We note that South West 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 ACTS.

The approach to calculating the RoRE range is set out in policy chapter A7.

Table A6.5 Whole company RoRE range

	Lower bound (%) – appointee	Upper bound (%) – appointee
Overall	-3.8%	+4.0%
ODIs	-1.7%	+1.4%

³The notional capital structure is the capital structure that reflects Ofwat’s assumption of an appropriate level of gearing to use in determining the allowed WACC.

	Lower bound (%) – appointee	Upper bound (%) – appointee
Totex	-1.5%	+1.9%
Financing	-0.3%	+0.5%
SIM	-0.3%	+0.2%

Commentary:

The whole company RoRE range is from 2.1% to 9.9%, with a base case of 5.9%, with overall impacts from -3.8% to +4.0%. This is similar to the draft determination RoRE range, but shifted up by 0.3 percentage points to reflect a continued allowed wholesale cost of capital of 3.7% associated with enhanced status together with a lower notional cost of debt. This is partially offset as we have excluded additional returns from non-household retail control to be consistent with approach in our risk and reward guidance (which lowers the base case returns from 6.0% to 5.9%).

The totex risk range from -1.5% to +1.9% is unchanged from the draft determination. It was modelled by South West Water using Monte Carlo functionality within its financial model and is based on a variety on internal and external sources. We consider the approach to be robust and well evidenced. The skew towards the upside is mainly driven by risk sharing arrangements with contractors, which protect the downside.

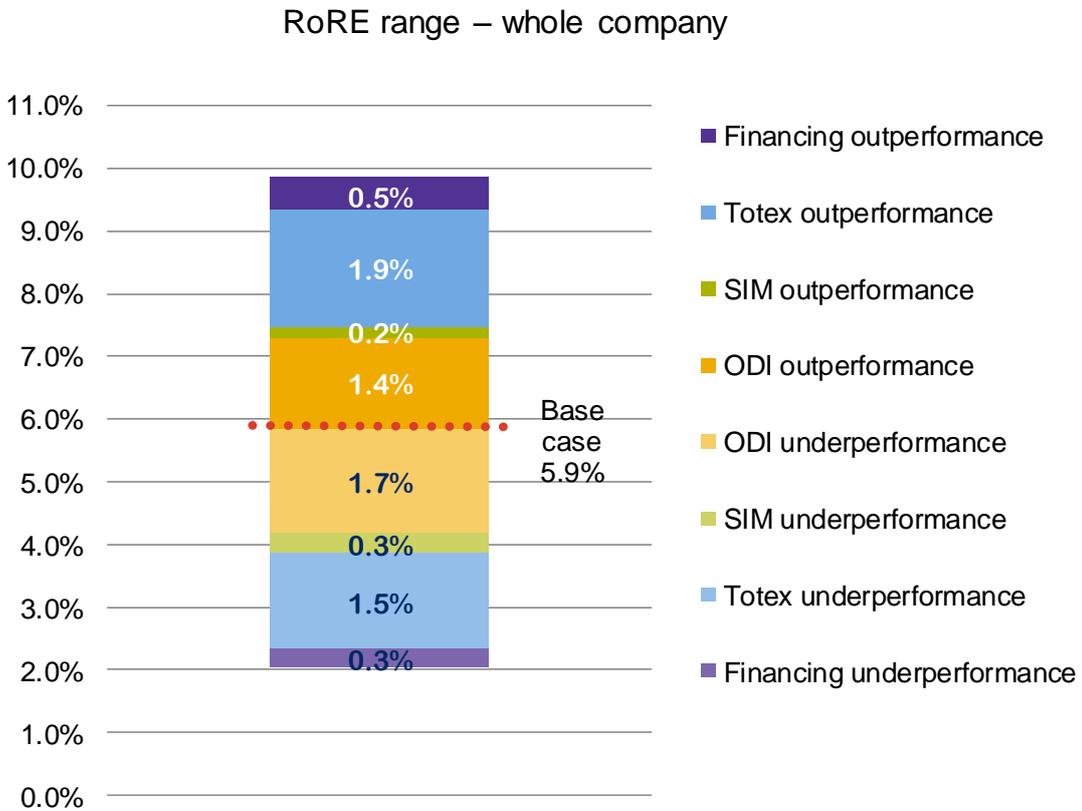
The ODI risk range proposed by South West Water in its business plan was from -1.7% to +1.4%. South West Water was awarded enhanced status so we have made minimal changes to ODIs (see annex 4) which do not impact the overall range from the business plan.

Financing risk impacts from -0.3% to +0.5% are unchanged from the draft determination. These were assessed using a downside scenario of +75 basis points on the cost of new debt and an upside scenario of -100 basis points.

The SIM risk range of -0.3% to +0.2% is also unchanged from the draft determination. SIM impacts have been estimated using an assumption of maximum rewards and penalties (+0.5% to -1% of revenue).

The composition of the RoRE range for South West Water at an appointee level is shown in figure A6.1 below.

Figure A6.1 South West Water’s RoRE range – appointee



Source: Our calculations based on information from South West Water.

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

A6.5 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 their financeability and to set out their 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 their business plan and our draft and final determination financial ratios.

In table A6.6, we set out the notional financeability ratios associated with South West Water's business plan, draft determination and final determination.

Table A6.6 Company and Ofwat financial ratio calculations based on the company business plan and financial ratios based on our final determination

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on Ofwat calculations (average 2015-20)	
	Company calculation	Ofwat calculation	Draft determination	Final determination
Cash interest cover (ICR)	2.88	2.96	3.23	3.08
Adjusted cash interest cover ratio (ACICR)	1.45	1.47	1.56	1.53
Funds from operations(FFO)/debt	9.62%	10.99%	10.37%	9.74%
Retained cash flow/debt	7.14%	5.98%	7.63%	7.11%
Gearing	60.80%	62.87%	59.11%	62.04%
Dividend cover (profit after tax/dividends paid)	1.58	1.05	1.49	1.43
Regulatory equity/regulated earnings for the regulated company ¹	17.55	15.39	18.15	17.56
RCV/EBITDA	11.20	10.51	10.42	10.40
Commentary:				
On the company's business plan there were some differences between the Ofwat and company calculations, largely reflecting different dividend assumptions, which impacted on				

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

gearing and consequently dividend cover and regulatory equity/regulated earnings for the regulated company.

For the draft determination, the financial ratios were consistent with those submitted by the company in its business plan and at levels that the company had satisfied itself and us were consistent with a company that was financeable.

The financial ratios for the final determination are at levels consistent with the draft determination. We therefore consider that the final determination is financeable.

Note:

1. The regulatory equity/regulatory earnings ratio is now defined on the basis of earnings after real interest and tax; previously, this has been defined on the basis of nominal interest for the early draft determinations. The use of real interest is more consistent with this measure as an economic measure of equity returns.

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 A6.7 sets out the PAYG and RCV run-off rates, which shows whether revenue has been brought forward compared with the December plan and the impact that this has on RCV growth and longer-term affordability and financeability. As South West Water is an enhanced company, we have amended PAYG rates to target its proposed bills.

Table A6.7 Impact of changes in cost recovery rates on RCV growth

	PAYG rate	RCV run-off	RCV growth (%) – 1 Apr 2015 to 31 Mar 2020
Company December plan	55.5%	4.2%	0.9%
Company June update	55.4%	4.2%	1.8%

	PAYG rate	RCV run-off	RCV growth (%) – 1 Apr 2015 to 31 Mar 2020
Draft determination	55.6%	4.2%	2.5%
Final determination	56.8%	4.2%	2.2%

South West Water did raise one representation issue in relation to financeability. We set this out in table A6.8 below, along with our response.

Table A6.8 Representations specific to South West Water’s financeability

Respondent	Summary of comment	Ofwat response
South West Water	The household retail control is unfinanceable due to the treatment of legacy depreciation.	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. We note that based on South West calculations and taking account of retail margins, that South West is earning positive returns in four out of five years of the control.

A6.6 Affordability

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

Table A6.9 sets out any changes in household bill profile between the company’s December business plan, its March update, the draft determination, the company’s representation to target its proposed bill profile and the final determination.

Table A6.9 Household bill profile

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	512	502	503	502	499	497

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company March update	512	485	483	482	480	477
Ofwat calculation for draft determination – pre-reprofiling	516	492	488	485	482	479
Ofwat calculations for draft determination	516	492	488	485	482	479
Company representation	516	494	490	486	483	481
Ofwat calculations for final determination	516	494	490	486	483	481

Companies have not necessarily used the same method of calculating household bills as Ofwat – for example, we have included economies of scope for household retail when calculating combined water and sewerage bills. So the Ofwat calculations are not directly comparable to the company plans (lines 1 and 2 of Table A6.9).

The final determination leads to a reduction in bills in 2015-20. As South West Water is an enhanced company, we have amended bill profiles to target its proposed bills.

The following text sets out the reasons why this final determination is assessed as affordable. It describes key changes in relation to South West Water’s December business plan that we assessed as affordable and sets out our response to CCWater’s representation.

A6.6.1 Acceptability

In its December submission, South West Water’s research found that customer acceptability of the plan stood at 84%.

In its March 2014 business plan update, South West Water provided sufficient and convincing evidence that accepting Ofwat’s revised risk and reward and cost of capital assumptions had enabled it to further reduce customers’ average bills (by around 4%). There is no evidence that the scale or scope of the proposed service package has been reduced.

In its representation, the company explained how it conducted additional

acceptability research to assess customer support for the changes to its plan resulting from the revised risk and reward guidance. This new phase of research found that customers' acceptability levels remain consistent with the results of the engagement carried out for the December plan. We received one representation from a third party on acceptability.

Table A6.10 Representations specific to South West Water's affordability measures

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 50% of customers find the draft determination acceptable after they have been provided with information on bills, inflation and what the water company will deliver.	We note that the CCWater research was not intended to be comparable. It has produced a significant difference to the research that the company undertook on its revised business plan, which was that 84% found the plan acceptable. The company's plan has been developed with input from its CCG. The CCG's role was to help ensure the business plan reflected the views and priorities of customers. We have reviewed the company's acceptability research, which included reviewing the transparency and accuracy of the bill and inflation information. We also note that the CCWater survey did not take into account the government subsidy to South West Water's bills. We consider that the acceptability that the company reported is sufficiently robust. We also consider that the CCWater survey results indicate the importance of continued engagement with customers.

Note:

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

A6.6.2 Identification of affordability issues and appropriate support measures

The company already had a comprehensive set of affordability measures in place. Its business plan pledged to increase the numbers of customers benefiting from these measures by 10% over the course of 2015-20. The key measures are summarised in table A6.11.

Table A6.11 Key affordability measures

Measure	Current coverage (no. of customers)	Forecast 2019-20 coverage
WaterSure	12,937	14,000
Water direct	4,449	Coverage to remain consistent
Flexible payment plans	9,254	Customer driven
Debt advice – in house helpline	69,695	Customer driven
Debt advice – 3rd party	Available to all customers	Available to all customers
Write-off scheme (restart)	10,472	Customer driven
Water efficiency advice/audits	Wide range of activities available to all customers	Wide range of activities available to all customers
Social tariff	1,100	8,000
WaterCare+ programme (bills and efficiency advice)	12,500	14,000
Freshstart Fund	825	2,000

A6.6.3 Longer-term affordability

In its business plan, the company explained how its proposed adjustments to its PAYG rates for water and wastewater are designed to align with its customers' views by avoiding large increases in bills beyond 2020. In its updated March plan the company provided sufficient and convincing evidence that no changes have been made to its PAYG rate or RCV run-off rate. We consider the adjustments we have made to PAYG, in line with the company's preferences, to target the company's proposed bill profile are consistent with longer-term affordability.

A6.6.4 Longer-term affordability – ODIs

In its updated March business plan, the company presented sufficient and convincing evidence that it had revisited its ODIs in line with the risk and reward guidance, and, as a result, made minor alterations to the balance of penalties and rewards to the package of ODIs compared to those proposed in the December plan.

The company also provided an assurance that the maximum bill impact likely to result from these amended rewards and penalties remains lower than the bill level tested in the acceptability research, and therefore will not negatively impact the customers' level of acceptability of the plan.

A6.7 Financial modelling

In response to company-specific representations, we have made some adjustments to our financial model. The representations, and our response, are set out in table A6.12.

Table A6.12 Representations specific to South West Water for financial modelling

Respondent	Summary of comment	Ofwat response
South West Water	<p>South West Water raised the following issues on the financial modelling.</p> <ul style="list-style-type: none"> • We should consider using a 30% index linked debt assumption. • Dividends should be paid in year. • There should be 45 day wholesale/retail creditor. 	<ul style="list-style-type: none"> • We consider that a 33% index linked debt assumption is appropriate as set out in IN 14/11 and we have used this assumption for all companies to ensure consistent notional cost of capital. • We have adjusted dividends so that they are 100% interim, consistent with the company's proposed approach. • We have altered the payment terms to be 45 days to better align to the Open Water guidance.

Annex 1 Wholesale costs

Establishing final determination thresholds

Enhanced companies' draft determinations have been updated for wholesale costs, as these do not fall under the 'do no harm' principle.

