

August 2014

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



OFWAT

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Overview

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

The revisions that Sembcorp Bournemouth Water made to its business plan have many strengths. On the whole, the company addressed the concerns that were identified in the risk-based review around its cost allocation and some of its special cost claims. We do however have a number of targeted concerns. These mainly relate to the decision that the company took to smooth bills up to 2025 by bringing cash forward into 2015-2020. Although customers would be no worse off over the longer term, we are concerned that the company took this decision without adequate customer engagement. We have therefore intervened in this area of the company's plan. In addition, we are making some further interventions designed to safeguard customers' interests. Some of these interventions are around outcomes and the associated delivery incentives which are common to all companies.

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

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

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

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

This means that the companies cannot recover more revenue than allowed under each specific price control. The revenue allowance for each price control is determined by the costs specific to that particular price control. This means that companies cannot cross-subsidise between controls in terms of costs or revenues, which gives important benefits for providing more effective incentives. It also supports the development of the relevant markets and in particular those provided for by the Water Act 2014.

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

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

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

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

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

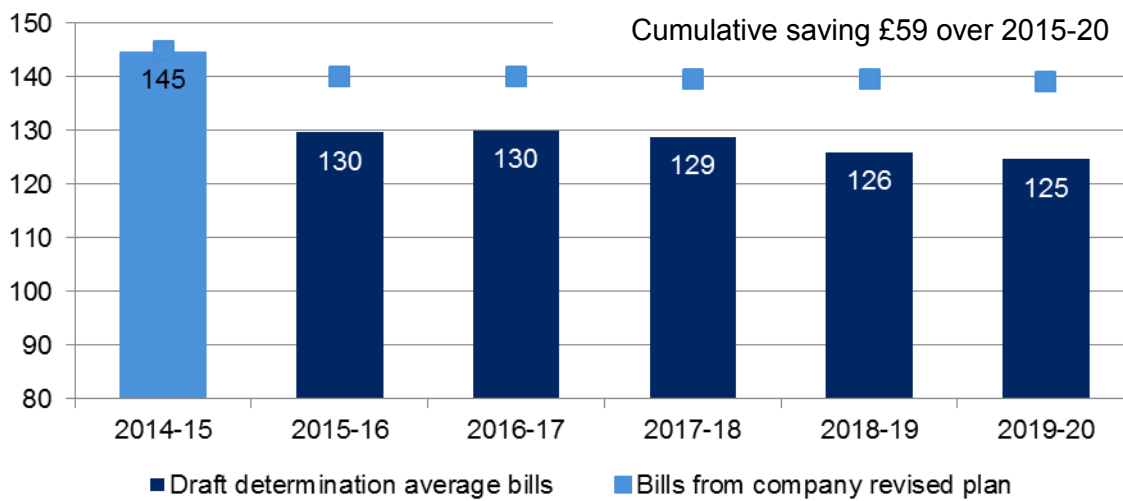
Annexes 1 to 4 form part of the draft price control determination.

A1. Draft determination – at a glance

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

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

Average household bill (£)



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

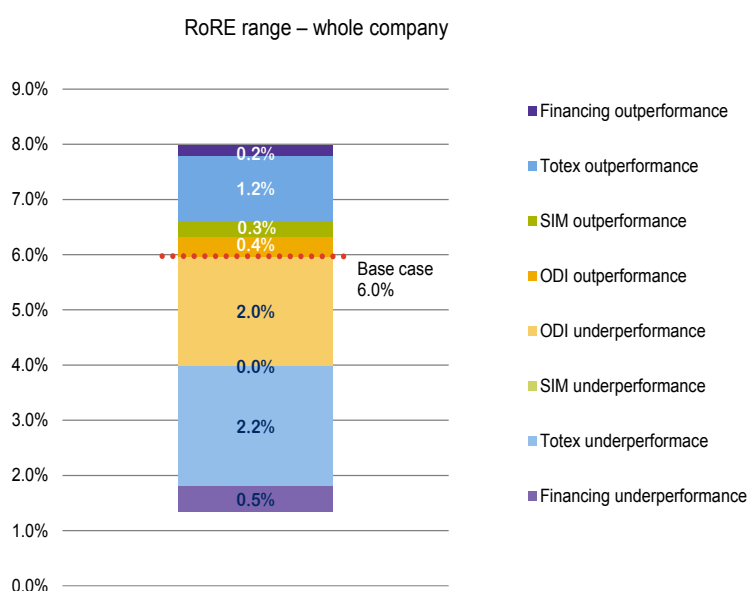
Outcomes

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

Allowed costs/expenditure¹

Wholesale	Water	
Totex – 2015-20 total (£m)	131.1	
Allowed weighted average cost of capital (%)	3.85	
Allowed wholesale revenue in 2015-20 (£m)	159.9	
Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	22.0	
Margin (%)	1.0	2.5
Retail allowed revenue (£m)	23.4	3.3
Average bill per household customer – retail component only (£)	25	

Notes: Wholesale figures in 2012-13 prices and retail figures in nominal prices – this is consistent throughout this draft determination unless otherwise stated

RoRE ranges**Ofwat's calculation of notional financeability ratios**

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover	3.27
Adjusted cash interest cover ratio (ACICR) – base case (average over five years)	1.88
Funds from operations/debt	11.16%
Retained cash flow/debt	8.49%
Gearing	60.88%
Dividend cover (profit after tax/dividends paid)	1.41

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Regulatory equity/regulated earnings for the regulated company	16.94
RCV/EBITDA	9.37

Summary of interventions

<p>Outcomes</p> <ul style="list-style-type: none"> • Cap: We have imposed an overall cap and collar on outcome delivery incentives of +/- 2% of RoRE. • Horizontal check: We have adjusted the performance level, incentive rate and deadbands and collars for some PC/ODIs. • Bottom up analysis: We have adjusted the incentive rate and deadbands across a number of incentives. 	<p>Wholesale costs</p> <ul style="list-style-type: none"> • The company proposed wholesale water totex of £136.4million which is £4.6million above our draft determination threshold of £131.9 million. • We rejected some of the company's wholesale cost adjustments, only partially allowed two cost adjustments and fully accepted one. We also made some adjustments to reflect our modelling approach.
<p>Retail</p> <ul style="list-style-type: none"> • We rejected the company's proposed adjustment for input price pressure (household). • We rejected the adjustment for the company's new costs. 	<p>Reconciling 2010-15 performance</p> <ul style="list-style-type: none"> • We made some minor adjustments relating to the service incentive mechanism (SIM), revenue correction mechanism (RCM) and capital expenditure incentive scheme (CIS). The total value of our interventions is -£0.4m (in customers favour).
<p>Risk and reward</p> <ul style="list-style-type: none"> • We have only applied a 15bp company specific uplift to the weighted average cost of capital (WACC) instead of the 19bp requested by the company. • We do not accept Sembcorp Bournemouth Water's proposal for their proposed pain/gain sharing mechanism. We support transparent performance monitoring and gain sharing mechanisms. However, we are concerned that the proposal is not yet sufficiently well specified and that it exposes customer to pain share risk in 2015-20 period and so does not protect customer interests. • In relation to the Business Rates uncertainty mechanism, we changed the sharing rate from 80:20% to 75:25% in line with other companies given the absence of a suitable pain/gain sharing mechanism. 	<p>Financeability and Affordability</p> <ul style="list-style-type: none"> • We adjusted the pay as you go (PAYG) ratios from 80% to 75% as it was not clear that customers supported the approach of having higher bills in 2015-2020 to reduce the risk of price increases in 2020-25. In addition it is not clear whether the company could deliver and maintain the approach it proposed through to 2025.

A2. Wholesale water

A2.1 Company outcomes, performance commitments and delivery incentives

A2.1.1 Outcomes, performance commitments and incentives

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

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

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

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

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

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
A: Safe wholesome water	A1: Water quality contacts from customers re appearance- reduce numbers	Financial – penalty only	Horizontal check: We reduced the committed performance level from 1.25 to 1.22 contacts/1000 population (upper quartile) from 2017-18. Removed the penalty

Company proposal			Intervention
Outcome			
			deadband. We maintained the distance between the committed performance level and penalty collar which the company proposed.
	A2: Maintain compliance with all water regulations	Financial – penalty only	Horizontal check: We introduced a penalty only incentive. We changed committed performance levels for 2017-18 to 2019-20 and introduced penalty deadbands and collars for those years. We introduced a penalty rate based on the average water-only company.
B: Reliable water supply	B1: Reduce leakage	Financial – reward and penalty	Bottom-up analysis: We changed the penalty collar to 22 MI/d.
	B2: Minimise customer disruption (minimise risk of large scale interruption to 12,000 customers)	Financial – reward and penalty	No intervention.
	B3: Minimise customer disruption re supply interruptions \geq 3 hours	Financial – penalty only	Horizontal check: The company is already an upper quartile performer in terms of average minutes per property but we introduced a

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
			<p>penalty-only ODI for performance worse than 7.3 hours per affected (interrupted) property in the first four years, and 4.6 in 2019-20.</p> <p>We set the penalty rate equal to the average for water-only companies, converted to hours per affected property.</p>
	B4: Serviceability (maintain assets – Ofwat methodology)	Financial – penalty only	<p>Bottom-up analysis: We applied a potential penalty of 10% of capital maintenance spend, rather than company proposal of 3.85%. This is necessary to ensure sufficient strength of incentive to protect customers.</p>
	B5: Metering – continue current strategy (17950 meters in place by 2020)	Financial – penalty only	No intervention.
	B6: Water use – reduce average consumption	Reputational	No intervention.
C: Providing an excellent customer experience	C1: fixing visible leaks – improve response time (improve the number repaired in 7 days of Sembcorp Bournemouth Water becoming aware-	Financial – penalty only	No intervention.

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
	average)		
D: Environmentally sustainable operations	D1: Reduce carbon created delivering water (reduce average energy used by 2020)	Reputational	No intervention.
	D2: Help support a natural healthy water environment	Reputational	No intervention.
E: Engage well with our community and customers	E1 : Contribute to our community	Reputational	No intervention.

