December 2014

Setting price controls for 2015-20

Final price control determination notice: company-specific appendix – Affinity Water

Contents

Overview

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

An enhanced final determination

We awarded Affinity Water enhanced status after the completion of our risk-based review, which assessed the quality of business plans companies submitted for the 2014 price review (PR14). Enhanced status means the company produced a high-quality business plan that stood apart from the other companies. For example, in its business plan the company proposed community level reporting, giving its communities a clear picture of performance against its commitments within their local area and the ability to compare performance across the eight communities. It also means that we have had to make minimal changes to the company's plan to protect customers' interests and act in line with our other statutory duties.

Enhanced companies gain the reputational advantages of enhanced status and a fast track through the price review process. As we said in 'Setting price controls for 2015-20 – decisions on enhanced companies and next steps' (our pre-qualification decision document), these companies also receive financial benefits, through an initial financial award and access to enhanced cost performance menus, reflecting the benefits of high-quality business plans to current and future customers. Affinity Water chose to recover its initial reward of £4 million through an addition to its regulatory capital value (RCV).

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

We explain the 'do no harm' principle in more detail in table A4 in appendix 2 of our pre-qualification decision document. In line with the 'do no harm' principle, the company is not subject to the reduction in the allowed return. A reduction in the allowed return of 0.1 percentage points has a value of £5 million to the company. The company is also protected from changes driven by new information relevant to the wider industry framework.

Enhanced companies' draft determinations have been updated to reflect new information since the December business plan in relation to their own costs of delivering its current and future performance commitments (PCs) and for any changes in 2010-15 performance. These changes are not covered by the 'do no harm' principle.

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

Changes since draft determination

On 10 March, Affinity Water pre-qualified as an enhanced company, and it had a limited number of actions to address. We confirm that the company has met all of these actions.

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

In June and October 2014, Affinity Water made technical representations on a small number of areas of its draft determination – including on the retail average cost to serve (ACTS) and on the wholesale total expenditure (totex) profile. It has submitted additional evidence in some areas (such as its asset health index, and on PR09 legacy), including in response to areas we flagged the need for in our August draft determinations (retail cost allocation). We agree with the company representations and have made changes in the final determination to reflect them.

We have also received a small number of specific representations from the Environment Agency in relation to some of Affinity Water's PCs. The Consumer Council for Water (CCWater) raised a number of specific concerns around the acceptability and affordability of Affinity Water's business plan, when taking into consideration sewerage bills. We respond to these comments in this document and in the relevant policy chapters. Affinity Water's customer challenge group (CCG) did not make representations on the April draft determination, and in October it confirmed it did not have any concerns about Affinity Water's representation that it wanted to draw to our attention.

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

About this document

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

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

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

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

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

As set out in 'Policy chapter A1 – introduction' ('policy chapter A1'), the final determination protects consumers in accordance with our statutory duties and 'Setting price controls for

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

2015-20 – final methodology and expectations for companies' business plans' (our 'final methodology statement'). We have also had regard to relevant guidance from the UK Government and the principles of best regulatory practice to be transparent, accountable, proportionate, consistent and targeted.

Implementing these price limits

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

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

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

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

A1 Enhanced final determination – at a glance

This chapter provides a summary of the enhanced final determination for Affinity Water. It summarises what the final determination will mean for customers, with respect to the average bills they will pay and the outcomes that the company will deliver in return, and for the company in terms of its allowed costs and revenues, RoRE and financeability ratios. We also summarise the minor changes we have made to the company's draft determination in order to protect the interests of customers.

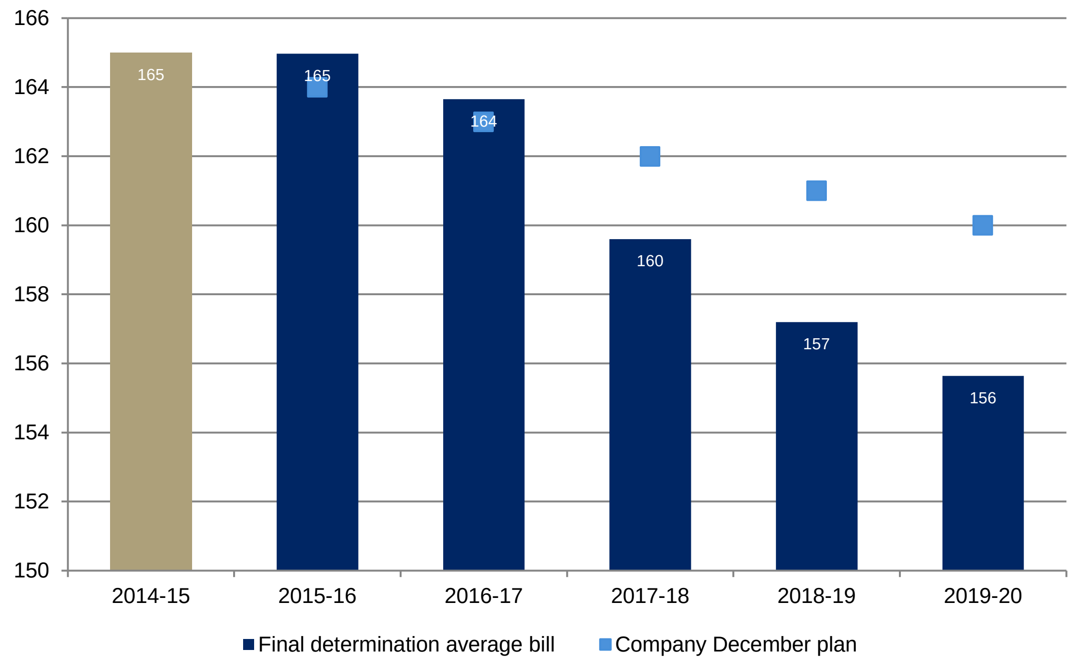
Combined average household bill (£)