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
591.4	131.7	0.0	18.2	741.3	31.2

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
83.3	19.8	27.9	0.7	0.0	131.7

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 vs plan
684.4	741.3	-56.9	43.5

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
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Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment ¹	Amount allowed
Deep dives							
North Plymouth WTW	53.0	34.8	Pass	Pass	Pass	Pass	18.2
Upstream innovative thinking – assessed as unmodelled	14.3	-	-	-	-	-	-
Carbon reduction commitment costs	3.9	0.0	Pass	N/a	Fail	Fail	-
Supply demand balance – metering adjustment ²	11.6	11.6	-	-	-	-	-
Unmodelled cost assessment³							
Representation: Investment to address raw water deterioration (THM, nitrates, crypto, pesticides, others)	23.5	10.0	Pass	Fail	Pass	Fail	-
Representation: NEP drinking water protected areas (includes upstream	13.7	0.0	Pass	Pass	Fail	Fail	-

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment ¹	Amount allowed
innovative thinking)							

Note:

1. Where we have not accepted claims for South West Water, this is mostly because they were already covered by our implicit allowances and/or the cost threshold should be sufficient to fund efficient expenditure – we set our assessment out in full in the populated version of final determination cost threshold models.
2. Adjustment not required as we used the company variables.
3. For the water service, the unmodelled adjustment to the basic cost threshold is triangulated and is therefore one third of the amount allowed.

Table AA1.5 Movement from basic cost threshold to final determination threshold for wholesale wastewater totex (£ million)

Basic cost threshold	Policy additions ¹	Unmodelled costs adjustment	Private sewage pumping stations	NEP5	Update of private sewer model delta	Deep dive	Final determination threshold	Deep dives fully or partially not added
789.9	51.5	-9.5	18.6	49.3	2.8	-7.6	894.9	6.5

Notes:

1. See Table AA1.6 below.
2. Deep dives are net of implicit allowances. A value of zero means deep dives are wholly covered by implicit allowances.

Table AA1.6 Policy additions to the wholesale wastewater basic cost threshold (£ million)

Business rates	Pension deficit payments	Third party costs	Open market costs	Net v gross adjustments	Total
31.7	17.7	1.2	0.8	0.0	51.5

Table AA1.7 Comparison of company wholesale wastewater totex with the final determination threshold and 2010-15 totex (£ million)

Plan ¹	Final determination threshold	Gap ²	2010-15 vs plan
898.1	894.9	3.1	93.2

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 AA1.5 if the company's claims for special treatment in the costs thresholds are not equal to the gap.

Table AA1.8 Summary of wholesale wastewater deep dive assessments (£ million)

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment ¹	Amount allowed
Deep dives							
Downstream innovative thinking	8.9	8.9	-	-	-	-	-
Carbon reduction commitment costs	6.5	-	Pass	N/a	Fail	Fail	-
NEP5 managing uncertainty	49.3	0.0	Pass	Pass	Fail	Pass	49.3
Ofwat adjustment: bathing waters	0.0	0.0	N/a	N/a	N/a	N/a	-7.6

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment ¹	Amount allowed
schemes carried out in AMP5 ²							

Note:

1. Where we have not accepted claims for South West Water, this is mostly because they were already covered by our implicit allowances and/or the cost threshold should be sufficient to fund efficient expenditure – we set our assessment out in full in the populated version of final determination cost threshold models.
2. Ofwat adjustment to take account of the revision to the NEP for 2015-20 and to increase the modelled allowance for the remaining storage schemes.

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, and our response to the representations specific to the household retail adjustments for South West Water.

Doubtful debt – summary

- In its response to our pre-qualifying conditions for enhanced status South West Water proposed an adjustment for doubtful debt £34.7 million over 2015-20.
- We accepted the company's proposal in the draft determination.
- Our position is unchanged at final determination.

Doubtful debt – our final assessment

Materiality

The company's proposed adjustment of £34.7 million is material, at 19.6% of household retail operating expenditure plus depreciation over 2015-20.

Beyond efficient management control

We found that South West Water had provided strong evidence of its management practices in relation to bad debt and that these were in line with a qualitative review of good practice in the management of bad debt costs. Similarly, in relation to bill levels our assessment demonstrated that South West Water had costs that were efficient. We therefore consider that South West Water provided sufficient and convincing evidence that doubtful debt costs are beyond efficient management control.

Impact company in materially different way

We considered that the company's initial modelling to support its proposed adjustment, which it submitted as part of its December business plan had some statistical shortcomings. There was also insufficient evidence to support the

assumptions around how changes in deprivation and bill levels during 2015-20 would impact on bad debt costs.

South West Water updated its econometric modelling analysis to address these issues as part of its actions to qualify for enhanced status. It also modelled a range of alternative approaches⁴. South West Water concluded that the values produced by the modelling approaches were not significantly different from the value on which it based the doubtful debt adjustment it had previously proposed in its business plan.

We concluded, on the basis of additional analysis from our advisers, that the company had broadly met our conditions and that it had demonstrated it was impacted in a materially different way to other companies in relation to doubtful debt. Consequently, and taking into account the company's wider business plan revisions in response to our risk and reward guidance and prequalification conditions, we confirmed South West Water as an enhanced company on 4th April 2014 and made an adjustment to its allowed retail revenues.

The additional analysis our advisers carried out consisted of replicating and reviewing the company's alternative modelling to check its robustness and calculations, and performing cross checks using two other alternative modelling approaches⁵.

Value of proposed adjustment

For its original doubtful debt adjustment proposal the company included a three-year glidepath to reach the efficient level of bad debt for its area. We did not consider there was sufficient customer support for this. The company removed this proposal as part of its response to its pre-qualification actions. This means that South West Water feels the full effect of the efficiency challenge that the company has set itself from the start of the period, instead of it being phased in during the first three years of the period. Because of this, the company is under pressure to realise efficiency gains in its operations earlier in the period, and this will reduce the amount of the bad debt charge that customers will bear.

⁴ A report describing South West Water's modelling approaches can be found on [our website](#). Note that the figures in this report are in 2010-11 constant prices not 2013-14 prices.

⁵ A note describing PwC's review of South West Water's modelling approaches, as well as its additional two modelling approaches (and the accompanying data upon which the models are based), can be found on [our website](#). Note that the figures in this report are in 2010-11 constant prices.

As a result of the company’s updated modelling, and the removal of its glidepath, we accepted its proposed adjustment of £34.7 million in full.

We considered one representation specific to this part of the household retail control, which is set out in table AA2.1 below, but our final determination position is unchanged from our draft determination.

Table AA2.1 Representations specific to the household retail adjustments for South West Water

Respondent	Summary of comment	Ofwat response
CCWater	CCWater considers there is scope for further cost reductions associated with customer debt.	We considered in our draft determination that the company had provided strong evidence in this area and the information submitted by CCWater has not changed our assessment.

Table AA2.2 below sets out the value of the adjustments we have accepted in our final determination, and the value of the adjustments at each stage of the price review.

Table AA2.2 Household retail adjustments (£ million, nominal prices)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments proposed in South West Water's April business plan						
Bad and doubtful debt	6.934	6.934	6.934	6.934	6.934	34.672
Pension deficit repair costs	0.744	0.744	0.744	0.744	0.744	3.719
Outcome B1: Customers assisted by water poverty measures	0.500	0.500	0.500	0.500	0.500	2.500
Adjustments included in business plan	8.178	8.178	8.178	8.178	8.178	40.891
Adjustments included in draft determination						
Bad and doubtful debt	6.934	6.934	6.934	6.934	6.934	34.672
Pension deficit repair costs	0.721	0.721	0.721	0.721	0.721	3.604
Outcome B1: Customers assisted by water poverty measures	Not included as adjustment – forms part of new cost					
Adjustments included in draft determination	7.655	7.655	7.655	7.655	7.655	38.276
Adjustments proposed in South West Water's representations						
Doubtful Debt	6.934	6.934	6.934	6.934	6.934	34.672
Pension deficit repair costs	0.723	0.723	0.723	0.723	0.723	3.615
Outcome B1: Customers assisted by water poverty measures	0.500	0.500	0.500	0.500	0.500	2.500
Adjustments included in business plan	8.157	8.157	8.157	8.157	8.157	40.787

Adjustments included in final determination						
Doubtful Debt	6.934	6.934	6.934	6.934	6.934	34.672
Pension deficit repair costs	0.721	0.721	0.721	0.721	0.721	3.604
Outcome B1: Customers assisted by water poverty measures	Not included as adjustment – forms part of new cost					
Adjustments included in final determination	7.655	7.655	7.655	7.655	7.655	38.276

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

Household retail revenue modification

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

Table AA2.3 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 AA2.4 sets out the baseline number of customers.

Table AA2.3 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	32.29	32.50	32.64	32.48	32.77
Unmetered wastewater only customer	32.29	32.50	32.64	32.48	32.77
Unmetered water and wastewater customer	41.98	42.25	42.43	42.23	42.59
Metered only water customer	35.42	35.63	35.81	35.66	35.82
Metered wastewater only customer	32.29	32.50	32.64	32.48	32.77
Metered water and wastewater customer	45.30	45.58	45.77	45.59	45.90

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

Table AA2.4 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	30.2	29.2	28.2	27.2	26.2
Unmetered wastewater only	2.4	2.4	2.4	2.3	2.3
Unmetered water and wastewater	120.4	112.7	105.9	99.9	94.6

Number of customers	2015-16	2016-17	2017-18	2018-19	2019-20
Metered water only	30.4	31.8	33.3	34.8	36.3
Metered wastewater only	2.2	2.3	2.4	2.4	2.5
Metered water and wastewater	541.6	555.3	568.0	579.8	591.0

Annex 3 Reconciling 2010-15 performance

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

Enhanced companies' draft determinations have been updated for adjustments to reconcile 2010-15 performance, as these do not fall under the 'do no harm' principle.

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 South West Water resulting from the company's actual performance during the 2010-15 period.

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

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

In this annex, we provide an overview – comparing the company's view of the required revenue adjustments included in its revised business plan for each of the incentive tools for water and wastewater 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 South West Water 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 South West Water, and any consequential impact on our final determination, are summarised in the table below.

Table AA3.1 Representations specific to reconciling 2010-15 performance for South West Water

Area	Respondent	Summary of comment	Ofwat response
SIM	CCWater	CCWater considered that the company's SIM performance warranted a bigger penalty than had been included in the draft determination. (Noting that this was provided before the SIM range for all companies was published.)	Our August draft determination applied the SIM adjustments as set out in our methodology. Some companies' performance was worse than South West Water, and hence South West Water's performance did not sit at the bottom of the range.
OIA	South West Water	The company updated its view of its OIA to take account of updated actuals and to correct the calculation error it had made in its business plan. The company has reviewed its pension adjustments to ensure the overall calculated allowance is fair and reasonable.	We have accepted the company's updated view of its OIA.
Change protocol	South West Water	Private sewer adoptions programme: The company submitted a slightly revised claim for private sewers for the final determination. The original claim comprised £19.155 million capex and £6.059 million opex (pre-efficiency). The revised claim is slightly higher at £20.176 million capex and £6.662 million opex (pre-efficiency). In post efficiency terms, this is £19.158 million.	We accepted the company submission for the draft determination assumptions. We have accepted the company's revised proposal for the logging up of private sewers

Area	Respondent	Summary of comment	Ofwat response
	South West Water	<p>Bathing water requirements: the company submitted a slightly revised claim for bathing waters for the purposes of the final determination. The original claim comprised £17.384 million of capex (pre-efficiency). The revised claim is slightly higher at £18.498 million capex (pre-efficiency). In post efficiency terms, this is £17.211 million.</p>	<p>We accepted the company submission for the draft determination.</p> <p>We are accepting the company’s revised claim for the final determination.</p>
Service standard outputs	South West Water	<p>The company provided evidence in its responses to queries SWT/LEGACY/001 and 001a to confirm that the service standard outputs have been achieved.</p>	<p>Having considered the evidence provided in the company’s responses to queries, we are satisfied that the service standard outputs have been achieved. There are therefore no shortfall adjustments for the final determination.</p>
Serviceability performance	None	<p>The company provided additional information on its forecast of pollution incidents, flooding net of severe weather and flooding other causes, including monthly data for 2013-14 for the sewage treatment works look-up table non-compliance indicator. The data shows an improving trend in pollution incidents and performance below the reference level for sewage treatment works compliance.</p>	<p>We have not intervened for the final determination. However, our assessment is conditional upon the performance in 2014-15 being improved to a stable position. We will review serviceability performance in 2015 once actual data is available for the whole of 2010-15 period. Any shortfalls arising from this review will be applied at the next price control.</p> <p>Our assessment of the company’s specific representations, in relation to exclusions</p>

Area	Respondent	Summary of comment	Ofwat response
			and mitigating circumstances for example, is set out in table AA3.11.
CIS	South West Water	The company made minor changes to its plan when updating the 2013-14 and 2014-15 information.	As explained in policy chapter A4, we have corrected a minor error in the CIS model for all companies with respect to the discount rate used when calculating the future value of the revenue adjustment in the 2010-15 period. This minor change had no material impact of the final revenue adjustments.

Summary of 2010-15 adjustments

All companies were required to put in business plans their own adjustments for PR09 reconciliation. Table AA3.2 below sets out for each of the incentive tools for water and wastewater services:

- the company's view of the required revenue adjustments included in its business plan, as updated for its June information submission; and
- our own view.

Our view reflects our understanding of the company's performance using these incentives, based on information provided in its revised business plan, subsequent query responses and representations on our draft determination. The table also shows other adjustments, such as those relating to tax resulting from the company's actual performance during the 2010-15 period.