A2.1.2 Outcome delivery and reporting

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

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

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

A2.2 Calculating the wholesale water price control

A2.2.1 Calculating allowed wholesale water expenditure

Our approach to calculating allowed wholesale expenditure is set out in the [wholesale water and wastewater technical appendix](#).

In Sembcorp Bournemouth Water's revised plan the company proposed wholesale water totex of £136.4 million over 2015-2020 (which is the same as its December plan). We calculated the draft determination threshold at £131.9 million, giving rise to a difference of £4.6 million or 3.5%. We did consider making a further £5 million in adjustments to our threshold (net of implicit allowances), however the company did not provide sufficient evidence to support these claims. We also note that the company made representations to our cost models following the publication of these in April. The representations made and our response is summarised in [wholesale water and wastewater technical appendix](#).

It is also important to bear in mind that the actual gap faced by the company is smaller than what would be implied when looking at the totex gap. This is because the use of menus and our approach to setting baselines reduces the difference faced by the company. In particular, the difference between the company's plan and the amount that it would ultimately recover from customers is only 1.7%.

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	2015-20 total
Draft determination cost threshold						131.9
Costs excluded from menu						2.0
Menu cost baseline ¹	27.8	27.1	26.2	24.8	24.0	129.9
Company's view of menu costs ²						134.4
Implied menu choice						103.5
Allowed expenditure from menu	28.1	27.3	26.4	25.0	24.2	131.0
Costs excluded from menu	0.4	0.4	0.4	0.4	0.4	2.0
Total allowed expenditure ³	28.5	27.7	26.8	25.4	24.6	133.0
Less pension deficit repair allowance	0.4	0.4	0.4	0.4	0.4	1.9
Totex for input to PAYG	28.1	27.3	26.4	25.0	24.2	131.1

Notes:

1. Menu baseline is equal to the draft determination threshold less pension deficit recovery costs, third party costs and market opening costs related to 2014-15 (see annex 1).
2. Based on company plan totex minus costs for items excluded from the menu.
3. Includes pension deficit repair allowance.

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

Table A2.3 shows the PAYG ratios and associated totex recovery for wholesale water, which we have used as the basis for this draft determination. This reflects our interventions on PAYG ratios as discussed in section A5.4 on financeability.

Table A2.3 Sembcorp Bournemouth Water wholesale water PAYG ratios

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	28.1	27.3	26.4	25.0	24.2	131.1
PAYG %	72.1	73.7	74.9	76.2	77.7	74.9
Resulting PAYG (£m)	20.3	20.1	19.8	19.0	18.8	98.1

Table A2.4 shows the RCV run-off amounts included within the wholesale water charge. This reflects a run-off rate of 4% for the RCV as at 31 March 2015 and 25 years for the totex additions to the RCV over 2015-20.

Table A2.4 Sembcorp Bournemouth Water wholesale water RCV run-off (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	5.7	5.4	5.2	5.0	4.8	26.1
RCV run-off of totex additions	0.2	0.5	0.7	1.0	1.2	3.5
Total RCV run-off	5.8	5.9	5.9	6.0	6.0	29.7

A2.2.3 Return on the RCV

Sembcorp Bournemouth Water has asked for a company specific uplift of 19 basis point to the wholesale WACC of 3.70% set out in the risk and reward guidance. We have considered whether it would be appropriate to allow for this uplift based on the approach we set out in our risk and reward guidance:

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

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

Consistent with our guidance, we have then considered whether there would be offsetting benefits to customers from providing this company specific uplift to this company. For the reasons set out in the [risk and reward technical appendix](#), we expect the benefits from providing the company specific uplift to Sembcorp Bournemouth Water to more than offset the costs. This means that the company passed test 2.

We have therefore applied a company specific uplift to Sembcorp Bournemouth Water and have used a wholesale water cost of capital of 3.85% in this draft determination. This results in a return on capital of around £27.8 million over 2015-20.

Table A2.5 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A2.2.4 below. The average RCV, set out in subsequent table

takes into account the proportion of totex additions to the RCV determined by the PAYG ratio and RCV run-off.

Table A2.5 Sembcorp Bournemouth Water wholesale water opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	139.2
Land sales	0.1
Adjustment for actual expenditure 2009-10	1.3
Adjustment for actual expenditure 2010-15 ¹	1.3
Net adjustment from logging up, logging down and shortfalls	-0.4
Other adjustments	0.0
Opening RCV 1 April 2015	141.1

Note:

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

Table A2.6 Sembcorp Bournemouth Water wholesale water return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	141.4	143.5	144.7	145.4	145.4
RCV additions (from totex)	7.8	7.2	6.6	5.9	5.4
Less RCV run-off	5.8	5.9	5.9	6.0	6.0
Closing RCV	143.5	144.7	145.4	145.4	144.8
Average RCV (year average)	142.4	144.1	145.1	145.4	145.1
Return on capital	5.5	5.6	5.6	5.6	5.6

A2.2.4 Reconciling 2010-15 performance

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

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale water services to reconcile performance in 2010-15. We have intervened and as a result the revenue adjustments for wholesale water have changed from -£2.4 million to -£2.8 million. We summarise these interventions in Table A2.7 below, and quantify the resulting adjustments within this draft determination in table A2.8. The impact on the opening RCV of 2010-15 adjustments is -£0.4m as illustrated in Table A2.9 above – this adjustment arises on account of small differences associated with the capital expenditure incentive scheme (CIS). We discuss our interventions in this area further in annex 3.

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

Area	Intervention	Why we did it	Total 2010-15
Service incentive mechanism (SIM)	There are no interventions in this area.	n/a	0.9

Area	Intervention	Why we did it	Total 2010-15
Revenue correction mechanism (RCM)	<p>We have intervened in the following areas:</p> <ul style="list-style-type: none"> • FD09 assumptions • Number of households billed • Outturn financial year average RPI 	We have concerns on FD09 assumptions and data inconsistencies.	-2.1
Opex incentive allowance (OIA)	There are no interventions in this area.	n/a	0.0
Capital expenditure incentive scheme (CIS)	<ul style="list-style-type: none"> • We have used the values submitted in table A9 in the CIS model. • We have used the values submitted in table W15 in the CIS model. • We have included our view of the applicable change protocol amounts, and reclassified the company's shortfall claim to a log down. • We have used our assumption of the cost of capital (3.70%) as the discount rate when profiling the revenue adjustment. 	<p>The company has broadly applied the published Ofwat methodology. However we identified inconsistencies between the actual capex values contained in the submitted CIS feeder model and table W15.</p> <p>The company also used a discount rate of 0% in its CIS model for profiling the revenue adjustment.</p>	-1.6
Other adjustments	There are no interventions in this area.	n/a	0.0
Total	n/a	n/a	-2.8

A2.2.5 Calculation of allowed revenue

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

Overall, we consider that the company's wholesale water revenue allowance should be £32.5 million in 2015-16, decreasing by 3.9% to £31.2 million in 2019-20.

Table A2.8 Sembcorp Bournemouth Water wholesale water allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	28.1	27.3	26.4	25.0	24.2	131.1
PAYG ratio	72.09%	73.74%	74.92%	76.23%	77.70%	-
Totex additions to the RCV	7.8	7.2	6.6	5.9	5.4	33.0
RCV (year average)	142.4	144.1	145.1	145.4	145.1	-
Wholesale allowed revenue build up:						
PAYG ¹	20.6	20.5	20.2	19.4	19.2	100.0
Return on capital	5.5	5.6	5.6	5.6	5.6	27.8
RCV run-off	5.8	5.9	5.9	6.0	6.0	29.7
Tax ²	0.6	0.5	0.4	0.4	0.4	2.3
Income from other sources	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
Reconciling 2010-15 performance	-0.6	-0.6	-0.6	-0.6	-0.6	-2.8
Ex ante additional menu income	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Capital contributions from connection charges and revenue from infrastructure charges	0.9	0.9	0.9	0.9	0.9	4.5
Final allowed revenues	32.5	32.5	32.2	31.4	31.2	159.9

Notes:

1. PAYG includes the PAYG calculated from totex and the pension deficit repair allowance.
2. Including tax on adjustments for reconciling 2010-15 performance and ex-ante additional menu income.

A2.3 Uncertainty mechanisms

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

Table A2.9 Sembcorp Bournemouth Water proposals for wholesale water uncertainty mechanisms

Sembcorp Bournemouth Water proposals	Our assessment
<p>Semcorp Bournemouth Water has proposed an uncertainty mechanism for water business rates with a sharing rate of 80% customer and 20% company.</p>	<p>We consider that the materiality, comparability and control over risk criteria for water business rates are met. We have included a 75%:25% uncertainty mechanism for all companies consistent with our prior guidance and earlier draft determinations.</p> <p>In previous draft determinations we considered that a 75:25 customer:company sharing rate would be in the interests of customers in the absence of an appropriate gain sharing mechanism. However as we do not consider Sembcorp Bournemouth Water’s proposed pain/gain sharing mechanism to be acceptable, we therefore consider a 75:25 sharing rate to be appropriate.</p> <p>The specific text of this Notified Item and the rationale for its inclusion in the draft determination is set out in the risk and reward technical appendix .</p>

A3. Household retail

A3.1 Company outcomes, performance commitments and delivery incentives

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

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

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

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

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
A: Providing an excellent customer experience	A1: Improve customer experience – increase Service Incentive Mechanism score. (Maintain position > 1 standard deviation above the industry average)	Reward and penalty	n/a
B: A financially stable business	B1: Fair customer bills (Efficient debt management – %age of average bill)	Reputational	n/a

A3.1.1 Outcome delivery and reporting

In the [assurance technical appendix](#), we set out our proposed framework for the form and level of reporting, monitoring and assurance we will seek from companies during

the five year regulatory period 2015-2020 in relation to the delivery of their commitments for the price review. This sets out three levels of assurance and the opportunities available for a company to improve its category status through the finalisation of the price controls and during the regulatory period itself.