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

Our final determination means that average bills in 2019-20 will be £156, which is 5% lower than current average bill levels (of £165).

The difference between the company's December plan and our final determination is the result of the actions the company took to qualify as an enhanced company, including accepting 'Setting price controls for 2015-20 – risk and reward guidance' (our 'risk and reward guidance'). This represents a cumulative saving of £9 for the average customer over the 2015-20 period.

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



Note:
The comparative bills from 'Company December plan' is based on the data submitted in the business plan but projected using our financial model, thereby ensuring consistency with the final determination projection. So the company's proposed bills illustrated above may not necessarily be the same as those described in its March business plan update.

The outcomes committed to by Affinity Water

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

These outcomes reflect the priorities of customers set out in research and engagement with the CCG. We have accepted these outcomes. Details of the types of incentives and level of PCs associated with these outcomes are set out in annex 4.

Wholesale water
Making sure our customers have enough water, whilst leaving more water in the environment Supplying high quality water you can trust Minimising disruption to you and your community
Retail
Providing a value for money service

Allowed costs and revenue for Affinity Water

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

The table below shows the wholesale totex we have allowed over the period from 2015 to 2020. The final determination allows Affinity Water to receive revenues of £1,389 million. This combines allowed revenues for the wholesale and household retail controls. For non-household retail, we have also set average revenue controls per customer for each of the customer types proposed by the company. The £25.9 million of non-household revenue shown in the table below is indicative, as it does not assume any gains or losses from competition or the company charging customers at levels different to the relevant default tariffs.

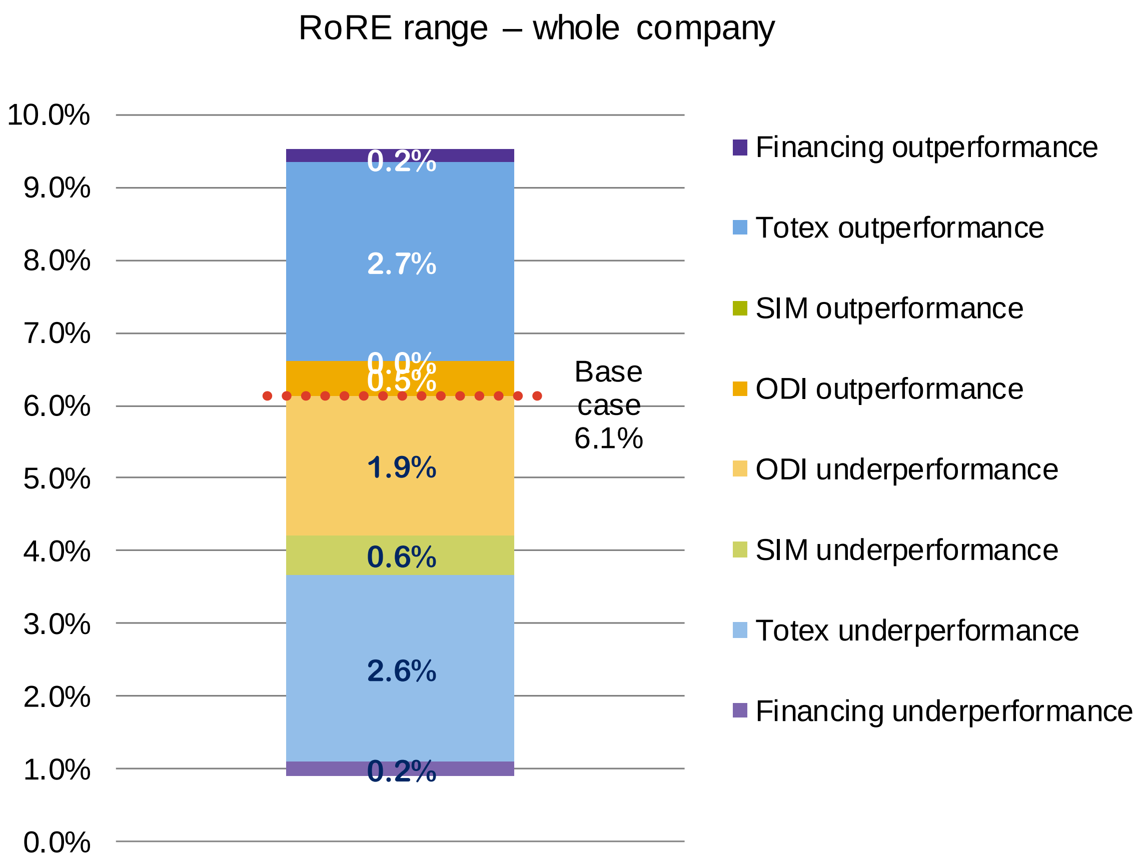
Wholesale	**Water**	
Totex 2015-20 total (£m)	1,074.3	
Allowed return (%)	3.70%	
Allowed wholesale revenue 2015-20 (£m)	1,245.0	
Retail	**Household**	**Non-household**
Cost allowance – 2015-20 total (£m)	131.5	
Margin (%)	1.00%	2.50%
Retail allowed revenue (£m)	144.1	25.9