Table AA3.1 notes the comments that we have received that are specific to this aspect of the wholesale water and wastewater controls of South West Water and outlines how any changes have been influenced by our consideration of these responses. The changes we have made in the final determination compared to our draft determination are mainly as a result of incorporating the company's revised business plan assumptions with updated actuals for 2013-14 and forecasts for 2014-15. The overall impact of the changes increased the final determination revenues by £1.7 million (compared to the draft determination).

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

	Water service		Wastewater service	
	Company view	Ofwat view	Company view	Ofwat view
SIM	-5.600	-5.364	-6.740	-6.484
RCM	5.795	5.839	-11.755	-11.701
OIA – post-tax	3.698	3.696	0.000	0.000
CIS	-4.797	-4.795	-8.376	-8.225
Tax refinancing benefit clawback	0.000	0.000	0.000	0.000
Other tax adjustments	0.000	0.000	0.000	0.000

	Water service		Wastewater service	
	Company view	Ofwat view	Company view	Ofwat view
Equity injection clawback	0.000	0.000	0.000	0.000
Other adjustments	0.000	0.000	0.000	0.000
Total wholesale legacy adjustments	-0.904	-0.625	-26.871	-26.410

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 for both water and wastewater can be seen in table AA3.15. This adjustment is net of any logging up, logging down or shortfalls. A full reconciliation showing all of the midnight adjustments to the RCV, including the impact of logging up, logging down and shortfalls, can be seen in table A2.7 and A3.7.

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 view and our view of the annualised rewards and penalties from the company's SIM performance. Our final determination penalty differs from the company's revised plan and our draft determination, because we have used updated predicted turnover data for 2014-15 provided by the company.

Table AA3.3 SIM annualised rewards (£ million)

		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water	Company view	-1.120	-1.120	-1.120	-1.120	-1.120	-5.600
	Ofwat view	-1.073	-1.073	-1.073	-1.073	-1.073	-5.364
Wastewater	Company view	-1.348	-1.348	-1.348	-1.348	-1.348	-6.740
	Ofwat view	-1.297	-1.297	-1.297	-1.297	-1.297	-6.484

Table AA3.4 Changes to proposed 2010-15 SIM adjustments

Area	What we did	Why we did it
Predicted turnover	We have updated the calculation using the company's latest predicted turnover for 2014-15.	For consistency with our approach for other companies.

RCM

This final determination includes our view of the company's RCM annualised adjustment amounts as detailed in Table AA3.5 below.

Table AA3.6 summarises any changes in relation to South West Water's proposed 2010-15 RCM adjustments.

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

		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water	Company view	1.159	1.159	1.159	1.159	1.159	5.795
	Ofwat view	1.168	1.168	1.168	1.168	1.168	5.839
Wastewater	Company view	-2.351	-2.351	-2.351	-2.351	-2.351	-11.755
	Ofwat view	-2.340	-2.340	-2.340	-2.340	-2.340	-11.701

Table AA3.6 Changes on proposed 2010-15 RCM adjustments

Area	What we did	Why we did it
FD09 assumptions – measured non-household's revenue for the measured non-household group immediately above and below the 50ML threshold	Our final determination includes our view of the FD09 assumptions for the inputs to the RCM model. Our view of the company's revenue assumptions for the measured non-household group immediately below and above	There were minor 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-households revenue for the

Area	What we did	Why we did it
	<p>the 50 Ml tariff basket threshold originate from the company's FD09 revenue forecasts that come from the tariff basket model, which we used for PR09.</p>	<p>Measured Non-household group immediately above and below the 50ML threshold' compared with our view of its FD09 assumptions.</p> <p>Our assumptions for the final determination include the FD09 revenue forecasts as contained in the PR09 tariff basket model in accordance with our published methodology 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance'.</p>
<p>Out-turn financial year average RPI</p>	<p>Our assumptions for the out-turn financial year average RPI at the final determination uses the data that the company has submitted in business plan table A9 to calculate our view of the RCM adjustment.</p>	<p>There are minor inconsistencies with the out-turn financial year average RPI between table A9 and the company's populated RCM model. Our assumptions for the final determination apply the information within table A9.</p>
<p>Number of households billed</p>	<p>Our assumptions for the final determination includes the number of households billed in 2009-10 as submitted by the company in table 7 and 13 of its June return and the data the company submitted in business plan table R3 to calculate our view of the RCM adjustment compared with the values in the company RCM model.</p>	<p>There is a minor difference with the number of households billed between the June return and the company's populated RCM model. We have applied the number of households billed in 2009-10 as submitted in the June return.</p>

Operating expenditure incentive allowance

Table AA3.7 below summarises the company's view and our view of the incentive allowances for 2015-20. There are no changes in this area.

Our final determination is different to our draft determination due to accepting the company's revised OIA, which is now calculated in accordance with the published

methodology. This increases the final determination revenue by £2.2 million compared to the draft determination.

Table AA3.7 Operating expenditure incentive allowances for 2015-20 (£ million)

		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water service							
Incentive allowance (post-tax)	Company view	1.730	1.730	0.238	0.000	0.000	3.698
	Ofwat view	1.729	1.729	0.237	0.000	0.000	3.696
Wastewater service							
Incentive allowance (post-tax)	Company view	0.000	0.000	0.000	0.000	0.000	0.000
	Ofwat view	0.000	0.000	0.000	0.000	0.000	0.000

Change protocol (logging up, logging down and shortfalls)

Table AA3.8 and table AA3.9 below summarise South West 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 some minor changes from our draft determination as a result of accepting the company's revised logging up claims for the private sewers adoptions programme and bathing water requirements, but there are no interventions in this area. These changes increase the logging up value taken forward into the CIS and RCV reconciliations by £2.0 million compared with the draft determination.

Table AA3.8 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	Water service		Wastewater service		Total service	
	Company view	Ofwat view	Company view	Ofwat view	Company view	Ofwat view

2009-10 to 2014-15 – post-efficiency capex	Water service		Wastewater service		Total service	
	Company view	Ofwat view	Company view	Ofwat view	Company view	Ofwat view
Logging up (two-sided)	0.000	0.000	36.370	36.370	36.370	36.370
Logging down (two-sided)	0.000	0.000	0.000	0.000	0.000	0.000
Shortfalls (one-sided)	0.000	0.000	0.000	0.000	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 AA3.9 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	Water service		Wastewater service		Total service	
	Company view	Ofwat view	Company view	Ofwat view	Company view	Ofwat view
Logging up	0.000	0.000	6.059	6.059	6.059	6.059
Logging down	0.000	0.000	0.000	0.000	0.000	0.000
Shortfalls	0.000	0.000	0.000	0.000	0.000	0.000
Shortfalls for serviceability	0.000	0.000	0.000	0.000	0.000	0.000

Service standard outputs

Service standards are regulatory outputs that we set out in the 2009 final determination (FD09) supplementary reports⁶. Where companies have not reported progress on these service standards, we would have expected them to demonstrate

⁶ In the final determination supplementary reports we said: “Both the project activity (as proposed in your final business plan) and the service standard are the defined output. You must demonstrate delivery of the stated service standard output through the June return. We recognise that companies may decide to prioritise activity differently in order to achieve the service output in a more efficient manner. All material changes to the project activity must be reported and explained through your June return.

achievement of the service standards to both customers and Ofwat as part of the price review process.

Following queries SWT/LEGACY/001 and 001a, the company provided satisfactory evidence that it has achieved the service standards for energy generation, monitoring, odour and resilience as set out in the 2009 final determination and therefore we have not applied a shortfall.

Serviceability performance

Table AA3.10 below summarises our serviceability assessments for South West Water.

Table AA3.11 summarises any changes in relation to South West Water’s proposed adjustments for serviceability.

There are no changes from our draft determination, no interventions in this area and no impact on the RCV. Although there are no interventions in this area, this is conditional on the company demonstrating stable performance in 2014-15.

Table AA3.10 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	Stable	Stable	Stable	Stable	Stable
Wastewater infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Stable	Stable	Stable	Stable	Stable
Wastewater non-infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Stable	Stable	Stable	Stable	Stable

Note:

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

Table AA3.11 Changes to proposed 2010-15 serviceability adjustments

Area	What we did	Why we did it
Pollution incidents	<p>For the purposes of the final determination, there is no intervention for this indicator. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We will consider a shortfall adjustment if this is not achieved. Serviceability performance in AMP5 is due to be reviewed in 2015 once data is available for the whole of AMP5 period. Any shortfalls arising from this review will be applied at the next price control.</p>	<p>The company has had two breaches of the upper control limit in 2012-13 and 2013-14. However, 2014-15 performance is expected to improve to below the upper control limit. The company has provided evidence to show that severe weather in 2012 and the winter of 2013 had an adverse impact on performance. We consider this to be a reasonable explanation for the increase in pollution incidents and have therefore not applied a shortfall. Taking these exceptional events into account, we would expect the company to demonstrate stable performance in 2015. If this is not achieved, we may consider a shortfall.</p>
Flooding overloaded sewers excluding severe weather	<p>For the purposes of the final determination, there is no intervention for this indicator. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We will consider a shortfall adjustment if this is not achieved. Serviceability performance in AMP5 is due to be reviewed in 2015 once data is available for the whole of AMP5 period. Any shortfalls arising from this review will be applied at the next price control.</p>	<p>The company has had two breaches of the upper control limit in 2012-13 and 2013-14. However, 2014-15 performance is expected to improve to below the reference level. The company has provided evidence to show that performance in those years was adversely impacted by extreme prolonged periods of rain, which are not automatically excluded as severe weather from this measure. We consider this to be a reasonable explanation for the increase in internal flooding incidents and have therefore not applied a shortfall. However, we would expect projected 2014-15 performance to be achieved.</p>

Area	What we did	Why we did it
		If this is not achieved, we may consider a shortfall adjustment.
Properties internally flooded in year because of other causes	For the purposes of the final determination, there is no intervention for this indicator. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We will consider a shortfall adjustment if this is not achieved. Serviceability performance in AMP5 is due to be reviewed in 2015 once data is available for the whole of AMP5 period. Any shortfalls arising from this review will be applied at the next price control.	The company has had one breach of the upper control limit in 2012-13. Performance in 2013-14 recovered to near the reference level and performance in 2014-15 (based on six months of actual failure data) is expected to be at the same level as 2013-14 that is, near to the reference level. We require the company to demonstrate stable serviceability as part of the 2015 review. If this is not achieved, we will consider a shortfall adjustment.
Population equivalent (sewage treatment) non-compliance	For the purposes of the final determination, there is no intervention for this indicator. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We will consider a shortfall adjustment if this is not achieved. Serviceability performance in AMP5 is due to be reviewed in 2015 once data is available for the whole of AMP5 period. Any shortfalls arising from this review will be applied at the next price control.	The company has had one breach of the upper control limit in 2013-14. The company has provided evidence to show that this is one-off failure at two treatment works where improvement work is planned during AMP5. The monthly data for 2014 up to September demonstrate that performance will be delivered within the reference level for 2014-15. We require the company to demonstrate stable serviceability as part of the 2015 review. If this is not achieved, we will consider a shortfall adjustment.

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

Table AA3.12 below confirms South West Water’s proposed transition programme. There are no interventions in this area.

Table AA3.12 Transition programme in 2014-15

Net capital expenditure	2014-15 (£ million)	Proportion of forecast in 2014-15	Proportion of capital programme in 2015-20
Water service	1.2	2.4%	0.4%
Wastewater service	1.0	1.2%	0.2%

Capital expenditure incentive scheme

Table AA3.13 provides details of the CIS ratios and performance incentive. It also gives the:

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

Table AA3.14 then sets out the profiled values of the revenue adjustments in each year 2015-20, table AA3.15 shows the components of the opening RCV which are included in the CIS adjustment. There are no changes in this area. Table AA3.16 summarises our minor update to South West Water’s proposals.

In carrying out the CIS assessment for the final determination, we have used the updated information on 2013-14 and 2014-15 submitted after the draft determination in accordance with the process for a company with enhanced status.

In its representation on the draft determination, the company noted the difference between the company view and Ofwat view of the wastewater CIS adjustments is driven by its treatment of efficiency in the wastewater change protocol adjustments. The efficiency issue was addressed when updating the 2013-14 actual and 2014-15 forecast.

We have also updated our methodology since the draft determination and have used the post-tax cost of capital as the discount rate when calculating the future value of revenue adjustments.

The overall impact of the changes increased the final determination revenues by £1.7 million (compared to the draft determination).

Table AA3.13 CIS true-up adjustments

		Water service	Wastewater service	Total service
Restated FD09 CIS bid ratio ¹	Company view	105.080	108.854	N/a
	Ofwat view	105.080	108.854	N/a
Out-turn CIS ratio	Company view	96.474	102.315	N/a
	Ofwat view	96.484	102.330	N/a
Incentive reward/penalty (%) ²	Company view	0.904	-0.861	N/a
	Ofwat view	0.901	-0.865	N/a
Reward/penalty (£m)	Company view	2.698	-3.548	-0.850
	Ofwat view	2.690	-3.563	-0.874
Adjustments to 2015-20 revenue (£m) ³	Company view	-4.710	-8.223	-12.933
	Ofwat view	-4.708	-8.075	-12.784
RCV adjustment (£m) ⁴	Company view	-29.942	12.576	-17.366
	Ofwat view	-29.941	12.589	-17.352

Notes:

1. The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol (table AA3.8)
2. The reward/(penalty) is adjusted for the additional income included in the 2010-15 determination and the financing cost on the difference between actual spend and capital expenditure assumed in the 2010-15 determination to derive the value of the adjustment to 2015-20 revenue.
3. The adjustment to 2015-20 revenue values shown in this table assume a single year adjustment in the first year, and do not include the NPV profiling used for the final determination.
4. In table AA3.15 we show how the components of this agree to those shown in table A2.7 and table A3.7.