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

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

A3.2 Costs

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

A3.2.1 Allocation of costs

In table A3.4 below, we summarise our assessment of Sembcorp Bournemouth Water’s cost allocation methodology.

Table A3.2 Our assessment of Sembcorp Bournemouth Water’s cost allocation methodology

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

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

A3.2.2 Adjustments

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

Table A3.3 Sembcorp Bournemouth Water proposals for ACTS adjustments

		Adjustment assessment criteria			
Adjustment	Value (£m over 2015-20)	Materiality	Beyond efficient management control	Impact company in materially different way	Value of adjustment appropriate
Input price pressure	2.7	Pass	Pass	Efficiency benchmarking evidence: Fail	Pass
				Upper quartile: Fail	

Sembcorp Bournemouth Water proposed an adjustment for Input Price Pressure (IPP) for £2.7m across the period 2015-20.

Ofwat rejects Sembcorp Bournemouth Water’s proposal for an ACTS adjustment for input price pressure. The company does show that these costs are outside of efficient management control. They provide convincing benchmarking evidence on wages relative to companies outside of the water industry, but do not provide sufficient efficiency benchmarking evidence in other areas. Furthermore, our assessment does not show Sembcorp Bournemouth Water to be upper quartile efficient within the water household retail sector and so we do not consider that they are affected in a materially different way to other companies.

The value of the adjustment is material, at 9.5% of household retail operating expenditure plus depreciation over 2015-20.

We consider that the evidence provided on management practices is sufficient and convincing that the company manages its costs to the extent that future cost increases are outside of efficient management control.

The evidence provided on relative efficiency includes benchmarking of wages against salaries outside of the water industry. However, we do not consider that Sembcorp Bournemouth Water has provided sufficient evidence to demonstrate that it is an efficient retailer compared to companies outside of the water industry.

Our assessment for ACTS suggests that the company is not upper quartile efficient for unmetered or metered household retail costs. This assessment is subject to change up to final determination, for example, subject to cost allocation changes being made by companies that could affect the ACTS. Because of our assessment of their relative efficiency the company has not demonstrated that they are affected in a materially different way to the average company.

Although we do not consider that an adjustment for input price pressure is appropriate for Sembcorp Bournemouth Water, for completeness we have assessed the evidence provided on the size of an adjustment. The size of the adjustment is calculated bottom up from relevant inflation rates for appropriate cost areas. This appears to be a reasonable approach.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments proposed in Sembcorp and Bournemouth Water's business plan						
Input price pressure	0.347	0.438	0.520	0.624	0.741	2.670
Movement on G&S costs recharged from wholesale	0.083	0.121	0.159	0.192	0.222	0.777
Pension deficit repair costs	0.141	0.141	0.141	0.000	0.000	0.423
Adjustments included in business plan	0.571	0.700	0.820	0.816	0.963	3.870
Adjustments included in draft determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Movement on G&S costs recharged from wholesale	Not included as adjustment – forms part of new cost					
Pension deficit repair costs	0.080	0.080	0.080	0.080	0.080	0.399

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in draft determination	0.080	0.080	0.080	0.080	0.080	0.399

Note:

There will be no indexation for retail price controls.

A3.2.3 New costs

In Table A3.5 below, we outline Sembcorp Bournemouth Water's proposed 'new costs' and our assessment of this proposal. The new costs included in this draft determination are quantified in **Error! Not a valid bookmark self-reference..**

Table A3.5 Sembcorp Bournemouth Water proposals for household retail new costs

	New costs assessment criteria				
Value (£m over AMP 6)	Materiality	Need	Options and CBA	Robustness of costs	Customer protection
1.2	✓	x	x	x	x

Ofwat rejects Sembcorp Bournemouth Water's proposed new costs. All new costs above the materiality threshold are excluded from the calculation of allowed revenues. The evidence base supporting new costs is considered to be neither sufficient nor convincing. The need for the new costs is not justified, the costs have not been shown to be the most cost beneficial means of meeting the need, the costs are not shown to be robust and customer protection is not discussed in relation to the new investments.

Sembcorp Bournemouth Water's new costs are material (4.3% of total AMP6 household retail operating expenditure plus depreciation).

The evidence on the need for the new costs is limited. These costs are driven by increased metering costs per customer and increased depreciation – what is driving these increases is not explained.

No evidence has been provided on whether the proposed new costs provide the most cost beneficial solution. No options analysis or cost benefit analysis is provided.

There is no evidence that these are robust estimates of efficient costs; the capital costs are not explained as to what the investments are and the metering costs appear to be driven by increased wages for meter readers, despite the fact that Sembcorp Bournemouth Water has a separate IPP claim to cover wage inflation. There is no evidence of market testing of these costs to demonstrate that the costs are robust.

The SIM will provide some protection to customers for the impact of these costs on service levels, but an explicit link is not made from these costs to customer outcomes.

Due to the assumptions that we have made in our modelling on the profiling of the disallowed new costs, after new costs above the materiality threshold are removed, the remaining new costs do not result in a modification being made to the ACTS, as shown in table A3.5 below. Immaterial new costs are however considered when setting Sembcorp Bournemouth Water's allowed revenues.

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

	Value
Modification made to 2013-14 CTS for ACTS calculation	0.00

Note:

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

A3.3 Calculating the allowed revenues

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

A3.3.1 Net margins

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

Table A3.7 Household retail net margins (%)

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

The table below sets out the components of the allowed household retail revenue.

Table A3.8 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	20.60					
Metered water only customers	25.84					
Industry average cost to serve (£/customer)						
Unmetered single service customers	20.73					
Metered water only customers	26.78					
Allowed cost to serve¹ (£/customer)						
Unmetered single service customers		18.40	18.64	18.88	19.08	18.93
Metered water only customers		24.29	24.69	24.93	25.13	24.98
Total allowed (£ million)						
Cost to serve (excluding net margin)		4.2	4.3	4.4	4.5	4.5
Forecast household wholesale charge (including forecast RPI ²) ³		34.7	35.8	36.7	37.0	37.9
Household retail revenue (including an allowance for the net margin) ⁴		4	5	5	5	5

Notes:

There will be no indexation for retail price controls.

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

A3.4 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in the [risk and reward technical appendix](#). In Table A3.9 below, we set out Sembcorp Bournemouth Water’s proposed household retail uncertainty mechanisms and our assessment of these proposals.

Table A3.9 Sembcorp Bournemouth Water proposals for household retail uncertainty mechanisms

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

A4. Non-household retail

In the [non-household retail technical appendix](#), we outline our overall approach to the non-household retail price control. Further information regarding our observations on companies' proposals for their non-household retail price controls is set out in [Information Note 14 – 2014 price review – non-household customer engagement ahead of draft determination representations](#).

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

A4.1 Indicative non-household retail total revenue

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20
Indicative non-household retail total revenue price control including net margins	0.7	0.7	0.7	0.7	0.7

Note:

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

A4.2 Net margins

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

A4.3 Cost proposals

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

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

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

This resulted in the company's proposals being adjusted from £0.075 million over the control period, to £0.064 million.

In total, this resulted in the company's proposed costs being adjusted from £1.583 million over the control period to £1.572 million.

We note that from 2013-14 through to 2019-20 the company is proposing cost reductions of 20%. This is significantly greater than the proposed reduction for the household control. As part of its representations we request for the company to provide us with a clear explanation as to why it expects much higher cost reductions for its non-household retail activities than its household.

A5. Appointee

In this section we discuss at an appointee level:

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

A5.1 Bills and K factors

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

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

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

Table A5.1 Sembcorp Bournemouth Water’s draft determination – K factors, allowed revenues and customer bills ^A

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (£m) ¹	32.5	32.5	32.2	31.4	31.2	159.9
Wholesale water – K (%) ²	0.00	-0.09	-0.82	-2.50	-0.85	-
Retail household allowed revenue (£m)	4.5	4.6	4.7	4.8	4.8	23.4
Retail non-household expected revenue (£m)	0.7	0.7	0.7	0.7	0.7	3.3
Average household bill – water (£) ³	130	130	129	126	125	-

Notes:

A Wholesale figures in 2012-13 prices and retail figures in nominal prices

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

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

A5.2 Uncertainty mechanisms and gain share mechanisms

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

Table A5.2 Sembcorp Bournemouth Water's proposals for appointee level uncertainty and gain share mechanisms

Sembcorp Bournemouth proposals	Our assessment
<p>Sembcorp Bournemouth Water has proposed a pain/gain sharing mechanism, which they liken to South West Water's watershare mechanism.</p> <p>This mechanism is intended to monitor/challenge the company's performance during the period 2015-20 via an independent review body (Customer View group) and recommend gain, or pain, sharing with customers.</p>	<p>We do not accept Sembcorp Bournemouth Water's proposal for their proposed pain/gain sharing mechanism. We support transparent performance monitoring and gain sharing mechanisms. However, we are concerned that the proposal is not yet sufficiently well specified and that it exposes customer to pain share risk in 2015-20 period and so does not protect customer interests. We ask the company to consider further developing its proposal and to address customer protection issues in conjunction with its CCG in its response to the draft determination.</p>

A5.3 Return on regulated equity range

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

Table A5.3 Whole company RoRE range

	Lower bound (%) (appointee)	Upper bound (%) (appointee)
Overall	-4.6%	2.0%
ODIs	-2.0%	0.4%
Totex	-2.2%	1.2%
Financing	-0.5%	0.2%
SIM	0.0%	0.3%

Commentary:

The whole company RoRE range is from 1.8% to 8.0%, with a base case of 6.0%, with overall impacts from -4.2% to +2.0%. This range reflects our view of the appropriate small company uplift (see section A2.2.3), rather than Sembcorp Bournemouth Water's proposed uplift.