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

RoRE ranges – appointee

Affinity Water has estimated the range of RoRE that it could earn dependent on its performance and external risk factors over the price control period. The RoRE range reflects the company's views and is based on an efficient company with the notional capital structure[2]. We have identified the RoRE impact separately for ODIs, totex performance, financing and the service incentive mechanism (SIM). We note that Affinity Water's actual returns may differ from notional returns due to differences between notional and actual capital structure and notional and actual cost of debt and level of cost efficiency compared to allowed totex and household retail ACTS.

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



Source: Ofwat calculations based on information from Affinity Water
Note: Numbers presented based on calibration of the ODIs against an assumed menu choice of a 50% sharing factor

Our calculation of notional financeability ratios

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

Affinity Water provided assurance that its plan was financeable on the basis of a notional and its actual structure.

The notional financial ratios on which this final determination is based, which take account of our interventions, are set out in section A5 and summarised on a 5-year average basis below.

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

Financial ratios for notional company	Our calculation (average 2015-20)
Cash interest cover	3.56
Adjusted cash interest cover ratio (ACICR)	2.17
Funds from operations/debt	12.08%
Retained cash flow/debt	9.51%
Gearing	63.49%
Dividend cover (profit after tax/dividends paid)	2.00
Regulatory equity/regulated earnings for the regulated company	16.61
RCV/EBITDA	9.47

Summary of changes to the draft determination

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

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

Outcomes	Wholesale costs
• One of the company's actions it needed to achieve to qualify for enhanced was to provide further details on its serviceability measure. The company has proposed an asset health index, which we have included in the final determination. • The company is not affected by our comparative assessments as we consider that it is appropriate to accept the enhanced companies' business plans in the round in order to maintain the incentive on companies to produce the highest quality business plans.	• In response to Affinity Water's request, we have reprofiled its totex and revenue to reflect its business plan. • Affinity Water is now £57 million (-5%) below the wholesale cost threshold, which is further below than at draft determination (which was £47m, -4% below the threshold). This reduction is driven by a number of technical changes, the most significant being a reduction in company plan pension costs to match Ofwat numbers.
Retail	**Reconciling 2010-15 performance**
• We have used 2013-14 prices to set both the household and non-household retail control. • We have updated our industry view of the ACTS. • We have taken into account further evidence provided by the company after its draft determination on the allocation of retail efficiencies between metered and unmetered costs, which impacts the ACTS. • In response to our request, the company made minor adjustments to its retail cost allocation, which we have taken into account. This completes the company's action to comply with our cost allocation guidance.	• We have updated our assessment to reflect the latest information on 2013-14 and 2014-15 performance and to correct minor errors. • Overall, we have reduced the revenue by £12.3 million (£1.5 million less than the company proposed) and increased the RCV by £38.0 million (£40.5 million more than the company proposed). • The significant increase in the RCV is due to the removal of a balancing figure applied to the opening RCV balance and the adjustment for actual expenditure in 2009-10.

Risk and reward	Financeability and affordability
• In line with the ‘do no harm’ principle, the company is not subject to the reduction in the allowed return.	• Consistent with Affinity Water being an enhanced company, we have adjusted its pay as you go (PAYG) rate, in line with the company's preference, to target its desired final determination wholesale revenue, which helps to target the company’s bill profile at the level it proposed.

A2 Wholesale water

A2.1 Consideration of representations on our draft determinations

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

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

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

Table A2.1 lists the representations we have received that are specific to Affinity Water's wholesale water control and sets out where to find more information on our responses in this document.

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

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

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Calculation of revenues: PAYG and RCV run-off	None	Section A2.3.2 and A5.5
Return on the RCV	CCWater	Section A2.3.3
Reconciling 2010-15 performance	None	Annex 3
Uncertainty mechanisms	None	Section A2.4

A2.2 Company outcomes, performance commitments and delivery incentives

A2.2.1 Outcomes, performance commitments and incentives

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

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

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
Making sure our customers have enough water, whilst leaving more water in the environment	Leakage	Financial – reward and penalty	No change
	Average water use	Financial – penalty only	No change
	Water available for use	Financial – penalty only	No change
	Abstraction incentive mechanism (AIM)	Reputational	No change
	Sustainable abstraction reduction	Financial – reward and penalty	No change
Supplying high quality water you can trust	Compliance with water quality standards	Financial – penalty only	No change

Company proposal			Update to draft determination
Outcome	**Performance commitment**	**Incentive type**	
Minimising disruption to you and your community	Customers contacts about water quality	Financial – penalty only	No change
	Unplanned interruptions to supply over 12 hours	Financial – reward and penalty	No change
	Number of burst mains	Financial – penalty only	No change
	Affected customers not notified of planned interruptions	Reputational (with compensation payments)	No change
	Planned work taking longer to complete than notified	Reputational (with compensation payments)	No change

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

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

We reviewed representations on the company's outcomes but we do not consider that any interventions are required. As Affinity Water is an enhanced company, the changes to the comparative analysis that impact on other companies have not been applied. Overall, the outcomes that Affinity Water proposed are those which it will need to deliver over the next 5 years.