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

		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water	Company view	-2.355	-2.442	0.000	0.000	0.000	-4.797
	Ofwat view	-2.354	-2.441	0.000	0.000	0.000	-4.795
Wastewater	Company view	-4.112	-4.264	0.000	0.000	0.000	-8.375
	Ofwat view	-4.038	-4.187	0.000	0.000	0.000	-8.225

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

	Water service	Wastewater service
Adjustment for actual expenditure 2010-15	-29.941	-23.781
Net adjustment from logging up and logging down	0.000	36.370
Adjustment for shortfalls	0.000	0.000
RCV adjustment	-29.941	12.589

Table AA3.16 Adjustments to proposed CIS adjustments

Update	What we did	Why we did it
Methodology change	We have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period.	As explained in policy chapter A4, to address these issues we have changed the CIS model.

Other adjustments

There are no other adjustments for revenue and no changes from our draft determination and there are no interventions in this area. Table AA3.17 and table AA3.18 below confirm the assumptions included in this final determination with respect to other adjustments to the opening RCV.

In the draft determination, we used the company view of the opening RCV. For final determination, we have used our feeder model calculations.

Table AA3.17 Other adjustments to the opening RCV (£ million)

	Water service		Wastewater service	
	Company view	Ofwat view	Company view	Ofwat view
Land sales	-1.144	-1.154	-1.468	-1.507
2009-10 adjustment	0.000	10.380	0.000	-6.328
Enhanced rewards	5.189	5.189	5.189	5.189
Other adjustments	4.801	0.000	-12.983	0.000

Table AA3.18 Changes to proposed adjustments to the opening RCV

Area	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 with all companies.
2009-10 adjustment	Adjustment not shown in business plan	This provided a consistent approach with all companies.
Other adjustments	We calculated the component parts of the midnight adjustment as if the company was non-enhanced. Therefore this balancing figure was irrelevant for the final determination.	This provided a consistent approach with all companies.

Annex 4 Outcomes, performance commitments and outcome delivery incentives

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

In this annex, we provide an overview of the performance commitments and ODIs for South West Water. We then set out in detail these performance commitments and ODIs for the company's wholesale water, wholesale wastewater 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. On 4 April, we stated that the company had achieved enhanced status and that its cost-sharing rate at 100 would be 55% rather than 50%. Once the company has chosen its position on the enhanced 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 their menu choice on 16 January 2015 so that the recalibrated ODIs can be included in the regulatory reporting framework for 2015-16.

However, we first consider the responses to our draft determinations in relation to the performance commitments and ODIs for South West Water.

Consideration of representations on our draft determinations

Having considered representations on the draft determinations, the determinations for the enhanced companies have not been changed to reflect the comparative assessments, since we continue to consider that it is appropriate to accept the enhanced companies' business plans in the round. However, both enhanced companies have recognised that even though their financial incentives are not being changed, they face reputational incentives to improve their performance in areas where they are not yet delivering upper quartile performance. The companies are continuing to engage with their CCGs on how they will track performance against the upper quartile during the period, and both have recognised the reputational impacts in the latter years of the price control if their performance is below upper quartile.

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 performance commitments and ODIs for South West Water, and any consequential impact on our final determination, are summarised in the tables below as follows.

- Tables AA4.1 and AA4.2 consider representations received on our draft determinations as a result of comparative assessment in six areas for wholesale water and wholesale wastewater respectively.
- Tables AA4.3 and AA4.4 consider representations received on our draft determination as a result of our company-specific assessments for wholesale water and wholesale wastewater respectively.
- Table AA4.5 considers representations received on our draft determination as a result of our company-specific assessments for household retail.
- Table AA4.6 lists the performance commitments that were proposed by the company but that have been removed as part of our final determination.
- Table AA4.7 lists performance commitments excluded from the commentary tables above because we received no representations on them.

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

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
Compliance with water quality standard	Not applicable	CCWater asked whether South West Water’s performance commitment and ODI would be adjusted following the comparative assessment of mean zonal compliance.	No change.	<p>South West Water is the joint highest performer in the industry on mean zonal compliance over the last 3 years and is committing to maintaining its performance during 2015-20.</p> <p>We are not applying the results of our comparative assessment to South West Water as we undertook these after the company was awarded enhanced status. This protection is there to help incentivise companies to put forward a high quality business plan.</p>
Taste, smell and colour contacts	Not applicable	CCWater commented that Ofwat has set the performance commitment for the non-enhanced companies at the upper quartile level of 1.22 contacts per 1,000 population from 2017-18 onwards. South West Water’s commitment is to achieve 3.0 in 2019-20. CCWater asked whether	No change.	<p>South West Water has said it will engage with its CCG and regulators about how upper quartile performance will be tracked, monitored and reviewed through its WaterShare mechanism during 2015-20.</p> <p>South West Water has undertaken to have regard to upper quartile</p>

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
		<p>Ofwat would change South West Water's commitment to be in line with the non-enhanced companies.</p>		<p>performance in anticipation of its 2019 price determination</p> <p>We are not applying the results of our comparative assessment to South West Water as we undertook these after the company was awarded enhanced status. This protection is there to help incentivise companies to put forward a high quality business plan.</p>
Duration of interruptions in supply	Not applicable	<p>CCWater commented that Ofwat has set the performance commitment for the non-enhanced companies at the upper quartile level of 10 minutes from 2017-18 onwards. South West Water's commitment is to achieve 12 minutes in 2019-20. CcWater asked whether Ofwat would change South West Water's commitment to be in line with the non-enhanced companies.</p> <p>CcWater asked whether South</p>	No change.	<p>Following representations from stakeholders on the supply interruptions comparative assessment we have revised the upper quartile to 12 minutes. South West Water's performance commitment is to achieve 12 minutes by 2019-20.</p> <p>Progress on both supply interruptions and leakage will benefit customers. If the company can exploit synergies between the two performance commitments that should benefit customers.</p>

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
		West Water’s commitment to improve leakage performance might have an impact on its supply interruptions commitment. CCWater asked us to clarify how the two performance commitments work alongside each other to benefit customers.		

Table AA4.2 Representations specific to the comparative assessments on wholesale wastewater

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
Internal sewer flooding incidents (number)	Not applicable	CCWater asked whether South West Water’s performance commitment and ODI would be adjusted following our comparative assessment of internal sewer flooding. The Environment Agency	No change.	South West Water was one of the companies that included transferred assets in its internal sewer flooding measure. It is not clear that if we excluded transferred assets that our comparative assessment of internal sewer flooding would lead to any change

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
		<p>commented that the financial incentive allows for a deterioration in performance before a penalty applies. It stated that this does not provide a robust incentive for driving an improvement towards zero.</p> <p>CCWater raised a concern that there might be a negative customer perception of a company being rewarded financially when properties have been flooded by sewage, even if the number of properties flooded annually represents an improvement in performance.</p>		<p>in the company’s performance commitment and ODI.</p> <p>South West Water says it will engage with its CCG and regulators as to how upper quartile performance will be tracked, monitored and reviewed through its WaterShare mechanism during 2015-20.</p> <p>We are not applying the results of our comparative assessment to South West Water as we undertook these after the company was awarded enhanced status. This protection is there to help incentivise companies to put forward a high quality business plan.</p> <p>South West Water has undertaken to consider whether any deterioration in its performance during 2015-20 would be in the interests of its customers.</p> <p>The reward incentivises South West Water to reduce the number of internal sewer flooding incidents, which is of</p>

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
				benefit to customers even if it does not reduce the number to zero. South West Water based its reward rate on its customers' willingness to pay.
Pollution incidents – category 3 and 4 (number)	Not applicable	<p>The EA said it would welcome a separation of the performance commitments for category 3 and 4 pollution incidents as it only verifies data on category 1, 2 and 3 pollution incidents.</p> <p>The Environment Agency asked whether the company, in setting the deadband for this performance commitment, took account of its expectation that the overall number of incidents should reduce by a third by 2020 (compared to 2012).</p> <p>CCWater asked whether South West Water's performance commitment and ODI would be adjusted following our comparative assessment of</p>	No change.	<p>South West Water has told us it will continue to include category 4 pollution incidents in this performance commitment. The company's research shows that its customers significantly value category 4 incidents being avoided, as well as category 3.</p> <p>South West Water says it will engage with its CCG and regulators about how upper quartile performance will be tracked, monitored and reviewed through its WaterShare mechanism during AMP6. We are not applying the results of our comparative assessment to South West Water as we undertook these after the company was awarded enhanced status. This protection is there to help incentivise companies to put forward a high quality</p>

PC/ODI affected	What we did at draft determination/ subsequent comparative assessment	Representations	What we did at final determination	Why we did it
		category 3 pollution incidents.		business plan.

Table AA4.3 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
Water restrictions placed on customers	Not applicable	<p>The Environment Agency commented that the reward on avoiding water restrictions might cause South West Water to delay applying restrictions when they are needed to protect the environment. The Environment Agency expects the company to manage a drought in line with its Drought Plan without regard to the financial implications of the reward.</p> <p>CCWater expressed concern that South West Water can achieve a reward of £7.2m at the end of the price control period if it does not impose any water use restrictions on customers, when the company has a supply surplus. CCWater stated the company</p>	No change.	<p>Companies' legal obligations as water and/or sewerage undertakers continue to apply regardless of their performance commitments and ODIs. South West Water has stated that it has a statutory duty to publish and follow its drought plan.</p> <p>South West Water's reward is contingent on there being no water restrictions throughout 2015-20. The reward is based on its customers' willingness to pay to avoid water restrictions. In the longer term, reducing the frequency of water restrictions involves investment and</p>

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		should not achieve a financial reward when it may not need to take any action to improve service delivery to achieve this.		management focus, which a reward should encourage.
Leakage levels (MI/d)	Not applicable	<p>The Environment Agency stated that this performance commitment is for a flat level of leakage over the period, but suggested it could be changed to consolidate improvements made year on year.</p> <p>The Environment Agency commented that the additional details section mentions measurement over the calendar year, while the performance commitment table shows financial years.</p>	No change.	<p>South West Water’s leakage target is below its Sustainable Economic Level of Leakage (SELL). The company will be incentivised to improve its performance during 2015-20 by the reward. The company has also set a target to reduce the number of days it takes to repair leaks.</p> <p>South West Water has clarified that the leakage figures should refer to calendar years.</p>
Supplies interrupted due to flooded company sites	Not applicable	<p>The Environment Agency suggested that South West Water should reconsider this incentive, as a reward will apply even if there is deterioration in current performance.</p> <p>CCWater argued that the reward on this performance commitment gives a poor message to customers that a company can earn a financial reward, even though up to</p>	No change.	The performance commitment relates to the unlikely event of a company site being flooded. South West Water will only earn a reward if less than 20% of properties served by the site are interrupted more than 24 hours. This gives the company an additional incentive to make sure its customers’ supplies are resilient to its sites

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		38,607 customers may be affected by a supply interruption.		flooding.
Sustainable abstractions (EA water stress status)	Not applicable	<p>The Environment Agency stated that this performance commitment is outside the control of the company as decisions on water stress are driven by conditions within the catchment rather than company operations.</p> <p>The Environment Agency also said that the definitions used by the company are also no longer used by the Environment Agency.</p>	We require South West Water to adopt the Environment Agency’s new water scarcity definitions or to provide a reconciliation between the definition used for the incentive and any subsequent definitions the Environment Agency introduces.	<p>This performance commitment is penalty only. The penalty applies if the water scarcity status changes and if South West Water does not deal with any issues that emerge.</p> <p>South West Water has based this performance commitment on the Environment Agency’s water scarcity definitions. As the Environment Agency has changed its definitions South West Water should adopt the new definitions or provide a reconciliation between the definition used for the incentive and any subsequent definitions the Environment Agency introduces.</p>

Table AA4.4 Representations specific to the company-specific assessments on wholesale wastewater

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
External sewer flooding incidents (number)	Not applicable	CCWater expressed concern that there may be a negative customer perception of a company being rewarded financially when properties have been flooded by sewage, even if the number of properties flooded annually represents an improvement in performance.	No change.	The reward incentivises South West Water to reduce the number of external sewer flooding incidents, which is of benefit to customers even if it does not reduce the number to zero. South West Water based its reward rate on its customers' willingness to pay. The reward rate is relatively small at £2,000 per incident.
Odour contacts – WWTWs (number)	Not applicable	CCWater noted that South West Water will obtain a reward if 344 or fewer customer contacts are received due to this service failure. CCWater considered there is a risk of a negative customer reaction for a company receiving a reward when this level of contacts has been received.	No change.	The reward incentivises South West Water to reduce the number of odour contacts, which is of benefit to customers even if it does not reduce the number to zero. South West Water based its reward rate on its customers' willingness to pay. The reward rate is relatively small at £2,000 per incident.
Asset reliability – pipes	Not applicable	The Environment Agency believes this penalty-only incentive should be reviewed, as it will not provide any financial penalty for	No change.	The penalty is triggered when South West Water has 1 year of deteriorating status or 3 years of