The totex performance range from -2.2% to +1.2% has been estimated by Sembcorp Bournemouth Water based on (a) modelling of the economic and rainfall scenarios published with the PR14 methodology; and (b) a consideration of specific downside opex risks that may arise over 2015-20. They have provided sufficient supporting evidence for the totex variation and we therefore consider the overall range to be acceptable. As set out in the [risk and reward technical appendix](#), we have not made any adjustments to the proposed totex performance range to take account of interventions on totex in the draft determination.

The ODI range from -2.0% to +0.4% is based on Sembcorp Bournemouth Water's ODI submissions and our calculated impact of our interventions (see Annex 4). The ODI impacts are skewed to the downside due to a larger number of penalty only ODIs. Following our interventions, the downside impact was -2.4%. However, in line with our methodology, we have capped the maximum penalty at -2.0%.

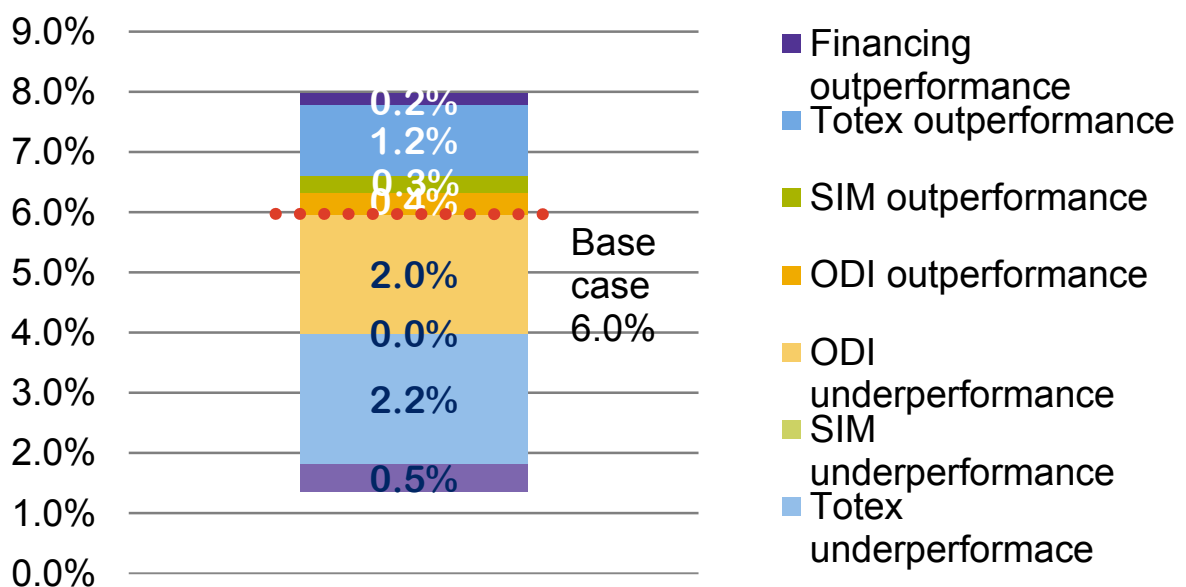
Sembcorp Bournemouth Water has assessed financing impacts with a greater downside than upside. The financing risk is based on analysis carried out by external advisors as well as the company's own analysis of current bond yields relative to their long-term averages. Financing risk is applied to the cost of new debt and is calculated on a notional basis. This results in a RoRE impact of -0.5% to +0.2%. We consider this to be based on reasonable analysis and the overall range is acceptable.

	Lower bound (%) (appointee)	Upper bound (%) (appointee)
Sembcorp Bournemouth Water has estimated SIM impacts using an assumption of a maximum reward of 0.5% of revenue, while they have assumed a downside of 0%. This results in a RoRE impact of 0% to 0.3%. Given that the company has consistently achieved a SIM ranking in the upper quartile, we consider this range to be acceptable.		

As part of their risk analysis, Sembcorp Bournemouth Water included a scenario in which they lost a single large special agreement customer. The loss of this customer had a large negative revenue impact in their scenario modelling. In practice, the company would be able to largely mitigate this negative revenue impact via the wholesale revenue forecasting incentive mechanism (WRFIM). However, Sembcorp Bournemouth Water considered that the bill increases that this would lead to would for its remaining customers would not be “politically acceptable”. We, therefore, recognise that this is a plausible risk for the company, but we have not included this in their RoRE analysis.

The composition of the RoRE range for Sembcorp Bournemouth Water at an appointee level is shown in figure A5.4 below.

Figure A5.4 Sembcorp Bournemouth RoRE range – appointee



Source:

Ofwat calculations based on information from Sembcorp Bournemouth Water.

A5.4 Financeability

We have compared the financial ratios provided by Sembcorp Bournemouth Water and our calculation of its financial ratios implied by the company's business plan proposals submitted on 27 June, when both are prepared on a notional basis. We illustrate these in table A5.5 below. The final column sets out the financeability ratios based on our draft determination revenues and costs.

Table A5.5 Company and Ofwat financial ratio calculations based on the company business plan and financial ratios based on our draft determination

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on our draft determination (average 2015-20)
	Company calculation	Ofwat calculation	
Cash interest cover (ICR)	3.65	3.65	3.27
Adjusted cash interest cover ratio (ACICR) – base case (average over five years)	2.22	2.24	1.88
Funds from operations(FFO)/debt	12.40%	13.08%	11.16%
Retained cash flow/debt	8.72%	10.37%	8.49%
Gearing	61.46%	59.48%	60.88%
Dividend cover (profit after tax/dividends paid)	1.25	2.02	1.41
Regulatory equity/regulated earnings for the regulated company	16.72	16.91	16.94
RCV/EBITDA	8.58	8.49	9.37

Commentary:

Financial ratios: Sembcorp Bournemouth Water has a target credit rating of BBB+ and has provided Board assurance that the company is financeable on an actual and notional basis. Based on the company's plan the financial ratios calculated by Ofwat are broadly consistent with the ratios that Sembcorp Bournemouth Water presented to us. The ratios for the draft determination are lower than those based on the company's own plan, this is as a result of our interventions which are discussed below, although we consider the plan to

continue to be financeable.

PAYG Changes: Sembcorp Bournemouth Water PAYG rates is largely unchanged from its December plan and is bringing forward revenue to 2015-20 period with a PAYG ratio of 106% of opex plus IRE. In addition, the company's total cost recovery that is, PAYG and RCV run off is 102% of Totex. We note the company's RCV run-off rate, which appears relatively low, may be an offsetting factor. However, RCV declines by around 1.5%. Sembcorp Bournemouth Water has proposed a high PAYG ratio (both in relation to proposed rate for 2020-25 and operating expenses and IRE) in order to maintain a stable bill profile over the 2015-25 period that is, across two price controls. This has the impact of increasing bills and benefiting financeability ratios over 2015-20 period compared to the level of bills and ratios with stable PAYG rate over both periods. Sembcorp Bournemouth Water intends to reduce its PAYG ratio to the level of opex +IRE in 2020-25 and so have the ability to absorb potential cost pressures in 2020-25. In effect this means that bills are higher in 2015-20 than they otherwise would have been in order to manage the risk of bill increase in 2020-25.

Pass through of WACC reduction: As Sembcorp Bournemouth Water has not materially changed PAYG and RCV run off rates since December, it has allowed 100% of its WACC reduction (from 4.51% to 3.89%) to pass through to customer bills in 2015-20.

Customer Support: Sembcorp Bournemouth Water states that it has brought forward revenue to ensure stable bills over the periods 2015-20 and 2020-25. However, there is no evidence that the company engaged with its CCG on smoothing bills between price control periods (as compared to within 2015-20 period), although the CCG supports the revised plan.

Conclusion on intervention: Given the strong notional ratios and the use of PAYG rates to bring forward revenue without evidence of customer support, we have intervened to lower PAYG ratios to be equal to opex plus IRE, which reduces customer bills in the current period, while maintaining financial ratios. This results in a small increase in the RCV over the 2015-20 period.

Sembcorp Bournemouth Water should engage and obtain explicit customer support if it subsequently proposes to change PAYG levers in response to the draft determinations. Any engagement on financeability should be undertaken on the basis of notional financeability.

Table A5.6 sets out the PAYG and RCV run-off rates which shows whether revenue has been brought forward compared to the December plan and the impact that this has on RCV growth and longer term affordability and financeability. The draft determinations reflect our interventions on PAYG.

Table A5.6 Impact on the longer term

	PAYG rate	RCV run-off	RCV growth % 1 April 2015 to 31 March 2020
Company December plan	80.4%	4.00%	-1.5%
Company June plan	79.6%	4.00%	-1.3%
Draft determinations	74.9%	4.00%	2.4%

A5.5 Affordability

Table A5.7 sets out the change in household bill profile between the company's December and June business plans and the draft determinations.

Table A5.7 Household bill profile (£)

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

Companies have not necessarily used the same method of calculating household bills as Ofwat – for example, we have included economies of scope for household retail when calculating combined water and sewerage bills. So the Ofwat calculations (lines 3 and 4 of Table A5.7) are not directly comparable to the company plans (lines 1 and 2 of Table A5.7). We have not re-profiled customer bills following our draft determinations as the proposed bill profile broadly follows the company's June business plan, albeit from a lower starting level.

Table A5.8 sets out the reasons why this draft determination is assessed as affordable. It describes key changes in relation to Sembcorp Bournemouth Water's December business plan that we assessed as affordable.