The determinations for the enhanced companies have not been changed to reflect the comparative analysis, since we continue to consider that it is appropriate to accept the enhanced companies' business plans in the round. However, both enhanced companies have recognised that even though their financial incentives are not being changed, they face reputational incentives to improve their performance in areas where they are not yet delivering upper quartile performance. Affinity Water has indicated that it will have regard to upper quartile performance in these areas in anticipation of its 2019 price determination.

As an enhanced company, Affinity Water gained its draft determination earlier than all non-enhanced companies, allowing it extra time to prepare for delivery of these outcomes for its customers.

Full detail of the wholesale water outcomes, PCs and incentives, and our consideration of relevant responses, is provided in annex 4. One of Affinity Water's pre-qualification actions was to consider PCs around its asset serviceability. When we announced that Affinity Water was an enhanced company, we confirmed that it had completed this action. Following the draft determination Affinity Water provided further detail on its overall performance measurement framework, which includes the PCs alongside a suite of key performance indicators (KPIs) and its new asset health index.

Affinity Water has developed the index it proposed in its business plan, in collaboration with its CCG, to focus on the availability and criticality of the non-infrastructure assets. This will allow the company to report on its non-infrastructure assets at an asset, community and company level. Our assessment concluded that the company's overall performance framework offers customers appropriate protection on asset health.

Therefore, in line with Affinity Water's enhanced status, and accepting the company's plan in the round, we confirm for final determination that we will not intervene to elevate the index to the level of a performance commitment. Affinity Water will continue to develop and refine the index throughout the 2015-20 period. We consider that Affinity Water's overall performance measurement framework will provide customers and stakeholders with a rounded view of performance to ensure the company is held to account.

A2.2.2 Outcome delivery and reporting

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

A2.3 Calculating the wholesale water price control

A2.3.1 Calculating allowed wholesale water expenditure

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

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

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

Following representations, the company's proposed wholesale water totex is £1,034 million over 2015-20 (versus £1,049 million it proposed ahead of its draft determination). This is 5% below the final determination threshold (post additions) of £1,091 million. Table A2.3 below notes the comments that we have received that are specific to this aspect of the wholesale water control of Affinity Water and outlines how our enhanced final determination has been influenced by our consideration of these responses.

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

Respondent	Summary of comment	Ofwat response
Affinity Water	The company suggested we should retain the totex profile from its business plan.	Consistent with our default approach to other companies, we have reprofiled the company's totex and revenue to reflect its business plan profile.
Affinity Water	Affinity Water requested that the final determination include its full pension deficit costs, without an efficiency challenge.	We have corrected for the minor error in the application of efficiencies. Consistent with IN 13/17 we have continued to apply the level of efficiencies as at PR09.

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

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

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Final determination cost threshold						1,091.3
Costs excluded from menu	2.9	2.8	2.8	2.8	2.8	13.9
Menu cost baseline[1]	245.1	247.6	215.2	192.1	177.4	1,077.4

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Company's view of menu costs[2]						1,020.1
Implied menu choice						94.7
Allowed expenditure from menu	241.8	244.3	212.3	189.6	175.0	1,063.1
Costs excluded from menu	2.9	2.8	2.8	2.8	2.8	13.9
Total allowed expenditure[3]	244.7	247.1	215.1	192.3	177.8	1,077.0
Less pension deficit repair allowance	0.6	0.6	0.6	0.6	0.6	2.8
Totex for input to PAYG	244.2	246.5	214.5	191.8	177.2	1,074.3

Notes:
1. Menu baseline is equal to the final determination threshold less pension deficit recovery costs, third party costs and market opening costs related to 2014-15 (see annex 1).
2. Based on company plan totex (reflecting its representation on its draft determination) minus costs for items excluded from the menu. The company will make a final menu choice by 16 January 2016 and any difference between this and the implied menu choice will be reconciled as part of PR19.
3. Includes pension deficit recovery costs.

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

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

Table A2.5 shows the PAYG rates and the amount of totex recovered for wholesale water, which we have used as the basis for this enhanced final determination. The 'Resulting PAYG (£m)' is the amount of money recovered from customers in the short term. Table A2.5 shows the RCV run-off amounts included within the wholesale water charge. This is the amount of money recovered in the long term through the company's RCV.

Table A2.5 Affinity Water's wholesale water PAYG rates

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	244.2	246.5	214.5	191.8	177.2	1,074.3

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
PAYG (%)	69.1%	67.4%	74.7%	81.9%	87.7%	76.2%
Resulting PAYG (£m)	168.8	166.2	160.3	157.2	155.4	807.9

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	39.1	37.5	36.0	34.6	33.2	180.5
RCV run-off of totex additions	1.5	4.6	7.3	9.1	10.2	32.7
Total RCV run-off	40.6	42.2	43.3	43.7	43.4	213.2

Note: The figures in this table reflect a run-off rate of 4% for the RCV as at 31 March 2015 and 25 years for the totex additions to the RCV over 2015-20.