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		deterioration in current performance from stable to deteriorating. This could result in reduced performance, which may impact on pollution incidents.		marginal status.
Asset reliability – processes	Not applicable	The Environment Agency believes this penalty-only incentive should be reviewed, as it will not provide any financial penalty for deterioration in current performance from stable to deteriorating. This could result in reduced performance, which may impact on pollution incidents.	No change.	The penalty is triggered when South West Water has 1 year of deteriorating status or 3 years of marginal status.
WWTW numeric compliance (%)	Not applicable	The Environment Agency support South West Water’s commitment to achieve 100% wastewater treatment numeric compliance by 2020. The Environment Agency commented that it would be helpful to include targets for intervening years to enable progress towards this 2020 commitment to be managed.	We have set South West Water non-financial interim performance commitments for 2015-16 and 2017-18.	The interim performance commitments will help the independent WaterShare panel to review and challenge the company’s progress towards its 100% performance commitment in 2020.
WWTW descriptive permit compliance	Not applicable	The Environment Agency stated that it does not believe that setting the penalty dead band at 92% sufficiently encourages the company to improve its performance. The	We are raising the penalty deadband to 95% compliance for each year in	We agree with the Environment Agency and CCWater that South West Water should incur a penalty if its performance declines from its forecast

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
(%)		<p>penalty deadband should be set at the starting level performance of 95% as a minimum and progressively tightened to reach a level of 98%, or alternatively be set as a flat line at 98%.</p> <p>CCWater questioned why the penalty deadband was set at 92% compliance when South West Water's starting point for the five years is 95%, improving to 100% by 2019-20. The penalty should apply if South West Water's compliance falls below its 95% starting level.</p>	2015-20.	2014-15 performance of 95%.
Bathing water quality (%)	Not applicable	The Environment Agency stated that the target of zero failing Bathing Waters to be achieved in 2020 needs to be brought forward to 2016 as 2016 is the statutory date for compliance with the Bathing Waters Directive. The penalty dead-band allows failures beyond the statutory completion date and there is a provision for rewards beyond 2016 to meet what will become a statutory obligation.	No change.	Companies' legal obligations as water and/or sewerage undertakers continue to apply regardless of their performance commitments and ODIs. South West Water has clarified with us that the Environment Agency's enforcement of agreed bathing water directive outputs is separate from the financial ODI.
River water	Not applicable	The Environment Agency believes the	No change.	South West Water has clarified with

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
quality standard (km)		<p>definition of this measure should be changed. The length of river improved should be calculated as the length of river that benefits from a change in classification as a result of work by South West Water. It should not include all subsequent downstream water bodies down to the tidal limits.</p> <p>The Environment Agency suggested that a financial rather than reputational only incentive for river water quality would give the company greater encouragement to go further and/or faster in its delivery of river water quality improvements, including those associated with the Water Framework Directive.</p>		<p>us that it considers its measure is appropriate for its outcomes. The company has stated that its statutory obligation to contribute to Water Framework Directive river quality outcomes still applies regardless of the definition of this performance commitment.</p> <p>Under the company’s WaterShare process an independent panel will review and challenge the company’s performance on an annual basis including its performance on reputational incentives.</p>

Table AA4.5 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
Customers assisted by water poverty initiatives	Not applicable	CCWater questioned whether the target to increase the number of customers receiving assistance from the current 21,500 to 23,200 is sufficiently ambitious, given the company's requirement to improve its debt recovery performance. CCWater recognised that this was a non-financial incentive.	No change.	The company has explained that the customer research it carried out, as part of developing its social tariff, showed household customer support for the level of vulnerable customer protection costs and social tariff cross-subsidies.

Table AA4.6 Performance commitments proposed by the company that we have removed from this final determination

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

Table AA4.7 Performance commitments excluded from the commentary tables because we received no representations to our draft determinations on them and we made no changes at draft determination

Wholesale water	Wholesale wastewater	Household retail
Asset reliability (pipes)	Compliance with sludge standard (%)	Customer overall satisfaction (%)
Asset reliability (process)	Operational customer contacts resolved first time (%)	SIM
Ability to move water around the network	WWTW pop. equiv. sanitary compliance (%)	Customers' satisfaction with value for money (%)
Time taken to fix significant leaks (days)	Pollution incidents – category 1 and 2 (number)	
Security of supply index	Operational carbon emissions (ktCO ₂ e)	
Operational customer contacts resolved first time (%)	Energy from renewable sources (%)	
Sustainable abstractions (EA/WFD classification)	Combined sewer overflow spills (number)	
Catchment management (acres)		
Catchment management (number of farms)		
Pollution incidents – category 1 and 2 (number)		
Pollution incidents – category 3 and 4 (number)		
Operational carbon emissions (ktCO ₂ e)		
Energy from renewable sources (%)		
Customers paying a metered bill		

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.

Companies also had to propose outcome delivery incentives. 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.

Under the company's current licence the adjustment to price controls for financial rewards and penalties will occur at the end of the control period (either as an RCV or revenue adjustment to future price controls). However, as set out in section A2.2.3, we are proposing a licence modification that will allow in-period adjustments to the level of price controls in relation to selected performance commitments.

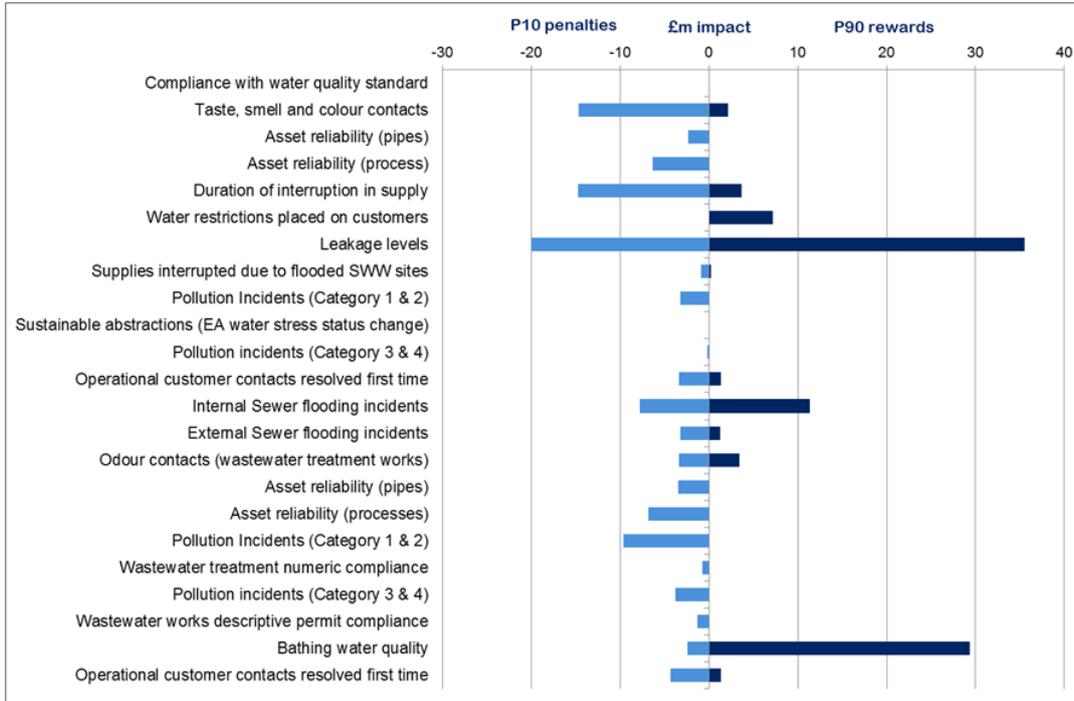
Table AA4.8 shows the balance between reward and penalty, penalty only and reputational incentives in the package of incentives for the company.

Table AA4.8 The composition of the package of ODIs

	Reward and penalty	Penalty only	Non-financial incentive
Wholesale water	6	7	8
Wholesale wastewater	5	6	6
Household retail	1	0	3
Total	12	13	17

Figure AA4.1 shows the potential financial impact 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



Note:

The PCs compliance with water quality standard and sustainable abstractions (EA water stress status change) are both penalty-only PCs but South West Water does not expect a penalty at a P10 level of performance.

As explained in policy chapter A2, we are introducing an aggregate cap on rewards and collar on penalties from the ODIs for non-enhanced companies. As an enhanced company, this cap and collar does not apply to South West Water. Details of how the cap/collar will operate are set out in section A2.6 of policy chapter A2.

In the remainder of this chapter, we provide the following information on each performance commitment in this final determination:

- the name and detailed definition of the performance commitment;
- the type of incentive;
- the performance commitment level;
- for financial incentives:
 - the limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable⁷; and
 - the incentive rates; and

⁷ Unless otherwise stated, a deadband is the level of service against which an incentive is calculated and the cap or collar is the level of service at which the maximum reward or penalty occurs. So for example, if the deadband is 1.29 and the actual performance level is 1.39, the result of the incentive would be a penalty of (1.39-1.29) times the specified penalty rate.

- additional details on the measure.

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

Performance commitments and ODIs in detail

Wholesale water outcome: clean, safe and reliable supply of drinking water

Performance commitment: compliance with water quality standard

Detailed definition of performance measure

Mean zonal compliance for the calendar year as measured by South West and reported in the Drinking Water Inspectorate (DWI) Chief Inspector's annual report.

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
Performance commitments	%	99.98	99.98	99.98	99.98	99.98	99.98
Penalty collar	%		90	90	90	90	90
Penalty deadband	%		99.9	99.9	99.9	99.9	99.9

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Penalty	90	99.9	0.044m

Additional details

Necessary detail on measurement units	The DWI's Mean Zonal Compliance index in per cent.
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Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Penalty applied annually to each calendar year.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: taste, smell and colour contacts

Detailed definition of performance measure

Information for the calendar year as provided by South West Water to the DWI in the return for the DWI Chief Inspector's annual report.

Calculation is the number of contacts for discoloured water (brown/black/orange) plus all taste/odour contacts multiplied by 1,000 divided by the resident population as reported to the DWI.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./1,000 pop	4.5	4.2	3.9	3.6	3.3	3.0
Penalty collar	No./1,000 pop		8.0	8.0	8.0	8.0	8.0

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty deadband	No./1,000 pop		4.2	3.9	3.6	3.3	3.0
Reward deadband	No./1,000 pop		2.02	2.02	2.02	2.02	2.02
Reward cap	No./1,000 pop		1.5	1.5	1.5	1.5	1.5

Incentive rates

Incentive type	Performance levels (no./1,000 population)		Incentive rate (£/no./1,000 pop/year)
	Lower	Upper	
Penalty 1	8.0	4.5	0.612m
Penalty 2	4.5	3.6	0.869m
Reward	2.02	1.5	0.833m

Additional details

Necessary detail on measurement units	Discoloured (brown/black/orange) contacts plus taste/odour contacts per 1,000 resident population.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Reward or penalty applied annually for each calendar year.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The penalty incentive rate of £0.869m applies from 4.5 to the penalty deadband within each year. An average value of the deadband has been used to complete the table.

Performance commitment: asset reliability (pipes)

Detailed definition of performance measure

Serviceability assessment of either stable/marginal/deteriorating as defined for the Ofwat key performance indicators (KPIs) in [IN 13/03: 'Regulatory reporting for 2012-13 – process'](#).

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
Performance commitments	Status	Stable	Stable	Stable	Stable	Stable	Stable
Penalty collar	Status		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Penalty deadband	Status		Marginal	Marginal	Marginal	Marginal	Marginal

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/change in status/year)
	Lower	Upper	
Penalty	Deteriorating	Marginal	0.458m

Additional details

Necessary detail on measurement units	Measurement units are based on serviceability assessment criteria, as defined for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel.

Timing and frequency of rewards/penalties	Penalty applied at the end of period.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	South West Water defines the ‘deteriorating’ level of performance that would trigger the penalty incentive to include the third and subsequent years of marginal status until stable performance is achieved. This would include any ‘marginal’ (and ‘deteriorating’) inherited from 2013-14 and 2014-15 performance. This includes the following standard serviceability guidance, ‘deteriorating’ status serviceability would not improve to ‘stable’ in at least the subsequent year even with improved metrics. Although the third ‘marginal’ status might improve to ‘stable’, in this situation the level of penalty applied as ‘deteriorating’ in the third year would reflect an appropriate penalty.

Detail on reference levels and control limits for sub-measures

Indicator	Unit		2015-16	2016-17	2017-18	2018-19	2019-20
Total bursts	nr	Ref	2430	2430	2430	2430	2430
		High	2900	2900	2900	2900	2900
		Low	1960	1960	1960	1960	1960
Interruptions >12h	nr	Ref	437	437	437	437	437
		High	1115	1115	1115	1115	1115
		Low	0	0	0	0	0
Iron non-compliance (as 100-Mean Zonal Compliance)	%	Ref	0.54	0.54	0.54	0.54	0.54
		High	1.02	1.02	1.02	1.02	1.02
		Low	0.06	0.06	0.06	0.06	0.06
DG2 Pressure	nr	Ref	204	204	204	204	204
		High	287	287	287	287	287
		Low	121	121	121	121	121
Customer contacts – discolouration	nr / 1000 population	Ref	9.46	9.46	9.46	9.46	9.46
		High	12.13	12.13	12.13	12.13	12.13

Indicator	Unit		2015-16	2016-17	2017-18	2018-19	2019-20
		Low	6.79	6.79	6.79	6.79	6.79
Distribution Index TIM (as 100-Mean Zonal Compliance)	%	Ref	0.18	0.18	0.18	0.18	0.18
		High	0.29	0.29	0.29	0.29	0.29
		Low	0.07	0.07	0.07	0.07	0.07

Key
 Ref = reference level
 High = upper control limit
 Low = lower control limit

Performance commitment: asset reliability (process)

Detailed definition of performance measure

Serviceability assessment of either stable/marginal/deteriorating as defined for the Ofwat KPIs in [IN 13/03](#).