Table A5.8 Business plan affordability assessment

	Commentary
Acceptability	<p>In its December plan, Sembcorp Bournemouth Water reported that its customer research had found that 79% of customers found its proposals acceptable.</p> <p>In its June submission, the company's proposed average bills were slightly lower than those in the December plan. It stated: "Our proposed PAYG ratios and run-off rates have been set to ensure we offer customers a stable bill profile over AMP6 and AMP7, while retaining enough cash within the business to remain financeable. Customers value stable bills and our proposed PAYG ratio and run-off rate combination will allow us to absorb potential shocks in AMP6 without having to return to customers for bill increases at PR19 unless there are new and additional costs to be borne"</p> <p>However, there is no evidence of customer support for the proposed use of PAYG rates to provide stable bills between 2015-20 and 2020-25 by raising bills in 2015-20 by use of PAYG. So we have intervened in the plan to set PAYG rates consistent with stable PAYG rate over 2015-25 and to reduce bills in the 2015-20 period.</p>
Identification of affordability issues and appropriate support measures	<p>In its December submission, the company proposed an appropriate range of measures designed to help those customers identified as having affordability problems, including ongoing research into social tariffs, tailored payment plans, a discretionary trust and a partnership with a third party debt advisor.</p> <p>In the revised submission, there is no indication that there has been any reduction in scale or scope of the company's affordability measures.</p>
Longer-term affordability – Cost Recovery tools	<p>In its December plan, the company outlined how it had used the PAYG ratio to smooth customers' bill profiles in the 2015-20 period, and also demonstrated that it had surveyed customers about levels of future bills, and used the results to ensure that it will not impose unaffordable price increases beyond 2020.</p> <p>In the revised plan, the company has slightly reduced the PAYG ratio for 2015-20 and for 2020-25, and left the RCV run-off rate unchanged. The company states that it has made these changes to ensure financeability, while continuing to provide customers with smooth bills. The CCG do not directly comment</p>

	Commentary
	<p>on the company’s cost recovery adjustments, but expresses overall support for the revised plan. As discussed above, Sembcorp Bournemouth Water is using PAYG rates to bring revenue forward, and we have intervened to reset PAYG rates.</p>
<p>Longer-term affordability – ODIs</p>	<p>The company has provided evidence that it has revisited its package of ODIs for the June submission, in accordance with the risk and reward guidance. As a result of the revision, the company has added financial rewards to two of its measures.</p> <p>However, we note that the company has not conducted specific customer research to support its revised ODIs, or to assess its customers’ attitudes towards the concept of linking bills to performance, but has used its existing WTP research as the basis for adding reward incentives to the ODIs.</p> <p>The CCG gives its support for the company’s overall ODI package.</p>

Annex 1 Wholesale costs

Establishing draft determination thresholds

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

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

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

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

Basic cost threshold	Policy additions ¹	Unmodelled costs adjustment	Deep dives ²	Draft determination threshold	Deep dives fully or partially not added
110.6	18.5	-2.4	5.2	131.9	1.4

Note:

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

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

Business rates	Pension deficit payments	Third party costs	Open market costs ¹	Net v gross adjustments	Total
16.4	1.9	0.0	0.2	0.0	18.5

Note:

1. Of this amount, £0.030m relates to 2014-15 open market costs.

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

Plan	DD threshold	Gap ¹	Plan v 2010-15
136.4	131.9	4.6	2.4

Note:

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

Table AA1.4 Summary of wholesale water deep dive assessments

Company proposal		Assessment				DD allowance	
Claim	Amount sought (£m)	Implicit allowance (£m)	Need	CBA	Robust costs	Assessment	Amount allowed (£m)
Fawley	19.7 ¹	0	Partial Pass	n/a	Partial Pass	Partially accept	2.6
Meter Installations	3.8	1.9	n/a	Fail	Fail	Partially accept	0.6
Additional NEP Catchment management expenditure	0.8	0	Fail	Pass	Fail	Reject	0
Leakage reduction	0.9	0.3	n/a	n/a	n/a	Reject	0
Mains renewals	1.9	0	Pass	Partial Pass	Pass	Accept	1.9

Note:

1. The £19.7m claimed by Sembcorp Bournemouth Water is the claim value included in the business plan table W11 which is the total cost of Fawley. In the detailed claim, Sembcorp Bournemouth Water have claimed a range of between £3.2 and £5.8m

Annex 2 Household retail revenue modification

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

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

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

Revenue modification per:	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only customer	19.55	19.81	20.07	20.27	20.13
Metered water only customer	25.81	26.25	26.50	26.70	26.57

Note:

There will be no indexation for retail price controls.

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

Number of customers	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only	59.8	56.2	52.6	49.0	45.4
Metered water only	128.0	132.7	137.5	142.2	146.8

Annex 3 Reconciling 2010-15 performance

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

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

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

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

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

	Company view	Ofwat view
Service incentive mechanism (SIM)	1.050	0.917
Revenue correction mechanism (RCM)	-1.950	-2.055
Opex incentive allowance – post-tax (OIA)	0.000	0.000
Capital expenditure incentive scheme (CIS) ²	-1.470	-1.613
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000
Total wholesale legacy adjustments ¹	-2.370	-2.751

Notes:

1. Totals may not add up due to rounding.

2. For the CIS mechanism, there is a corresponding adjustment to the RCV made at 1 April 2015 (part of the 'midnight' adjustments'). The impact on the RCV for water can be seen in Table AA3.155. 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 A29.

Service incentive mechanism (SIM)

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

Table AA3.2 provides the annualised rewards from the company’s SIM performance. The slight difference in views reflects updated turnover data.

Table AA3.2 SIM annualised rewards (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.21	0.21	0.21	0.21	0.21	1.05
Ofwat view	0.183	0.183	0.183	0.183	0.183	0.917

Revenue correction mechanism (RCM)

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.390	-0.390	-0.390	-0.390	-0.390	-1.950
Ofwat view	-0.411	-0.411	-0.411	-0.411	-0.411	-2.055

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

Area of intervention	What we did	Why we did it
FD09 assumptions	Our assumptions for the draft determination includes our view of the FD09 assumptions.	There are inconsistencies between the company's and our view of the FD09 assumptions used in the company's populated RCM model.
Number of households billed	Our assumptions for the draft determination uses the data the company submitted in business plan table R3 to calculate our view of the RCM adjustment	There were inconsistencies with the number households billed between business plan table R3 and the company's populated RCM model.
Outturn financial year average RPI	Our assumptions for the outturn financial year average RPI at the draft determination uses the data that the company submitted in business plan table A9 to calculate our view of the RCM adjustment.	There are inconsistencies with the outturn financial year average RPI between table A9 and the company's populated RCM model.

Operating expenditure incentive allowance (OIA)

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

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

Water service	2015-16	2016-17	2017-18	2018-19	2019-20	Total

Water service		2015-16	2016-17	2017-18	2018-19	2019-20	Total
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

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

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

Change protocol (logging up, logging down and shortfalls)

Table AA3.7 and Table AA3.8 below summarise Sembcorp Bournemouth Water’s view and our baseline view of total adjustments to:

- capex included in the CIS reconciliation; and
- the FD09 opex assumptions used in the calculation of the opex incentive revenue allowances.

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

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

2009-10 to 2014-15 – post-efficiency capex	Company view	Ofwat view
Logging up (two sided)	0.000	0.000
Logging down (two sided)	-0.443	-0.443
Shortfalls (one sided)	0.000	0.000

Notes:

1. Includes two-sided adjustments from the PR09 agreed overlap programme as set out in

2. Table AA3.13.

3. We exclude shortfalls for serviceability from the CIS reconciliation, but instead make direct adjustments to the RCV in 2015-16. We do this to allow the actual capex the company incurred in seeking to maintain serviceability, to be reflected in the rewards or penalties earned through the scheme. But to also ensure customers are not required to pay for the regulatory output the company has failed to deliver.

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

2009-10 to 2014-15 – post-efficiency opex	Company view	Ofwat view
Logging up	0.000	0.000
Logging down	-0.020	-0.020
Shortfalls	0.000	0.000
Shortfalls for serviceability	0.0	0.0

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

Area of intervention	What we did	Why we did it
Shortfall adjustments (capex and opex) for selective and optional meters	<p>We reclassified this shortfall as a logging down item.</p> <p>We have accepted the company's proposed capex (£0.483m) and the company's proposed opex (£0.021m). In post efficiency terms these values are £0.443m (capex) and £0.020m (opex)</p>	To ensure appropriate treatment of this adjustment within the CIS reconciliation.

Service standard outputs

The final determination supplementary reports in 2009 contained defined project(s) where the primary output was the service standard specified¹. These outputs were set out to recognise that companies may decide to prioritise investment differently in order to achieve the service output in a more innovative and efficient manner, while still holding the company to account for the benefits to customers and the environment.

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

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

For the purposes of these draft determinations, we will not applying shortfalls on this issue conditional upon this information being provided as part of companies' draft determination representations. We would expect companies to respond to this issue in their representations. If they do not provide adequate evidence to demonstrate achievement of the service

¹ In the final determination supplementary reports we said: "Both the project activity (as proposed in your final business plan) and the service standard are the defined output. You must demonstrate delivery of the stated service standard output through the June return. The service standard output is the primary output. We recognise that companies may decide to prioritise activity differently in order to achieve the service output in a more efficient manner. All material changes to the project activity must be reported and explained through your June return."

standards set out, then they should assume that we will apply a shortfall equal to the costs assumed for the project(s) at FD09 within our final determinations in December 2014.

Serviceability performance

Table AA3.10 below summarises our serviceability assessments for Sembcorp Bournemouth Water and Table AA3.11 quantifies the value and impact of any serviceability shortfall on the RCV.

Table AA3.12 summarises our interventions in relation to Sembcorp Bournemouth Water’s proposed adjustments for serviceability.

Table AA3.10 Serviceability assessments for 2010-15¹ (£ million)

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

Notes:

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

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

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

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

Area of intervention	What we did	Why we did it
Water treatment works coliforms non-compliance	For the purposes of the draft determination we have not intervened. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We may consider a shortfall adjustment if this is not achieved. We would expect the company to demonstrate its latest performance as part of its representations and in advance of the final determination.	The company has had two breaches of the upper control limit in 2010-11 and 2012-13. Performance has improved in the last year. The company has forecast to maintain 2013-14 performance in 2014-15. We require the company to demonstrate stable serviceability in 2014-15, if this is not achieved, we may consider a shortfall adjustment.

Notes:

The shortfall calculation methodology is detailed in the [wholesale water and wastewater technical appendix](#).