This reflects the change in RCV run-off rates as described in section A5.5 on financeability.

A2.3.3 Return on the RCV

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

In our risk and reward guidance, we set out a single industry cost of capital for both wholesale water and wastewater services based on market evidence, which at the time was 3.70%. The company accepted this guidance as a condition of its enhanced categorisation. As set out in policy chapter A7, based on the latest market evidence for the cost of new debt we have set the wholesale cost of capital at 3.60% for non-enhanced companies.

As Affinity Water is an enhanced company, it is protected against downward adjustments to the cost of capital by the 'do no harm' principle. This protection is an important part of the incentive framework; encouraging companies to produce high quality business plans. A reduction in the allowed return of 0.1 percentage points has a value of £5 million to the company.

Affinity Water's wholesale cost of capital is therefore 3.70%. This results in a return on capital of £191.7 million over 2015-20.

As discussed in policy chapter A3, the RCV is calculated as the RCV at the start of the period plus totex that is not funded on a PAYG basis minus RCV run-off (or regulatory depreciation).

Table A2.7 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A2.3.4 below. It also sets out the wholesale water element of the £4 million initial reward to the company as a result of it achieving enhanced status. In April 2014, the company chose to receive the reward through its allowed revenues and K factors.

The average RCV, set out in table A2.8 for each year, takes into account the proportion of totex additions to the RCV determined by the PAYG rate and RCV run-off as set out in tables A2.5 and A2.6 above.

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

	2015-16
Closing RCV 31 March 2015	939.5
Land sales[1]	-5.2
Adjustment for actual expenditure 2009-10[2]	24.4
Adjustment for actual expenditure 2010-15[3]	14.8
Net adjustment from logging up and logging down[3,4]	0.0
Adjustment for shortfalls[3,4]	0.0
Adjustment for serviceability shortfalls[5]	0.0
Enhanced reward	4.0
Other adjustments[6]	0.0
Opening RCV 1 April 2015	977.5

Notes:
1. Land sales adjustment is set out in table AA3.19.
2. 2009-10 actual expenditure adjustment is set out in table AA3.19.
3. A component of the capital expenditure (capex) incentive scheme (CIS) adjustment as set out in table AA3.16.
4. The net adjustment from the change protocol is set out in table AA3.7.

5. The serviceability shortfall adjustment is set out in table AA3.10.
6. Other RCV adjustments are set out in table AA3.19.

Table A2.8 Affinity Water's wholesale water return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	977.5	1,012.3	1,050.4	1,061.3	1,052.2
RCV additions (from totex)	75.4	80.3	54.2	34.6	21.9
Less RCV run-off	40.6	42.2	43.3	43.7	43.4
Closing RCV	1,012.3	1,050.4	1,061.3	1,052.2	1,030.7
Average RCV (year average)	994.9	1,031.4	1,055.9	1,056.8	1,041.5
Return on capital	36.8	38.2	39.1	39.1	38.5

A2.3.4 Reconciling 2010-15 performance

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

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

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale water services to reconcile performance in 2010-15 in December 2013. We and the company have made slight adjustments to these based on the identification of minor errors and on updated information for 2013-15 not available when we made our draft determination in April. As a result, the revenue adjustments for wholesale water have changed from -£ 13.9 million to -£12.3 million. We summarise these adjustments in table A2.9 below. The impact on the opening RCV of 2010-15 adjustments is shown in table A2.7 and we discuss our changes in this area further in annex 3.

When making these final determinations we do not have the full information on companies' performance in 2014-15. We set out in 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance' that we would reconcile for the revenue correction mechanism (RCM), change protocol and serviceability in

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

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

Area	Change to draft determination		Total revenue adjustment 2010-15 (post update).	
		Company view	Draft determination	Final determination
SIM	There are no changes in this area.	0.0	0.0	0.0
RCM	Our final determination reflects the company's updated RCM adjustments following updates to 2013-14 actuals and 2014-15 forecasts. We have included our view of the final determination 2009 (FD09) assumptions and used the out-turn financial year average RPI and forecasted 2014-15 tariff basket revenues as submitted in the company's business plan instead of what the company has submitted in its RCM model. Combined these changes increased revenue by £1.4 million compared to the company's business plan update.	0.8	2.5	2.3
Opex incentive allowance (OIA)	There are no changes in this area but we have included £0.0123 million as a post-tax incentive revenue adjustment in 2015-16.	0.0	0.0	0.0
CIS	As for all companies, in carrying out the CIS assessment for the final determination, we	-10.7	-8.8	-10.6

Area	Change to draft determination		Total revenue adjustment 2010-15 (post update).	
		Company view	Draft determination	Final determination
	have used the updated information on 2013-14 and 2014-15. We have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period. While the pre-tax discount rate has not been used in the final determination, we have corrected the input values for the PR09 pre-tax cost of capital. Combined these changes increase revenue by a further £0.1 million compared to the company's business plan update.			
Other adjustments	The company included a tax refinancing benefit clawback adjustment of £0.8 million a year due to in period changes in its capital structure. There are no changes in this area.	-4.0	-4.0	-4.0

Table A2.1 notes the comments that we have received that are specific to this aspect of the wholesale water control of Affinity Water. Our final determinations have been influenced by our consideration of these responses. The changes we have made in the final determination in reconciling the company's 2010-15 performance result from including updated actuals for 2013-14 and forecasts for 2014-15 and from correcting the company's data inconsistencies (see Annex 3 for details).