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
Performance commitments	Status	Stable	Stable	Stable	Stable	Stable	Stable
Penalty collar	Status		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Penalty deadband	Status		Marginal	Marginal	Marginal	Marginal	Marginal

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/change in status/year)
	Lower	Upper	
Penalty	Deteriorating	Marginal	1.269m

Additional details

Necessary detail on measurement units	Measurement units are based on serviceability assessment criteria, as defined for the Ofwat KPIs in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Penalty applied at the end of period.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	South West Water defines the 'deteriorating' level of performance that would trigger the penalty incentive to include the third and subsequent years of marginal status until stable performance is achieved. This would include any 'marginal' (and 'deteriorating') inherited from 2013-14 and 2014-15 performance. This includes the following standard serviceability guidance, 'deteriorating' status serviceability would not improve to 'stable' in at least the subsequent year even with improved metrics. Although the third 'marginal' status might improve to 'stable', in this situation the level of penalty applied as 'deteriorating' in the third year would reflect an appropriate penalty.

Detail on reference levels and control limits for sub-measures

Indicator	Unit		2015-16	2016-17	2017-18	2018-19	2019-20
WTW coliforms non-compliance	%	Ref	0.07	0.07	0.07	0.07	0.07
		High	0.12	0.12	0.12	0.12	0.12
		Low	0.02	0.02	0.02	0.02	0.02
Service reservoir	%	Ref	0.00	0.00	0.00	0.00	0.00

coliforms non-compliance		High	0.60	0.60	0.60	0.60	0.60
		Low	0.00	0.00	0.00	0.00	0.00
Turbidity non-compliance	nr	Ref	2	2	2	2	2
		High	4	4	4	4	4
		Low	0	0	0	0	0
Enforcement incidents	nr	Ref	0	0	0	0	0
		High	1	1	1	1	1
		Low	0	0	0	0	0
Unplanned maintenance	nr	Ref	2237	2237	2237	2237	2237
		High	2861	2861	2861	2861	2861
		Low	1613	1613	1613	1613	1613
Key							
Ref = reference level							
High = upper control limit							
Low = lower control limit							

Performance commitment: duration of interruptions in supply

Detailed definition of performance measure

Average hours of supply interruption per property within the South West Water supply area (includes both planned and unplanned interruptions) as defined for the Ofwat KPI in IN 13/03.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Hrs/prop	0.27	0.256	0.242	0.228	0.214	0.2
Penalty collar	Hrs/prop		0.8	0.8	0.8	0.8	0.8
Penalty deadband	Hrs/prop		0.256	0.242	0.228	0.214	0.2
Reward deadband	Hrs/prop		0.256	0.242	0.228	0.214	0.2
Reward cap	Hrs/prop		0.1	0.1	0.1	0.1	0.1

Incentive rates

Incentive type	Performance levels (hours/property)		Incentive rate (£/hrs/prop/year)
	Lower	Upper	
Penalty 1	0.8	0.27	4.930m
Penalty 2	0.27	0.228	8.015m
Reward	0.228	0.1	5.734m

Additional details

Necessary detail on measurement units	The measurement unit includes both planned and unplanned supply interruptions. Ofwat KPI as defined in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel. The incentive will be assessed based on an average performance.
Timing and frequency of rewards/penalties	Reward or penalty applied at the end of period.
Form of reward/penalty	RCV adjustment.

Any other information or clarifications relevant to correct application of incentive

Due to the phasing of the plan, average target is 0.23 hours per property. As the company is using an average, the neutral deadbands are set equal to the committed performance level (CPL) in each year.

Wholesale water outcome: available and sufficient resources

Performance commitment: water restrictions placed on customers

Detailed definition of performance measure

The number of water restrictions in place on customers in the report year.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./year	0	0	0	0	0	0
Penalty collar	No./AMP						2
Penalty deadband	No./AMP						1
Reward deadband	No./year		0	0	0	0	0
Reward cap	No./year		0	0	0	0	0

Incentive rates

Incentive type	Performance levels (No./AMP or year)		Incentive rate (£/no./AMP or year)
	Lower	Upper	
Penalty	2	1	3.199m
Reward	0	0	1.432m

Additional details

Necessary detail on measurement units	The number of water restrictions in place on customers in the report year. 'Water restriction' refers to any application of use or availability restrictions as per the South West Water Drought Plan. One restriction is from the first day within a financial year in which any restriction is applied within the South West Water region to the last consecutive day within a financial year of restriction.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Reward will be accrued on an annual basis and applied at the end of period if there has been no water restriction within the price review period. Any penalty would apply annually based on the cumulative number of restrictions occurring within 2015-20.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	While the reward will accrue on an annual basis if there are no water restrictions placed on customers, it will not apply if any water restriction has been imposed within the price review period. The penalty incentive is event based and will only apply to the second water restriction in 2015-20. Any reward that is accrued by performance to date would be reversed in full in the year of the first water restriction being applied.

Performance commitment: ability to move water around the network

Detailed definition of performance measure

South West Water considers the definition of ability to move water around the network requires further work at an industry level in order to define potential future financial outcomes.

Incentive type: Future incentive post-2020.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Limited/partial/increased/substantial	Partial					Increased

Incentive rates

Incentive type	Performance levels		Incentive rate
	Lower	Upper	
Future incentive post-2020	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	<p>N/a – measurement units will be defined as the incentive is developed but the company has currently used the following definitions for ‘partial’ and ‘increased’:</p> <p>‘Partial’ current status reflects that South West Water customers have already funded the South Devon and Cornwall spine mains which allow for water resources to be transferred from the South Dartmoor sources to both South Devon, Plymouth and South East Cornwall and the Cornwall spine main that allows some transfers from North Dartmoor towards North/Central Cornwall.</p> <p>The 2019-20 ‘increased’ level reflects that further investment in South West Water’s plan will reinforce and connect these two spine mains and allow more interchangeable water use to the West of Dartmoor.</p>
Frequency of PC measurement and any use of averaging	N/a – frequency of measurement will be defined as the incentive is developed.
Timing and frequency of rewards/penalties	N/a – timing and frequency of any rewards or penalties will be defined as the incentive is developed.
Form of reward/penalty	N/a – the form of the reward or penalty will be defined as the incentive is developed.

Any other information or clarifications relevant to correct application of incentive

N/a

Performance commitment: leakage levels

Detailed definition of performance measure

Leakage measured in megalitres/day for the calendar year; calculation as defined for the Ofwat KPI in IN 13/03.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014	2015	2016	2017	2018	2019
Performance commitments	MI/d	84	84	84	84	84	84
Penalty collar	MI/d		97	97	97	97	97
Penalty deadband	MI/d		84	84	84	84	84
Reward deadband	MI/d		84	84	84	84	84
Reward cap	MI/d		64	64	64	64	64

Incentive rates

Incentive type	Performance levels (MI/d)		Incentive rate (£/MI/d/year)
	Lower	Upper	
Penalty	97	84	0.556m
Reward	84	64	0.355m

Additional details

Necessary detail on measurement units	The measurement of leakage is rounded to the nearest MI/day in line with standard leakage measurement detailed in the performance measure definition. The leakage data is reported in calendar years.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The company will apply the incentive to annual performance.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The incentive applies to performance based on leakage performance calculated from the previous calendar year. Rounding the volume of leakage to the nearest MI/d creates an effective deadband of 1MI/d.

Performance commitment: time taken to fix significant leaks

Detailed definition of performance measure

Average time taken to fix significant customer reported leaks expressed in number of days. The categorisation of significance is determined through a structured classification process when the leak is reported to the company.

Incentive type: Reputational.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Days	<3					<2

Incentive rates

Incentive type	Performance levels		Incentive rate (£/days/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The measurement of customer reported significant leak repair time is reported as the average repair time in days to two decimal places.
Frequency of PC measurement and any use of averaging	Performance commitment measured for each relevant repair job and reported at the end of each financial year as an average performance figure for the year. Reported and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: security of supply index

Detailed definition of performance measure

Security of supply index determined according to the Ofwat KPI definition in [IN 13/03](#).

Incentive type: Reputational.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Value	100					100

Incentive rates

Incentive type	Performance levels		Incentive rate (£/value/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	There are no specific units for this measure, which derives an index value with a maximum score of 100.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Wholesale water outcome: resilience in extreme conditions

Performance commitment: supplies interrupted due to flooded South West sites

Detailed definition of performance measure

The number of incidents where drinking water supplies are interrupted (greater than 24 hours) due to flooded South West sites over the five-year period of the AMP.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./AMP (>24hrs)	0					0
Penalty collar	No. of props/AMP (>24hrs)						193,035
Penalty deadband	No. of props/AMP (>24hrs)						38,607
Reward deadband	No. of props/AMP (>24hrs)						38,607
Reward cap	No. of props/AMP (>24hrs)						0

Incentive rates

Incentive type	Performance levels		Incentive rate (£/no./AMP)
	Lower	Upper	
Penalty	193,035	38,607	0.000006m
Reward	38,607	0	0.000006m

Additional details

Necessary detail on measurement units	The committed performance level measurement unit is based on the number of incidents where supplies are interrupted for greater than 24 hours due to flooded South West Water sites, but the penalty collar, deadband and reward cap and deadband are based on the number of properties affected by the incidents of supply interruption.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The incentive will only apply if a South West Water site actually floods and will depend on the scale of the impact. A reward or penalty will be applied at the end of the period.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	The reward/penalty is therefore based on a contingent event of a flooding occurring, with the number of properties subsequently interrupted determining whether any reward or penalty applies. The 38,607 penalty/reward boundary is based on the 1 in 20 year probability of sites affecting 193,035 customers being flooded, with a 20% probability modelled estimate for the probability that individual customers would be interrupted for more than 24 hours if the site floods. A reward applies if the resilience output is more successful than this design standard, and a penalty applies if flooding interrupts more customer supplies and resilience at this performance level is not achieved.

Wholesale water outcome: responsive to customers

Performance commitment: operational customer contacts resolved first time

Detailed definition of performance measure

The percentage of wholesale water operational customer contacts that are resolved first time (includes written and telephone contacts).

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	90	91	92	93	94	95
Penalty collar	%		75	75	75	75	75
Penalty deadband	%		91	92	93	94	95
Reward deadband	%		91	92	93	94	95
Reward cap	%		100	100	100	100	100

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£%/year)
	Lower	Upper	
Penalty	75	93	0.037m
Reward	93	100	0.038m

Additional details

<p>Necessary detail on measurement units</p>	<p>Measurement units are the percentage of water operational customer contacts resolved first time. This is 100% minus the number of operational contacts which the audited South West Water system and process records as a repeat contact from the same customer on the same issue as a proportion of all operational contacts.</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The incentive will be applied to the average performance across the AMP.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>The incentive will apply on an annual basis based on the average performance to date across the AMP.</p>
<p>Form of reward/penalty</p>	<p>Adjustment to revenue.</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>Due to the phasing of the plan, the average target is 93%. As the company is using an average, the neutral deadbands are set equal to the committed performance level in each year. The average performance level for the deadband (equivalent to year 3 performance) has been used to complete the incentive rates table.</p> <p>The targets for wholesale water are incentivised separately from wholesale wastewater.</p>

Wholesale water outcome: protecting the environment

Performance commitment: sustainable abstractions (EA/WFD classification)

Detailed definition of performance measure

The number of abstraction sites where the Environment Agency has identified improvements for sustainability as being required and that are not completed at the end of the report year.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Improvements required	0					0

Incentive rates

Incentive type	Performance levels		Incentive rate (£/improvements required/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The number of abstraction sites where the Environment Agency have identified improvements for sustainability as being required and that are not completed at the end of the report year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.

Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: sustainable abstractions (Environment Agency water stress status)

Detailed definition of performance measure

The company's water scarcity status as defined by the Environment Agency changes because of South West Water unsustainable abstractions that emerge that have not been dealt with.

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
Performance commitments	Status	Moderate	Mod-erate	Mod-erate	Mod-erate	Mod-erate	Mod-erate
Penalty collar	Status		Severe	Severe	Severe	Severe	Severe
Penalty deadband	Status		Mod-erate	Mod-erate	Mod-erate	Mod-erate	Mod-erate

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/status change/year)
	Lower	Upper	

Incentive type	Performance levels (status)		Incentive rate (£/status)
Penalty	Severe	Moderate	0.930m

Additional details

Necessary detail on measurement units	<p>Measurement unit follows the Environment Agency’s water scarcity status definition. Unsustainable abstractions are any sites where the Environment Agency has informed South West Water that abstraction reductions are required.</p> <p>South West Water will adopt any new water scarcity definitions the EA introduces for this performance commitment or will provide a reconciliation between the definition used for the incentive and any subsequent definitions the EA introduces.</p>
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	This incentive will apply in 2020 from the point that the company is notified by the Environmental Agency.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	A penalty will only be applicable if the abstraction is still classified as unsustainable in 2020.