The 2009 agreed overlap programme

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

Table AA3.13 below confirms the zero assumptions included in this draft determination.

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

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

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

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

Capital expenditure incentive scheme (CIS)

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

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

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

Table AA3.15 Legacy true-up adjustments

		Water service
Restated FD09 CIS bid ratio¹	Company view	115.990
	Ofwat view	114.832
Outturn CIS ratio	Company view	112.159
	Ofwat view	111.981
Incentive reward/penalty (%)	Company view	-3.169
	Ofwat view	-3.241
Reward/penalty (£m)²	Company view	-1.380
	Ofwat view	-1.415
Adjustments to 2015-20 revenue (£m)³	Company view	-1.463
	Ofwat view	-1.502
CIS adjustment to RCV (£m)	Company view	0.854
	Ofwat view	0.890

Commentary:

The company has broadly applied the published Ofwat methodology. However we identified inconsistencies between the actual capex values contained in the submitted CIS feeder model and table W15. The company also used a discount rate of 0% in its CIS model for profiling the

	Water service
<p>revenue adjustment.</p> <ul style="list-style-type: none">• We have used the values submitted in table A9 in the CIS model.• We have used the values submitted in table W15 in the CIS model.• We have included our view of the applicable change protocol amounts, and reclassified the company's shortfall claim to a log down.• We have used our assumption of the cost of capital (3.70%) as the discount rate when profiling the revenue adjustment.	

Notes:

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

2. Table AA3.13).
3. 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.
4. The adjustment to 2015-20 revenue values shown in this table assume a single year adjustment in the first year, and do not include the NPV profiling used for the draft determination.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.293	-0.293	-0.293	-0.293	-0.293	-1.463
Ofwat view	-0.323	-0.323	-0.323	-0.323	-0.323	-1.613

Other adjustments

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

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

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

	Company view	Ofwat view	Commentary
Tax refinancing benefit clawback	0.000	0.000	No adjustment was proposed by the company

	Company view	Ofwat view	Commentary
Other tax adjustments	0.000	0.000	No adjustment was proposed by the company
Equity injection clawback	0.000	0.000	No adjustment was proposed by the company
Other adjustments	0.000	0.000	No adjustment was proposed by the company

Annex 4 Outcomes, performance commitments and outcome delivery incentives

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

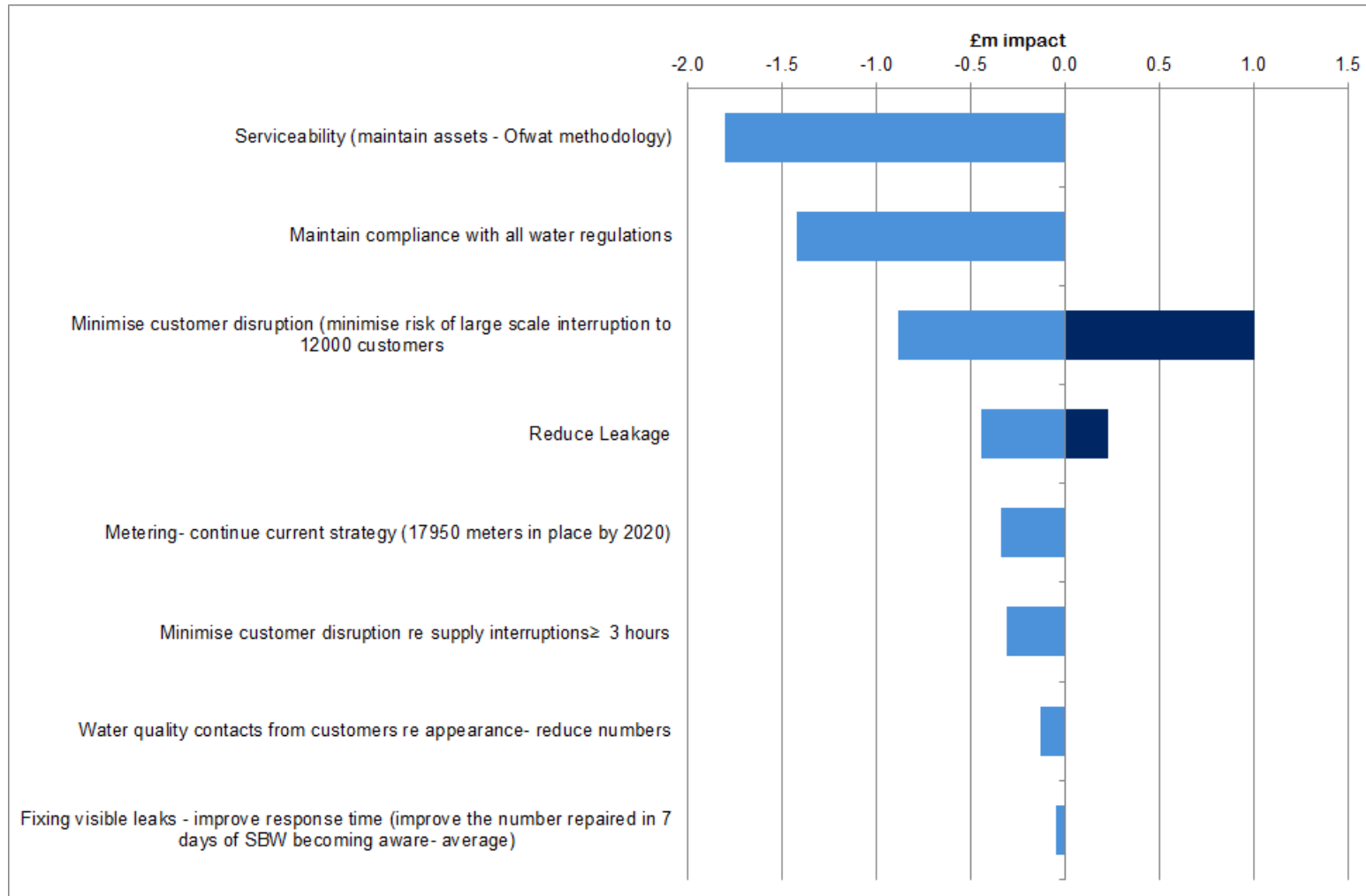
The two tables below first provide an overview of these performance commitments and ODIs. Table AA4.1 shows the balance between reward and penalty, penalty only and reputational incentives in the package of incentives for the company and

Figure AA4.2 shows the potential financial impact of each of the financial incentives.

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

	Reward and penalty	Penalty only	Non-financial incentives
Wholesale water	2	6	4
Household retail	1		1
Total number of PCs	3	6	5

Figure AA4.2 Overview of financial ODIs



Note: This figure does not include the SIM

As explained in the [outcomes technical appendix](#), we are proposing the introduction of an aggregate cap on rewards and collar on penalties from the outcome delivery incentives. Details of how the cap/collar will operate are set out in section A5 of the [outcomes technical appendix](#).

Tables AA4.3 and AA4.4 set out a more detailed explanation of our interventions in the company’s wholesale water and household retail outcomes.

Table AA4.3 Summary of interventions on wholesale water outcomes, performance commitments and incentives

PC/ODI affected	What we did	Why we did it
B4: Serviceability (maintain assets – Ofwat methodology)	Applied a potential penalty of 10% of capital maintenance spend, rather than Sembcorp Bournemouth Water’s proposal of 3.85% (its weighted average cost of capital).	It is important that potential penalty is sufficiently large to strongly disincentivise deteriorations in asset health. 10% is comparable with potential penalties for other companies.
A2: Maintain compliance with all water regulations	Introduced a penalty only incentive. Changed committed performance levels from 2017-18 to 2019-20 and introduced penalty deadbands and collars for those years. Introduced a penalty rate based	Company is a high performer in this area, but we have intervened following a review of mean zonal compliance and upper quartile performance across all companies. The Company has defined Outcome Delivery Incentives for drinking water quality compliance with a penalty at less than 100%. This penalty represents an incentive to the company to not reduce its compliance with water quality measures. This threshold represents the

PC/ODI affected	What we did	Why we did it
	<p>on the average water-only company.</p>	<p>point at which financial incentives will be applied to the company through the price setting process. All companies are subject to drinking water quality obligations regulated by the DWI, which are the overriding statutory obligations that a water company must comply with as part of their Section 37 obligations. The company’s Board has confirmed as part of its business plan submission that it will comply with all relevant statutory obligations.</p> <p>See the outcomes technical appendix for further details. The company will only face penalties if its performance were to fall substantially below its projected level of performance.</p>
<p>B1:Reduce Leakage</p>	<p>Changed the penalty collar to 22 MI/d.</p>	<p>We have intervened following a review of leakage across all companies to ensure that the companies are incentivised to achieve upper quartile performance. See the outcomes technical appendix for further details.</p>
<p>A1: Water quality contacts from customers re appearance – reduce numbers</p>	<p>Reduced the committed performance level from 1.25 to 1.0 contacts/1000 population (upper quartile) from 2017-18. Removed the penalty deadband. Maintained the distance between the committed performance level and penalty collar which the company proposed.</p>	<p>We have intervened following a review of water quality contacts across all companies to ensure that the companies are incentivised to achieve upper quartile performance. See the outcomes technical appendix for further details.</p>

PC/ODI affected	What we did	Why we did it
B3: Minimise customer disruption re supply interruptions \geq 3 hours	Introduced a penalty-only ODI for performance worse than 7.3 hours per affected property in the first four years, and 4.6 in 2019-20. Set penalty rate equal to the average for water-only companies.	We have intervened following a review of supply interruptions across all companies to ensure that the companies are incentivised to achieve upper quartile performance. See the outcomes technical appendix for further details.

Table AA4.4 Summary of interventions on household retail outcomes, performance commitments and incentives

PC/ODI affected	What we did	Why we did it
We have added a performance commitment for the Service Incentive Mechanism (SIM).		