A2.3.5 Calculation of allowed revenue

We set out the calculation of the allowed revenue for Affinity Water's wholesale water control in Table A2.10.

Overall, the company's wholesale water revenue allowance will be £254 million in 2015-16, decreasing by 3.9% to £244 million in 2019-20.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	244.2	246.5	214.5	191.8	177.2	1,074.3
PAYG rate (%)	69.1%	67.4%	74.7%	81.9%	87.7%	
Totex additions to the RCV	75.4	80.3	54.2	34.6	21.9	266.4
RCV (year average)	994.9	1,031.4	1,055.9	1,056.8	1,041.5	
Wholesale allowed revenue build up:						
PAYG[1]	169.3	166.8	160.9	157.7	155.9	810.6
Return on capital	36.8	38.2	39.1	39.1	38.5	191.7
RCV run-off	40.6	42.2	43.3	43.7	43.4	213.2
Tax[2]	2.0	1.2	0.2	0.9	2.0	6.5
Income from other sources[3,4]	-2.6	-2.6	-2.6	-2.6	-2.6	-13.0
Reconciling 2010-15 performance	-2.3	-2.4	-2.5	-2.5	-2.6	-12.3

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Ex ante additional menu income	1.8	1.8	1.5	1.4	1.3	7.7
Wholesale allowed revenue adjustments:						
Capital contributions from connection charges and revenue from infrastructure charges	8.4	8.4	8.0	7.8	8.0	40.6
Final allowed revenues	**254.0**	**253.5**	**248.0**	**245.5**	**244.0**	**1,245.0**

Notes:
1. PAYG includes the PAYG calculated from totex and the pension deficit repair allowance.
2. Including tax on adjustments for reconciling 2010-15 performance and ex-ante additional menu income.
3. We have adjusted other income values to remove the deferred income element relating to IFRIC18, as this is an accounting adjustment.
4. Our assessment of income from other sources is discussed in section A3.5.2 of policy chapter A3.

A2.4 Uncertainty mechanisms

We have set the company's allowed revenues for the 2015-20 period. All companies face uncertainty about future costs and revenues and this is reflected in the rate of return and the established framework in the licence.

We outline our approach to incremental uncertainty mechanisms in policy chapter A7, where we set out our response to the representations made by stakeholders in support of sector wide uncertainty mechanisms.

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

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

Table A2.11 Affinity Water's proposals for wholesale water uncertainty mechanisms

Assessment at draft determination	Our final assessment
In the draft determination, we accepted Affinity Water's proposed uncertainty mechanism for water business rates with the proposed sharing rate of 75:25 (customer:company).	For our final determination, we confirm the uncertainty mechanism included in our draft determination. The specific text of this Notified Item is in the annex to the final determination letter. The rationale for its inclusion in the final determination is set out in policy chapter A7. Affinity Water has not objected to our approach in the draft determination. We have not included any additional uncertainty mechanisms for the company.

A3 Household retail

A3.1 Consideration of representations on our draft determinations

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

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

- Policy chapter A2.
- 'Policy chapter A5 – household retail costs and revenues' ('policy chapter A5').
- Policy chapter A7.

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

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

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	None	Annex 4
Outcome delivery and reporting	None	Annex 4
Allocation of costs	Affinity Water	Section 3.3.1 and Annex 1
Adjustments	None	Section A3.3.2 and A5.5
New costs	None	Section A3.3.3
Uncertainty mechanisms	None	Annex 3

A3.2 Outcomes, performance commitments and incentives

We summarise the outcomes, PCs and ODIs for the household retail control for Affinity Water in table A3.2 below.

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

Company proposal			Update to draft determination
Outcome	Performance commitment	Incentive type	
Providing a value for money service	SIM[1]	Financial – reward and penalty	No change
	Value for money survey	Reputational	No change

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

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

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

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

As an enhanced company, Affinity Water gained its draft determination earlier than all non-enhanced companies, allowing it extra time to prepare for delivery of these outcomes for its customers.

Full detail of the household outcomes, PCs and incentives, and our consideration of relevant responses, is provided in annex 4.

A3.3 Costs

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

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

A3.3.1 Allocation of costs

Table A3.3 Representations specific to the allocation of Affinity Water’s household retail costs

Respondent	Summary of comment	Ofwat response
Affinity Water	The company has allocated its costs in line with our guidance.	We have accepted the company’s cost allocation.
Affinity Water	The company provided revised allocations of the forecast efficiencies between metered and unmetered costs.	We have accepted the company’s revised allocation of forecast efficiencies.