Performance commitment: catchment management

Detailed definition of performance measure

The number of acres of farmland under revised management to deliver environmental outcomes and the number of farms where a plan has been agreed to benefit the environment. Both cumulative totals at the end of the financial year.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Acres	4,942					8,154
Performance commitments	Number of farms	650					1,400

Incentive rates

Incentive type	Performance levels		Incentive rate (£/number of acres and farms/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The number of acres of farmland under revised management to deliver environmental outcomes and the number of farms where a plan has been agreed to benefit the environment. Both cumulative totals at the end of the financial year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: pollution incidents (category 1 and 2)

Detailed definition of performance measure

The number of drinking water asset pollution incidents categorised as South West Water's responsibility and as either 1 or 2 according to the Environment Agency's definition as reported to Ofwat by the Environment Agency in MD109 for the relevant calendar year.

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
Performance commitments	No./yr	0	0	0	0	0	0
Penalty collar	No./yr		2	2	2	2	2
Penalty deadband	No./yr		0	0	0	0	0

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty	2	0	0.313m

Additional details

Necessary detail on measurement units	The number of South West Water responsible drinking water asset pollutions in categories 1 and 2 in MD109 for the relevant calendar year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel. Performance is also reported at the end of each calendar year by the Environment Agency.
Timing and frequency	The incentive applies annually.

of rewards/penalties	
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The measure for water category 1 and 2 pollution incidents is incentivised separately from wastewater category 3 and 4 pollutions. Measure applies to performance in the previous calendar year.

Performance commitment: pollution incidents (category 3 and 4)

Detailed definition of performance measure

The number of drinking water asset pollution incidents categorised as South West Water's responsibility and as either 3 or 4 according to the Environment Agency's definition as reported to Ofwat by the Environment Agency in MD109 for the relevant calendar year.

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
Performance commitments	No./yr	2	2	2	2	2	2
Penalty collar	No./yr		4	4	4	4	4
Penalty deadband	No./yr		2	2	2	2	2

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	

Incentive type	Performance levels (No./yr)		Incentive rate
Penalty	4	2	0.009m

Additional details

Necessary detail on measurement units	The number of South West Water responsible drinking water asset pollutions in categories 3 and 4 in MD109 for the relevant calendar year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel. Performance is also reported at the end of each calendar year by the Environment Agency.
Timing and frequency of rewards/penalties	The incentive applies annually.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The measure for water category 3 and 4 pollution incidents is incentivised separately from wastewater category 1 and 2 pollutions. Measure applies to performance in the previous calendar year.

Performance commitment: operational carbon emissions

Detailed definition of performance measure

Greenhouse gas emissions measured in thousands of tonnes of carbon dioxide equivalent (ktCO₂e) for the financial year calculated according to the Ofwat KPI definition in IN 13/03.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels
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		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	ktCO ₂ e	49.5					48

Incentive rates

Incentive type	Performance levels (ktCO ₂ e)		Incentive rate (£/ktCO ₂ e/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	Greenhouse gas emissions measured in thousands of tonnes of carbon dioxide equivalent (ktCO ₂ e) calculated according to the Ofwat KPI definition in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: energy from renewable sources

Detailed definition of performance measure

The percentage of renewable energy sourced out of total operational energy used in the financial year.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	8.36					12.2

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The percentage of renewable energy sourced out of total operational energy used in the financial year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Wholesale water outcome: fair charging

Performance commitment: customers paying a metered bill

Detailed definition of performance measure

The percentage of domestic customers paying a metered bill measured by the total number of billed measured household properties (excluding void properties) multiplied by 100 divided by the total number of household properties (excluding void properties) at 31 March in the report year.

The data used in this calculation is consistent with June return reporting requirements 2012, table 7.

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
Performance commitments	%	79	80.4	81.6	82.8	83.8	84.7
Penalty collar	%		79	79	79	79	79
Penalty deadband	%		79.4	80.6	81.8	82.8	83.7

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Penalty	79	81.7	0.710m

Additional details

<p>Necessary detail on measurement units</p>	<p>The percentage of water service billed on a measured basis of charging as a percentage of billed customers (at the end of each financial year).</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>The measure will be assessed on an annual basis and increases over the period due to the phasing of new meter optants and new connections.</p>
<p>Form of reward/penalty</p>	<p>RCV adjustment.</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>Penalty deadband reflects variation in timing of customer demand and installation.</p> <p>The average performance level for the deadband has been used to complete the incentive rates table and reflects that the rate of increase in the percentage of customers metered is expected to be higher towards the beginning of the AMP.</p>

Wholesale wastewater outcome: reliable wastewater services

Performance commitment: internal sewer flooding incidents

Detailed definition of performance measure

The number of incidents of internal flooding caused by hydraulic overload (including extreme weather) and other causes from the company's sewers (including those from the private sewer transfer) in the report year. The number of flooding incidents is produced in accordance with the JR11 regulatory reporting requirements for table 3.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
			2014-15	2015-16	2016-17	2017-18	2018-19
Performance commitments	No./yr	157	153	148	144	139	135
Penalty collar	No./yr		212	212	212	212	212
Penalty deadband	No./yr		193	188	184	179	175
Reward deadband	No./yr		153	148	144	139	135
Reward cap	No./yr		107	107	107	107	107

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty	212	184	0.085m
Reward	144	107	0.062m

Additional details

Necessary detail on measurement units	The measurement unit includes incidents from hydraulic overload and other causes and incorporates performance from adopted private sewers.
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The incentive is based on an average performance.
Timing and frequency of rewards/penalties	The incentive is based on an average performance and applied at the end of the AMP.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	As the company is using an average, the reward deadband is set equal to the committed performance level in each year. It has included an additional penalty deadband to account for uncertainty in forecasts relating to private sewers and variability in weather. Due to the phasing of the plan, the average target is 144 properties. The average performance levels for the deadband (equivalent to year 3 performance) have been used to complete the incentive rates table.

Performance commitment: external sewer flooding incidents

Detailed definition of performance measure

The number of incidents of external flooding caused by hydraulic overload (including extreme weather) and other causes from the company's sewers (including those from the private sewer transfer) in the report year. The number of flooding incidents is produced in accordance with the JR11 regulatory reporting requirements for table 3a.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels
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		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	3,500	3,440	3,380	3,320	3,260	3,200
Penalty collar	No./yr		3,800	3,800	3,800	3,800	3,800
Penalty deadband	No./yr		3,490	3,430	3,370	3,310	3,250
Reward deadband	No./yr		3,390	3,330	3,270	3,210	3,150
Reward cap	No./yr		3,150	3,150	3,150	3,150	3,150

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty 1	3,800	3,500	0.001m
Penalty 2	3,500	3,370	0.003m
Reward	3,270	3,150	0.002m

Additional details

Necessary detail on measurement units	The measurement unit includes incidents from hydraulic overload and other causes and incorporates performance from adopted private sewers.
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The incentive is based on an average performance.
Timing and frequency of rewards/penalties	The incentive is based on an average performance and applied at the end of the AMP.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	The company has included an additional penalty deadband to account for uncertainty in forecasts relating to private sewers and variability in weather. Due to the phasing of the plan, the average target is 3,320 properties. The average performance levels for the deadband (equivalent to year 3 performance) have been used to complete the incentive rates table.

Performance commitment: odour contacts (wastewater treatment works)

Detailed definition of performance measure

The number of contacts received relating to odours originating from South West Water's wastewater treatment works in the report year.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	410	388	366	344	322	300
Penalty collar	No./yr		500	500	500	500	500
Penalty deadband	No./yr		388	366	344	322	300
Reward deadband	No./yr		388	366	344	322	300
Reward cap	No./yr		0	0	0	0	0

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty 1	500	410	0.005m
Penalty 2	410	344	0.004m
Reward	344	0	0.002m

Additional details

Necessary detail on measurement units	The measurement unit only includes contacts relating to odours originating from the company's wastewater treatment works.
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The incentive is based on an average performance.
Timing and frequency of rewards/penalties	The incentive is based on an average performance and applied at the end of the price control period.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	South West Water is using an average and has set the neutral deadbands equal to the committed performance level (CPL) in each year. Due to South West Water's phasing of its plan, the average target is 344 complaints. The average performance levels for the deadband (equivalent to year 3 performance) have been used to complete the incentive rates table.

Performance commitment: asset reliability (pipes)

Detailed definition of performance measure

Serviceability assessment of either stable/marginal/deteriorating as defined for the Ofwat KPIs in IN 13/03.

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
Performance commitments	Status	Stable	Stable	Stable	Stable	Stable	Stable
Penalty collar	Status		Deterior	Deterior	Deterior	Deterior	Deterior

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
			ating	ating	ating	ating	ating
Penalty deadband	Status		Marginal	Marginal	Marginal	Marginal	Marginal

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/change in status/year)
	Lower	Upper	
Penalty	Deteriorating	Marginal	0.688m

Additional details

Necessary detail on measurement units	Measurement units are based on serviceability assessment criteria, as defined for the Ofwat KPIs in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Penalty applied at the end of the AMP.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	The company defines the 'deteriorating' level of performance that would trigger the penalty incentive to include the third and subsequent years of marginal status until stable performance is achieved. This would include any 'marginal' (and 'deteriorating') inherited from 2013-14 and 2014-15 performance. This includes the following standard serviceability guidance, 'deteriorating' status serviceability would not improve to 'stable' in at least the subsequent year even with improved metrics. Although the third 'marginal' status might improve to 'stable', in this situation the level of penalty applied as 'deteriorating' in the third year would reflect an appropriate penalty.

Detail on reference levels and control limits for sub-measures

Indicator	Unit		2015-16	2016-17	2017-18	2018-19	2019-20
Sewer collapses	nr	Ref	167	167	167	167	167
		High	221	221	221	221	221
		Low	113	113	113	113	113
Pollution incidents (CSO+RM+FS)	nr	Ref	70	70	70	70	70
		High	100	100	100	100	100
		Low	40	40	40	40	40
Properties flooded due to other causes	nr	Ref	80	80	80	80	80
		High	110	110	110	110	110
		Low	50	50	50	50	50
Properties flooded due to overloaded sewers excluding severe weather	nr	Ref	30	30	30	30	30
		High	45	45	45	45	45
		Low	15	15	15	15	15
Sewer blockages	nr	Ref	3600	3600	3600	3600	3600
		High	4464	4464	4464	4464	4464
		Low	2736	2736	2736	2736	2736
Equipment failures	nr	Ref	284	284	284	284	284
		High	376	376	376	376	376
		Low	192	192	192	192	192

Key

Ref = reference level

High = upper control limit

Low = lower control limit

Performance commitment: asset reliability (process)

Detailed definition of performance measure

Serviceability assessment of either stable/marginal/deteriorating as defined for the Ofwat KPIs in IN 13/03.

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
Performance commitments	Status	Stable	Stable	Stable	Stable	Stable	Stable
Penalty collar	Status		Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Penalty deadband	Status		Marginal	Marginal	Marginal	Marginal	Marginal

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/change in status/year)
	Lower	Upper	
Penalty	Deteriorating	Marginal	1.359m

Additional details

Necessary detail on measurement units	Measurement units are based on serviceability assessment criteria, as defined for the Ofwat KPIs in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Penalty applied at the end of the AMP.

Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	The company defines the ‘deteriorating’ level of performance that would trigger the penalty incentive to include the third and subsequent years of marginal status until stable performance is achieved. This would include any ‘marginal’ (and ‘deteriorating’) inherited from 2013-14 and 2014-15 performance. This includes the following standard serviceability guidance, ‘deteriorating’ status serviceability would not improve to ‘stable’ in at least the subsequent year even with improved metrics. Although the third ‘marginal’ status might improve to ‘stable’, in this situation the level of penalty applied as ‘deteriorating’ in the third year would reflect an appropriate penalty.

Detail on reference levels and control limits for sub-measures

Indicator	Unit		2015-16	2016-17	2017-18	2018-19	2019-20
Sewage Treatment Works (STW)	% non-compliance	Ref	7.20	7.20	7.20	7.20	7.20
		High	9.70	9.70	9.70	9.70	9.70
		Low	4.70	4.70	4.70	4.70	4.70
Population equivalent (PE)	% non-compliance	Ref	0.36	0.36	0.36	0.36	0.36
		High	0.57	0.57	0.57	0.57	0.57
		Low	0.15	0.15	0.15	0.15	0.15
Unplanned maintenance	nr	Ref	7335	7335	7335	7335	7335
		High	8841	8841	8841	8841	8841
		Low	5829	5829	5829	5829	5829
Key							
Ref = reference level							
High = upper control limit							
Low = lower control limit							

Performance commitment: compliance with sludge standard

Detailed definition of performance measure

Satisfactory sludge disposal complying with Ofwat KPI definitions in IN 13/03.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	100	100	100	100	100	100

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£%/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	<p>Satisfactory sludge disposed (dry solids) as a percentage of total sewage sludge disposed (measured as dry solids).</p> <p>Calculation details: $100 \times (C - D) / C$ where:</p> <p>C is total sewage sludge disposed of measured in thousand tonnes of dry solids; and D is total sewage sludge disposed of which cannot be confirmed as complying with the safe sludge matrix and other relevant regulations to be considered satisfactory.</p>
Frequency of PC	Performance commitment reported at the end of each financial

measurement and any use of averaging	year and reviewed through the WaterShare independent panel. The performance is based on end of year performance.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Wholesale wastewater outcome: responsive to customers

Performance commitment: operational customer contacts resolved first time

Detailed definition of performance measure

The percentage of wholesale wastewater operational customer contacts that are resolved first time (includes written and telephone contacts).