Outcome delivery and reporting

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

Table AA4.5 below summarises Sembcorp Bournemouth Water’s proposed approach to the measurement, reporting and governance of outcomes and our assessment of this approach.

Table AA4.5 Sembcorp Bournemouth Water’s proposals for outcome delivery and reporting

Sembcorp Bournemouth Water proposals	Our assessment
<p>Taken from page 2 onwards of data definitions for outcomes and performance commitments: ‘To hold us to account, in discussion with our Customer Challenge Group, we are creating an independent review body which we refer to as the Customer View group. Following the structure laid out here this group will review actual performance against targets and recommend to the Board what pain, or gain if appropriate, should be shared with the customers, as well as when and how.</p> <p>At least once every year we will report our performance against agreed Performance Commitments to the Customer View group. The group will review the performance and make any recommendations to our Board through the independent non-executive director that sits on the group.</p> <p>The Performance Commitments will be reported on each year, published on our website and in our ‘How we’re doing’ document, and be part of the Customer View group’s review process.’</p>	<p>Sembcorp Bournemouth Water has provided sufficient evidence demonstrating the approach it will undertake to ensure the PCs will be measured and reported consistently, and the proposed governance and assurance processes. We have therefore accepted the company’s proposal.</p>

In the remainder of this section, we provide the following information on each performance commitment we are proposing as part of this draft 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 applicable²; and
 - the incentive rates.
- Additional details on the measure.
- where Ofwat has not accepted the company’s proposals, the nature of the intervention made is also explained.

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

We have intervened in relation to a number of performance commitments proposed by the company. Where our intervention is to remove the performance commitment in question, details and reasoning are provided in Table AA4.6 below. Where we have amended the company’s proposed incentive but retained the performance commitment, we have intentionally set out our interventions below using a ~~strickethrough~~. What this means is that we have rejected the proposal that has been struck through and instead we have either used a different value or not included a value at all (for example, in the case of some rewards).

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

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

Performance commitment	Reason for its removal
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² In general, the cap or collar is the level of service at which the maximum penalty or reward occurs and a deadband is the level of service at which the incentive first applies. However, where a greater than or less than symbol precedes the figure this denotes that the maximum or initial incentive only occurs if service is greater than or less than this level.

Performance commitment	Reason for its removal
We have not removed any performance commitments	

Table AA4.7 Performance commitments that we have added to this draft determination

Performance commitment	Reason for its addition
We have not added any performance commitments	

Wholesale water outcome [1]: [Safe wholesome water]

Performance commitment [A]: [1]

Detailed definition of performance measure: [Water quality contacts from customers re appearance – reduce numbers]

Incentive type: Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Cont acts/ 1000 pop	1.25	1.25 1.24	1.25 1.23	1.25 1.22	1.25 1.22	1.25 1.22
Penalty collar	Cont acts/ 1000 pop		2.50	2.50	2.5 2.47	2.5 2.47	2.5 2.47
Penalty deadband	Cont acts/ 1000 pop		1.37 1.25	1.37 1.25	1.37 1.22	1.37 1.22	1.37 1.22

Incentive rates

Incentive type	Performance levels (contacts / 1000 / pop)		Incentive rate (£m/Contacts/1000 pop/year)
	Lower	Upper	
Penalty	2.5	1.25 1.22	-0.020 -0.040

Additional details

Necessary detail on measurement units	Measured on a calendar year basis and reported internally each month. (Set against our total population of approximately 436,000)
Frequency of PC measurement and any use of averaging	Annual
Timing and frequency of rewards/penalties	Measured on a calendar year basis and reported internally each month
Form of reward/penalty	[Adjustment to revenue]
Any other information or clarifications relevant to correct application of incentive	To be within lower and upper performance level range re our stated measure, that is,, between 2.50 and 1.25 1.22 contacts per 1000 head of population, targeting 1.25 1.22. Deadband set at 1.25 in the first two years, 1.22 in the last three years 1.25—1.37. Penalty trigger at 1.37 1.25 contacts / 1000 / population in the first three years and 1.0 in the last two years. £50,000 maximum / year scaled per 0.1 contacts implies an incentive rate of £40,000 / contact / 1000 population / year, as the range over which the penalties apply in every year is 1.25 contacts / 1000 population.

Performance commitment [A]: [2]

Detailed definition of performance measure: [Maintain compliance with all water regulations]

Incentive type: ~~Reputational~~ Penalty only

Performance commitments

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

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty deadband	%		99.96	99.96	99.96	99.96	99.96

Incentive rates

Incentive type	Performance levels (% compliance)		Incentive rate (£m/0.01%)
	Lower	Upper	
Penalty	99.95%	99.96%	0.284

Additional details

Necessary detail on measurement units	Compliance to all regulatory parameters required under the WS(WQ) regulations (%age overall compliance)
Frequency of PC measurement and any use of averaging	Monthly
Any other information or clarifications relevant to correct application of incentive	To be within lower and upper performance level range re our stated measure, and maintain our upper quartile position in the industry. Target compliance level 99.97% 100.00%. Lower Performance Level Percentage set at 99.95%. Upper Performance Level Percentage set at 100%.

Wholesale water outcome [2]: [Reliable Water Supply]

Performance commitment [B]: [1]

Detailed definition of performance measure: [Reduce Leakage]

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	MI/d	21.47					20.00
Penalty collar	MI/d						21.00 22.00
Penalty deadband	MI/d						20.10
Reward deadband	MI/d						19.90
Reward cap	MI/d						17.00

Incentive rates

Incentive type	Performance levels (MI/d)		Incentive rate (£m/ml/d/year)
	Lower	Upper	
Penalty 1	21.00 22.00	20.00	-0.231
Penalty 2			
Reward	20.00	17.00	0.078

Additional details

Necessary detail on measurement units	The total level of leakage, including customer supply pipe leakage, expressed in megalitres per day (MI/day)
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target

Timing and frequency of rewards/penalties	A £0.115m penalty applies for every 0.1MI/d missed from the target of 20.0MI/d. A £0.039m reward applies for every 0.1MI/d achieved over the target of 20.0MI/d
Form of reward/penalty	[Adjustment to revenue]
Any other information or clarifications relevant to correct application of incentive	Reduce leakage from current performance to 20.0 MI/d by 2020. Lower Performance Level Percentage set at 21.0 22.00 MI/d by 2020. Upper Performance Level Percentage set at 20.0 17.00 MI/d by 2020. We will monitor progress towards the target on an annual basis.

Performance commitment [B]: [2]

Detailed definition of performance measure: [Minimise customer disruption (minimise risk of large scale interruption to 12000 customers)]

Incentive type: Financial – reward and penalty.

Performance commitments

		Startin g level	Committed performance levels				
	Unit	2014- 15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Reduce risk per 1000 customers						12.00
Penalty collar	Reduce risk per 1000 customers						0.00
Penalty deadband	Reduce						11.50

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	risk per 1000 customers						
Reward deadband	Reduce risk per 1000 customers						12.50
Reward cap	Reduce risk per 1000 customers						18.00

Incentive rates

Incentive type	Performance levels (Reduce risk per 1000 customers)		Incentive rate (£m/Reduce risk per 1000 customers/year)
	Lower	Upper	
Penalty 1	0.00	12.00	-0.016
Penalty 2			
Reward	12.00	18.00	0.037

Additional details

Necessary detail on measurement units	<p>12000 customers to benefit from the laying of a reinforcement main by 2020.</p> <p>Penalties are in place to Sembcorp Bournemouth Water for every 1000 properties of the 12000 population not benefitting from this scheme.</p> <p>There are also rewards in place for Sembcorp Bournemouth Water for over-performance set at</p>
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	<p>1000 property intervals over the target of 12000 up to 18000.</p> <p>We will monitor progress towards the target on an annual basis.</p>
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target
Timing and frequency of rewards/penalties	<p>A £0.082m penalty applies for every 1000 properties not benefitting.</p> <p>A £0.186m* reward applies for every 1000 properties benefitting over 12000.</p>
Form of reward/penalty	[Adjustment to revenue]
Any other information or clarifications relevant to correct application of incentive	<p>* The reward and penalty are broadly symmetrical but the penalty is spread over a greater number of properties.</p> <p>The reward has been smoothed to ensure that there is a consistent incentive for Sembcorp Bournemouth Water to stretch its performance. An unsmoothed incentive results in a higher incentive for lower performance levels.</p>

Performance commitment [B]: [3]

Detailed definition of performance measure: [Minimise customer disruption re supply interruptions \geq 3 hours]

Incentive type: ~~Reputational~~ Penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Weighted average ratio	7.3	7.3	7.3	7.3	7.3	4.6

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	(hours)						
Penalty collar	Weighted average ratio (hours)		14.6	14.6	14.6	14.6	9.2
Penalty deadband	Weighted average ratio (hours)		7.3	7.3	7.3	7.3	4.6

Incentive rates

Incentive type	Performance levels (hours/affected property/year)		Incentive rate (£m/hour/affected property)
	Lower	Upper	
Penalty	14.6	4.6	£0.0419m

Additional details

Necessary detail on measurement units	<p>Decreasing average interruption greater than or equal to 3 hours calculated on the weighted average number of properties affected, by band in any one year.</p> <p>Number of hours lost per property served in the year with supply interruption greater than three hours (irrespective of whether it was planned, unplanned or caused by a third party).</p> <p>The weighted average hours of interruption ratio has been calculated on the data for the period 2008 to 2013 using the target number of properties as a denominator. This data reflects the following bands.</p> <p>Properties experiencing an interruption >or equal to 3 < 6 hours (target <2100 properties)</p> <p>Properties experiencing an interruption >6 < 12 hours</p>
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	<p>(target <50 properties)</p> <p>Properties experiencing an interruption >12 < 24hours (target 0 properties)</p> <p>Properties experiencing an interruption > 24hours (target 0 properties)</p> <p>Per property served is the number of connected properties (domestic and non-domestic) for water supply. This includes properties which are connected but not billed (for example, temporarily unoccupied) but excludes properties which have been permanently disconnected.</p> <p>A group of properties supplied by a single connection but separately billed should be counted as multiple properties</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>Annual review of performance against target</p>
<p>Any other information or clarifications relevant to correct application of incentive</p>	<p>To be within the lower and upper performance weighted average levels at 2020. Lower Performance Level set at 5.0 weighted average hours for 2020. Upper Performance Level set at 4.6 weighted average hours for 2020.</p> <p>Penalty deadband set at 7.3 for 2015-16 to 2018-19 which is equal to 2014-15 forecast performance. This ensures that deterioration in service is penalised. Penalty deadband set at 4.6 in 2019-20 which is the company's committed performance level.</p> <p>Penalty collar set at 14.6 in 2015-16 to 2018-19, which is twice the deadband level. Penalty collar set at 9.2 in 2019-20 which is twice the deadband level.</p> <p>Penalty rate set at average rate for all water-only companies, converted into a rate for hours per affected property.</p> <p>Current performance is 7.3 weighted average hours. We will monitor progress towards the target on an annual basis.</p> <p>'Enhanced GSS Compensation' will apply approximately £0.070m for AMP6.</p> <p>Any penalties applied should be netted off against the enhanced GSS compensation.</p>

Performance commitment [B]: [4]

Detailed definition of performance measure: [Serviceability (maintain assets – Ofwat methodology)]

Incentive type: Financial – penalty only.