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

Table A3.4 Our assessment of Affinity Water’s cost allocation methodology

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

We wrote to the company on 29 August 2014 to notify it of the outstanding cost allocation actions following our review of its June cost allocation submission. We required the company to address these actions by 3 October 2014. Table A3.4 shows our assessment of Affinity Water's cost allocation methodology, based on the information we received from the company by 3 October 2014. We are satisfied that the company has addressed the actions set out in our 29 August letter. Therefore, we have used the company's cost allocation between retail and wholesale and between household and non-household retail to set our final determination. This completes the company's action to comply with our cost allocation guidance.

One of these actions was for the company to undertake a cross check of its doubtful debts allocation based on write-offs against an allocation based on the movement in outstanding debt. The company has undertaken this cross check and has not changed its allocation of doubtful debts following this. We have accepted the company's allocation based on debt write-offs. This is because we agree that this is a more suitable proxy cost driver for the allocation of doubtful debts than the movement in outstanding debt, in the absence of the direct attribution that our guidance prescribes.

However, we note that from 2015-16 all companies will need to have the systems in place to be able to directly attribute their annual doubtful debt charge between household and non-household on a customer-type specific basis. We will confirm this in the regulatory accounting guidelines for 2015-16, which we will publish early in 2015 following consideration of responses to other matters covered in our recent consultation on regulatory reporting.

The company has also made a representation on the allocation of its forecasts of efficiency improvements between base costs and the additional costs to serve metered customers. The company has proposed a reallocation of its forecast efficiency improvements to the additional cost to serve metered customers from base cost to serve. The net effect of this is that the forecast additional cost to serve metered customers is lower than at draft determination.

We accept the reallocation of these forecast efficiency improvements. The allocation of efficiency improvements included in the draft determination business plan made a simplifying assumption that all efficiency improvements would be made on base costs, and none on the additional cost to serve metered customers. We consider that the company's revised allocation provides a more reasonable forecast of where in the business future efficiency improvements will be made.

A3.3.2 Adjustments

Affinity Water did not propose any ACTS adjustments except for pension deficit recovery costs.

Table A3.5 Adjustments included in final determination

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in final determination						
Pension deficit repair costs	0.120	0.120	0.120	0.120	0.120	0.600
Adjustments included in final determination	0.120	0.120	0.120	0.120	0.120	0.600

Pension deficit repair costs

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

A3.3.3 New costs

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

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

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

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

A3.4 Calculating the allowed revenues

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

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

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	1.0%	1.0%	1.0%	1.0%	1.0%

Table A3.8 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	16.0					
Metered water only customers	24.2					
Industry ACTS (£/customer)						
Unmetered single service customers	21.47					
Metered water only customers	27.26					

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Allowed cost to serve[1] (£/customer)						
Unmetered single service customers		15.5	15.3	15.1	14.8	14.7
Metered water only customers		23.1	22.3	21.5	20.6	20.5
Total allowed (£m)						
Cost to serve (excluding net margin)		26.5	26.4	26.2	26.0	26.4
Forecast household wholesale charge (including forecast RPI[2])[3]		241.3	248.1	250.9	255.8	261.7
Household retail revenue (including an allowance for the net margin)[4]		28.9	28.9	28.8	28.6	29.0

Notes:
There will be no automatic indexation for retail price controls to RPI. However, the wholesale price controls are indexed linked to RPI. This will affect the retail net margins.
1. Allowed cost to serve includes pension deficit repair costs.
2. The household wholesale charge includes forecast RPI so that the total household retail revenue can be displayed in the same price base as other retail costs.
3. The allocation of allowed wholesale revenue to different wholesale charges will be at the company's discretion, subject to charging rules and licence conditions, however, our assumed allocation of wholesale revenue is binding for the purposes of determining the allowance for the net margin which is one component of allowed household retail revenue.
4. This number is indicative, as allowed revenue will depend upon actual customer numbers.

A3.5 Uncertainty mechanisms

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

A4 Non-household retail

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

Our general policies relevant to the non-household control are set out in the policy chapter A6. This includes our responses to representations on sector-wide issues. In this chapter, we provide details of Affinity Water's non-household retail price control.

A4.1 Consideration of representations on our draft determinations

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

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

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

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

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Net margins	None	Section A4.3
Cost proposals	None	Section A4.4
Form of control	Affinity Water	Section A4.5

A4.2 Indicative non-household retail total revenue

Table A4.2 below shows the indicative total of non-household allowed revenue. The table is indicative, as it does not assume any gains or losses from competition or impacts from the company charging customers at levels different to the relevant default tariffs for the projected customers in each customer type. Furthermore, the controls for each customer type that we have set will only apply for two years; there will be a review in 2016. Years 2017-18 to 2019-20 below are shown for illustrative purposes only.

Table A4.2 Indicative non-household retail total revenue price control including net margins (£ million, nominal prices)

	2015-16	2016-17	2017-18	2018-19	2019-20
Indicative non-household retail total revenue price control including net margins	5.3	5.3	5.2	5.1	5.1

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

A4.3 Net margins

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

A4.4 Cost proposals

As set out in policy chapter A6, we have adjusted companies' costs to align to the 2013-14 base year. Historical costs are therefore presented in 2013-14 prices, and all future costs and revenues in nominal prices. All cost figures (unless otherwise specified) are five-year totals. As set out in 'policy chapter A6 – non-household retail costs and revenues', we expect our decisions on the total level of non-household retail costs now, will still apply for years 2017-18 to 2019-20 – the 2016 review will focus on the allocations between different non-household customer types.