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	90	91	92	93	94	95
Penalty collar	%		75	75	75	75	75
Penalty deadband	%		91	92	93	94	95
Reward deadband	%		91	92	93	94	95
Reward cap	%		100	100	100	100	100

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Penalty	75	93	0.048m
Reward	93	100	0.038m

Additional details

<p>Necessary detail on measurement units</p>	<p>Measurement units are the percentage of wastewater operational customer contacts resolved first time. This is 100% minus the number of operational contacts which the audited South West Water system and process records as a repeat contact from the same customer on the same issue as a proportion of all operational contacts.</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The incentive will be applied to the average performance across the AMP.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>The incentive will apply on an annual basis based on the average performance to date across the AMP.</p>
<p>Form of reward/penalty</p>	<p>Adjustment to revenue.</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>Due to the phasing of the plan, the average target is 93%. South West Water is using an average and the neutral deadbands are set equal to the committed performance level in each year. The average performance level for the deadband (equivalent to year 3 performance) has been used to complete the incentive rates table.</p> <p>The targets for wholesale wastewater are incentivised separately from wholesale water.</p>

Wholesale wastewater outcome: protecting the environment

Performance commitment: wastewater treatment numeric compliance

Detailed definition of performance measure

Wastewater treatment numeric compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 1.

Incentive type: Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
			2014-15	2015-16	2016-17	2017-18	2018-19
Performance commitments	%	97.5	98		99		100
Penalty collar	%						80
Penalty deadband	%						99

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/AMP)
	Lower	Upper	
Penalty 1	80	97.5	0.013m
Penalty 2	97.5	99	0.269m

Additional details

Necessary detail on measurement units

Percentage wastewater treatment numeric compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 1.

Frequency of PC measurement and any use of averaging	Performance commitment measured, reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The incentive is applied once to performance in 2020.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	<p>% of wastewater treatment works with numeric consents complying with those consents.</p> <p>Measure applies to performance at the end of the 2019 calendar year.</p> <p>The interim performance commitments in 2015-16 and 2017-18 are non-financial and do not attract a financial penalty if they are not met.</p>

Performance commitment: wastewater population equivalent sanitary compliance

Detailed definition of performance measure

The population equivalent for wastewater sanitary compliant works as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year, expressed as a percentage of the total population equivalent for all numeric works (calculated in accordance with JR11 table 15, line 7).

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	99.9					100.0

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Reputational	n/a	n/a	n/a

Additional details

Necessary detail on measurement units	The population equivalent for wastewater sanitary compliant works as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year, expressed as a percentage of the total population equivalent for all numeric works (calculated in accordance with JR11 table 15, line 7).
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: wastewater descriptive works permit compliance

Detailed definition of performance measure

Wastewater treatment descriptive compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 13.

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
Performance commitments	%	95	100	100	100	100	100
Penalty collar	%		<95	<95	<95	<95	<95
Penalty deadband	%		95	95	95	95	95

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£%/year)
	Lower	Upper	
Penalty	<95	95	0.250m

Additional details

Necessary detail on measurement units	Percentage wastewater treatment descriptive compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 13.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	A penalty is applied each calendar year for service levels below the existing (2012-13) level of service. The incentive will be applied to each year separately and the whole annual penalty will apply when performance drops below 95%. This incentive therefore represents a penalty for deterioration in performance.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	<p>% of wastewater treatment works with descriptive consents complying with these consents.</p> <p>Measure applies to performance in the previous calendar year.</p> <p>A penalty is triggered when performance drops below 95% when the maximum annual penalty of £0.25 million is incurred.</p>

Performance commitment: pollution incidents (category 1 and 2)

Detailed definition of performance measure

The number of wastewater asset pollution incidents categorised as South West Water's responsibility and as either 1 or 2 according to the Environment Agency's definition as reported to Ofwat by the Environment Agency in MD109 for the relevant calendar year.

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
Performance commitments	No./yr	2	0	0	0	0	0
Penalty collar	No./yr		8	8	8	8	8
Penalty deadband	No./yr		2	2	2	2	2

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty	8	2	0.313m

Additional details

Necessary detail on measurement units	The number of South West Water responsible wastewater asset pollutions in categories 1 and 2 in MD109 for the relevant calendar year.
Frequency of PC	Performance commitment measured, reported on at the end of

measurement and any use of averaging	each calendar year and reviewed through the WaterShare independent panel. Performance is also reported at the end of each calendar year by the Environment Agency.
Timing and frequency of rewards/penalties	The incentive applies annually.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The measure for wastewater category 1 and 2 pollution incidents is incentivised separately from water category 3 and 4 pollutions. Measure applies to performance in the previous calendar year.

Performance commitment: pollution incidents (category 3 and 4)

Detailed definition of performance measure

The number of wastewater asset pollution incidents categorised as South West Water's responsibility and as either 3 or 4 according to the Environment Agency's definition as reported to Ofwat by the Environment Agency in MD109 for the relevant calendar year.

Incentive type: Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
			2014-15	2015-16	2016-17	2017-18	2018-19
Performance commitments	No./yr	248	238	228	218	208	198
Penalty collar	No./yr		262	262	262	262	262
Penalty deadband	No./yr		238	228	218	208	198

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty 1	262	248	0.009m
Penalty 2	248	218	0.019m

Additional details

Necessary detail on measurement units	The number of South West Water responsible wastewater asset pollutions in categories 3 and 4 in MD109 for the relevant calendar year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel. Performance is also reported at the end of each calendar year by the Environment Agency.
Timing and frequency of rewards/penalties	The incentive applies annually.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	<p>The upper performance level for the penalty incentive rate of £0.019 million is equal to the penalty deadband in each year. The average performance level for the deadband (equivalent to year 3 performance) has been used to complete the incentive rates table.</p> <p>The measure for water category 3 and 4 pollution incidents is incentivised separately from wastewater category 1 and 2 pollutions.</p> <p>Measure applies to performance in the previous calendar year.</p>

Performance commitment: operational carbon emissions

Detailed definition of performance measure

Greenhouse gas emissions measured in thousands of tonnes of carbon dioxide equivalent (ktCO₂e) for the financial year calculated according to the Ofwat KPI definition in IN 13/03.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	ktCO ₂ e	100.5					102

Incentive rates

Incentive type	Performance levels (ktCO ₂ e)		Incentive rate (£/ktCO ₂ e/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	Greenhouse gas emissions measured in thousands of tonnes of carbon dioxide equivalent (ktCO ₂ e) calculated according to the Ofwat KPI definition in IN 13/03.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: energy from renewable sources

Detailed definition of performance measure

The percentage of renewable energy sourced out of total operational energy used in the financial year.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	2.64					7.8

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The percentage of renewable energy sourced out of total operational energy used in the financial year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

Wholesale wastewater outcome: benefiting the community

Performance commitment: bathing water quality

Detailed definition of performance measure

The number of bathing waters meeting or exceeding the standard agreed with the Environment Agency for 2020, or where failure is not allocated to a South West Water asset by the Environment Agency.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No. of bathing waters	-15	-12	-9	-6	-3	0
Penalty collar	No. of bathing waters		-15	-15	-15	-15	-15
Penalty deadband	No. of bathing waters		-15	-13	-10	-7	-4
Reward deadband	No. of bathing waters		-12	-9	-6	-3	0
Reward cap	No. of bathing waters		20	20	20	20	20

Incentive rates

Incentive type	Performance levels (no. of bathing waters)		Incentive rate (£/no. of bathing waters/year)
	Lower	Upper	
Penalty	-15	-10	0.093m
Reward	-6	20	0.226m

Additional details

Necessary detail on measurement units	The bathing waters standards are agreed with the Environment Agency through the National Environment Programme (NEP). The incentive excludes failed bathing beaches where Environment Agency allocates responsibility to non-South West Water sources (for example, agricultural run-off).
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The incentive applies to the annual performance and is applied at the end of the AMP.
Form of reward/penalty	RCV adjustment.
Any other information or clarifications relevant to correct application of incentive	<p>The incentive rate of £0.226 million applies from the reward deadband (set equal to the committed performance level) to the reward cap. The average performance of six bathing waters not meeting the required status (equivalent to year 3 performance) has been used to complete the incentive rates table.</p> <p>The incentive rate of £0.093 million applies from the penalty deadband to the penalty collar. The average penalty deadband value of ten bathing waters not meeting the required status (equivalent to year 3 performance) have been used to complete the incentive rates table. Measure applies to performance in the previous calendar year.</p>

Performance commitment: combined sewer overflow spills

Detailed definition of performance measure

The number of spills from a South West Water combined sewer overflow.

Incentive type: Future incentive post-2020.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No. of CSO spills	N/a	N/a	N/a	N/a	N/a	N/a

Incentive rates

Incentive type	Performance levels (no. of CSO spills)		Incentive rate (£/no. of CSO spills/year)
	Lower	Upper	
Future incentive post 2020	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	N/a – measurement units will be defined as the incentive is developed.
Frequency of PC measurement and any use of averaging	N/a – frequency of measurement will be defined as the incentive is developed.
Timing and frequency of rewards/penalties	N/a – timing and frequency of any rewards or penalties will be defined as the incentive is developed.
Form of reward/penalty	N/a – the form of the reward or penalty will be defined as the incentive is developed.
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: river water quality improved

Detailed definition of performance measure

The length in kilometres of the water body into which the treatment works improved under the programme discharges. It includes the length of all subsequent downstream water bodies down to the tidal limit. Data is provided by the Environment Agency.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	km	0					650

Incentive rates

Incentive type	Performance levels (no. of bathing waters)		Incentive rate (£/no. of bathing waters/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The length in kilometres of the water body into which the treatment works improved under the programme discharges. It includes the length of all subsequent downstream water bodies down to the tidal limit.
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a

Any other information
or clarifications
relevant to correct
application of incentive

N/a

Household retail outcome: responsive to customers

Performance commitment: customer overall satisfaction

Detailed definition of performance measure

The average percentage of customers satisfied or very satisfied with South West Water's overall service in the financial year as measured through the company's long-term customer satisfaction tracking survey.

Incentive type: Reputational.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	86					90

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	Measurement units are the average percentage of customers saying they are satisfied or very satisfied with South West Water's overall service in the financial year as measured through the company's long-term customer satisfaction tracking survey.
Frequency of PC measurement and any use of averaging	Average performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.

Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment: Service incentive mechanism

Detailed definition of performance measure

SIM score as defined in Ofwat’s SIM guidance April 2012 and updated by [IN 13/03](#).

Incentive type: Financial – reward and penalty

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Score	77					85

Incentive rates

Incentive type	Performance levels (score)		Incentive rate (£/score/year)
	Lower	Upper	
Penalty and reward	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	SIM score calculated using the methodology outlined in the performance measure definition.
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Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	As under the existing mechanism for SIM, any reward or penalty will be applied at the end of AMP.
Form of reward/penalty	As under the existing mechanism for SIM, the reward or penalty would be an adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	Penalty or reward is applied under existing mechanisms. No additional incentive rates are applied to this measure.

Performance commitment: customer satisfaction with value for money

Detailed definition of performance measure

The average percentage of customers satisfied with the value for money of South West Water's services in the financial year as measured through the company's long-term customer satisfaction tracking survey.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	47					90

Incentive rates

Incentive type	Performance levels (%)	Incentive rate
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	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	Measurement units are the average percentage of customers expressing satisfaction with the value for money of South West Water's services in the financial year as measured through the company's long-term customer satisfaction tracking survey.
Frequency of PC measurement and any use of averaging	Average performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Household retail outcome: fair charging

Performance commitment: customers assisted by water poverty initiatives

Detailed definition of performance measure

The number of domestic customers South West Water assists through its water poverty initiatives WaterCare+ and Restart at 31 March in the report year.

Incentive type: Reputational.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Number	21,500					23,210

Incentive rates

Incentive type	Performance levels (number)		Incentive rate (£/number/year)
	Lower	Upper	
Reputational	N/a	N/a	N/a

Additional details

Necessary detail on measurement units	The cumulative number of customers assisted by the company's water poverty initiatives WaterCare+ and Restart at 31 March in the report year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	N/a

Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Outcome delivery and reporting

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

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

Table AA4.9 South West Water's proposals for outcome delivery and reporting

South West Water's proposals	Our assessment
<p>South West Water has proposed an independently monitored and transparent performance-sharing framework for 2015-20 called 'WaterShare'. This framework involves the company publishing a scorecard on an annual basis that summarises its performance and allows for the sharing of net benefits with customers in a timely manner.</p> <p>As set out in section A2.2.3 of this document, the framework operates at an appointee level and generally can only result in customer gain. If the company accepts the licence modification we have proposed alongside this final determination, it will be able to increase customer bills to recover outcome delivery rewards in 2015-20, though it will consider any changes within its wider WaterShare framework.</p> <p>South West Water has committed to measuring and reporting on its performance</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>South West 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</p>

South West Water's proposals	Our assessment
<p>commitments on an annual basis.</p> <p>The independent WaterShare panel will review and challenge on an annual basis: performance delivery; the financial impact calculation; the approach to and scale of customer benefit; and the timing of sharing any net gain (or net pain where this is to recover outcome delivery rewards in 2015-20).</p> <p>The company's Board Assurance statement confirmed that the company has established processes within its existing governance and assurance processes to ensure the data for the performance commitments is robust in all material aspects and that they will be recorded and measured consistently.</p>	<p>company's annual risk and compliance statement.</p>

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