Performance commitments

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

Incentive rates

Incentive type	Performance levels (Stable Category)		Incentive rate (£m/Stable Category/year)
	Lower	Upper	
Penalty [add additional lines as required]	Deteriorating	Stable	-0.086-0.225

Additional details

<p>Necessary detail on measurement units</p>	<p>Assessment of the recent historical trend in serviceability to customers, as measured by movements in service and asset performance indicators. (Ofwat methodology)</p> <p>Remain in Stable status.</p> <p>To maintain stable serviceability to customers and the environment by managing and maintaining assets such that all indicator values remain well within the control limits and oscillate around the reference level year on year.</p> <p>Ofwat KPI indicators:</p> <p>Green = Overall Improving or Stable serviceability status.</p> <p>Amber = Overall Marginal serviceability status.</p> <p>Red = Overall Deteriorating serviceability status.</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>We will monitor progress towards the target on an annual basis.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>The company will assess, supported by independent technical review, the overall serviceability in each sub-service and update the serviceability status as one of the following.</p> <ul style="list-style-type: none"> • Improving. • <input type="checkbox"/> Stable. • Marginal. • <input type="checkbox"/> Deteriorating. <p>When making the assessments, Ofwat’s serviceability assessment toolkit and the 2009 price review final determination, which states the reference level and control limits for each indicator will be used.</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>At ‘Deteriorating’ level £0.087m £0.225m applies per year per sub service. Potential maximum penalty over the AMP is £0.866m £2.25m. Dead-band in operation between Marginal and Deteriorating</p>

Performance commitment [B]: [5]

Detailed definition of performance measure: [Metering- continue current strategy (17950 meters in place by 2020)]

Incentive type: Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Meter Numbers						17950
Penalty collar	Meter Numbers						17950
Penalty deadband	Meter Numbers						17850

Incentive rates

Incentive type	Performance levels (Meter Numbers)		Incentive rate (£m/meter/year)
	Lower	Upper	
Penalty [add additional lines as required]	0	17950	-0.000027

Additional details

Necessary detail on measurement units	Continue current strategy (17950 meters installed by 2020)
Frequency of PC measurement and any use of averaging	Annual review of progress towards March 2020 target
Timing and frequency of rewards/penalties	To continue with the current metering strategy of installing optional and change of occupier meters and to have installed an additional 17950 meters by March

	2020
Form of reward/penalty	[Adjustment to revenue]
Any other information or clarifications relevant to correct application of incentive	To be at the target of 17950 by 2020. Penalty will be any shortfall (valued by FD14 cost modelling) plus 10% We will monitor progress towards the target on an annual basis Dead-band 17850 -17950 (100 meters)

Performance commitment [B]: [6]

Detailed definition of performance measure: [Water use – reduce average consumption]

Incentive type: Reputational.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/h/d	142	142				138

Additional details

Necessary detail on measurement units	Reduce the per capita consumption (PCC). To achieve a PCC of 130 litres/head/day by March 2030. 2014 -15 performance is 142 litres/head/day
Frequency of PC measurement and any use of averaging	Annual review of performance against target
Any other information or clarifications relevant to correct application of incentive	To be at the target for PCC of 130 litres/head/day by 2030 We will evaluate the effectiveness based on a 5 year rolling average downward trend to counteract weather volatility. This will be reported for independent scrutiny. At

2030 we will target the absolute number of 130 litres/head/day.

We will not return funds to the customers as this will incentivise them to be less efficient regarding consumption. However we will engage the Customer View group to decide on the activity required to get back on track.

Weighted average per capita consumption calculated in line with Ofwat June Return calculation

Measure of average water use for each person in an appointed water company's area.

Increased activity required to reach target. To be decided by independent Customer View group.

Wholesale water outcome [3]: [Providing an excellent customer experience]

Performance commitment [C]: [1]

Detailed definition of performance measure: [Fixing visible leaks – improve response time (improve the number repaired in 7 days of Sembcorp Bournemouth Water becoming aware- average)]

Incentive type: Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%age	77.0					85.0
Penalty collar	%age						77.0
Penalty deadband	%age						84.5

Incentive rates

Incentive type	Performance levels (%age)		Incentive rate (£m/%age/year)
	Lower	Upper	
Penalty [add additional lines as required]	77.0	85.0	-0.001

Additional details

<p>Necessary detail on measurement units</p>	<p>Percentage of visible leaks being repaired within 7 calendar days of Sembcorp Bournemouth Water becoming aware.</p> <p>85% or more of visible leaks being repaired within 7 calendar days of Sembcorp Bournemouth Water becoming aware.</p> <p>To achieve by March 2020</p> <p>Lower Performance Level Percentage set at 77%</p> <p>Upper Performance Level Percentage set at 85%</p>
<p>Frequency of PC measurement and any use of averaging</p>	<p>Annual review of progress towards March 2020 target.</p> <p>To be within lower and upper performance level percentage by 2020. We will monitor progress towards the target on an annual basis.</p>
<p>Timing and frequency of rewards/penalties</p>	<p>85% of visible leaks that are made aware to Sembcorp Bournemouth Water should be repaired within 7 working days from the time of notification to Sembcorp Bournemouth Water.</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>Maximum financial penalty for AMP6 set at £0.050m.</p> <p>Dead-band set at 85% to 84.5%.</p>

Wholesale water outcome [4]: [Environmentally sustainable operations]

Performance commitment [D]: [1]

Detailed definition of performance measure: [Reduce carbon created delivering water (reduce average energy used by 2020)]

Incentive type: Reputational.

Performance commitments

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

Additional details

Necessary detail on measurement units	Reduce the amount of energy used to deliver water by 2020
Frequency of PC measurement and any use of averaging	<p>Annual review of performance towards March 2020 target.</p> <p>To reduce KWhrs used per megalitre (MI) of water delivered to 530 by March 2020. Current performance is 580. Lower Performance Level: 535. Upper Performance Level: 530.</p> <p>To be within the lower performance level of 535 KWhrs and the upper performance level of 530 KWhrs used per MI of water delivered by 2020. We will monitor progress towards the target on an annual basis.</p>
Any other information or clarifications relevant to correct application of incentive	The penalty is included in the cost of power and in the carbon levy. If the target is not met there is a cumulative cost to Sembcorp Bournemouth Water on power. The cost in the final year would be

approximately £0.268m (2012-13 prices). Therefore the total potential penalty could be around £1m.

Performance commitment [D]: [2]

Detailed definition of performance measure: [Help support a natural healthy water environment]

Incentive type: Reputational.

Performance commitments

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

Additional details

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

Wholesale water outcome [5]: [Engage well with our community and customers]

Performance commitment [E]: [1]

Detailed definition of performance measure: [Contribute to our community]

Incentive type: Reputational.

Performance commitments

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

Additional details

Necessary detail on measurement units	Increase educational visits to schools and working days for volunteer and charity work
Frequency of PC measurement and any use of averaging	<p>Increase to 175 working days spent on educational visits to schools and volunteer and charity work by March 2020. Current performance is 84 working days.</p> <p>Achieve target of 175 working days spent on educational visits to schools and volunteer and charity work by 2020.</p> <p>We will monitor progress towards the target on an annual basis.</p>
Any other information or clarifications relevant to correct application of incentive	Also an equivalent value of the number of days less short of 175 day target at £100/day (indexed annually at RPI) to be paid to a local charity of the Customer View group's choice.

Household retail outcome [1]: [Providing an excellent customer experience]

Performance commitment [A]: [1]

Detailed definition of performance measure: [Improve customer experience – increase Service Incentive Mechanism score. (Maintain position > 1 standard deviation above the industry average)]

Incentive type: Reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Average SIM score	87					89

Additional details

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

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

Household retail outcome [2]: [A financially stable business]

Performance commitment [B]: [1]

Detailed definition of performance measure: [Fair customer bills (Efficient debt management – %age of average bill)]

Incentive type: Reputational.

Performance commitments

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

Additional details

Necessary detail on measurement units	Fair customer bills (efficient debt management – %age of average bill)
Frequency of PC measurement and any use of averaging	To maintain debt management costs at an average percentage of between 3% and 3.75% over 2015-20. We will monitor progress towards the target on an annual basis. Calculation = [Household outstanding revenue collection opex + household revenue written off + (household revenue outstanding x 5% bank base rate)] / Number of households billed. Expressed as a percentage of the average bill.
Any other information or clarifications relevant to correct application of incentive	Customer View Group to review and impose sanctions if deemed appropriate.

Future incentives proposed for the period post-2020

Summary table

Performance commitment	Detailed definition of performance measure	Incentive type	Additional details
n/a	n/a	n/a	n/a

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



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