In the draft determination, we noted that the company's 2013-14 costs were significantly higher than the preceding three years. We requested as part of its representations that the company provide us with a clear explanation as to the cost increase, and to explain why the increase should not be treated as an exceptional one-off event.

In its representations, the company explained that this was due to a reallocation between household and non-household retail. We were able to observe a corresponding decrease to the company's household retail costs. We therefore did not intervene with the company's base-year cost proposals.

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 PR14. 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 £0.105 million over the control period, to £0.096 million.

In total, this resulted in the company's proposed costs being adjusted from £18.182 million over the control period to £18.174 million.

A4.5 Form of control

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

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

A4.6 Average revenue controls

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

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

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

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Affinity Water Measured Half Yearly, no volume band, water, metered	£	51.86	50.88	49.96	48.84	47.50
	%	1.0%	1.0%	2.4%	2.4%	2.5%
	£ (r)	57.03	56.18	63.03	62.45	61.65
Affinity Water Measured Monthly, no volume band, water, metered	£	182.53	179.10	175.84	171.88	167.20
	%	4.4%	4.4%	2.6%	2.6%	2.5%
	£ (r)	653.98	666.53	464.02	459.65	454.96
Affinity Water Unmeasured, no volume band, water, unmetered	£	44.14	43.31	42.52	41.57	40.43
	%	1.0%	1.0%	2.4%	2.4%	2.5%
	£ (r)	48.35	47.60	53.13	52.56	51.86
Affinity Water Assessed, no volume band, water, unmetered	£	28.63	28.09	27.58	26.96	26.22
	%	1.0%	1.0%	2.4%	2.4%	2.5%
	£ (r)	29.61	29.09	30.03	29.49	28.85
Affinity Water Special Agreements, no volume band, water, measured	£	154.27	151.37	148.62	145.28	141.31
	%	3.0%	3.1%	3.1%	2.7%	2.5%
	£ (r)	2,028.29	2,085.39	2,104.75	1,905.66	1,803.16

A5 Appointee financeability and affordability

In this section, we discuss at an appointee level:

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

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

A5.1 Consideration of representations on our draft determinations

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

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

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

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Bills and K factors	None	Section A5.2
Appointee level uncertainty and gain share mechanisms	Environment Agency	Section A5.3
RoRE range	None	Section A5.4
Financeability	Affinity Water CCWater	Section A5.5
Affordability	CCWater	Section A5.6
Financial modelling	Affinity Water	Section A5.7

A5.2 Bills and K factors

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

- statutory duties; and
- associated PCs.

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

Affinity Water received financial benefits as an enhanced company in the form of an initial reward and an enhanced totex menu with enhanced sharing rates. It chose to recover its initial reward, of £4m, through its allowed revenues.

Table A5.2 Affinity Water's enhanced final determination – K factors, allowed revenues and customer bills[1]

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (£m)[2]	254.0	253.5	248.0	245.5	244.0	1,245.0
Wholesale water – K (%)[3]	0.0%	0.4%	-2.1%	-1.2%	-0.8%	-
Retail household allowed revenue (£m)	28.9	28.9	28.8	28.6	29.0	144.1
Retail non-household expected revenue (£m)	5.3	5.3	5.2	5.1	5.1	25.9
Average household bill – water (£)[4]	165	164	160	157	156	-

Notes:
1. Wholesale figures in 2012-13 prices as revenue will be affected by inflation and retail figures in nominal prices as revenue will not be affected by inflation.
2. The allowed revenue for our final determination is based on an implied menu choice. The company will have the opportunity to make its own menu choice, which will impact on its allowed revenues and customers' bills from 2020. Customer bills in the regulatory period from 2020 will also be affected by Affinity Water's performance in the forthcoming regulatory period in relation to costs and the regulatory incentives in place for performance delivery and revenue projection performance.
3. It should be noted the average household bill illustrated above reflects a notional allocation (by Ofwat but based on the company's split of household and non-household customers) of the overall wholesale revenue requirement across Affinity Water's household and non-household customer base. In practice, this will depend upon the structure of wholesale charges implemented by Affinity Water.

As discussed in policy chapter A3, K is set to zero for 2015-16 for wholesale water and wastewater because there are no directly equivalent wholesale revenues for 2014-15 (on account of the new price review structure). As such, there is no existing reference point against which to express a change in K.

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

Table A5.3 Affinity Water's allowed wholesale revenue for 2014-15

Affinity Water	Wholesale water
Allowed wholesale revenue 2014-15 (£ million)	268.0

A5.3 Uncertainty and gain share mechanisms

We outline our approach to uncertainty mechanisms and “pain and gain share” in policy chapter A7.

Affinity Water has not proposed any appointee level uncertainty mechanisms beyond those that will already form part of the regulatory framework for 2015-20.

A5.4 RoRE range

Affinity Water has estimated the range of returns on regulatory equity (RoRE) that it could earn dependent on its performance and external risk factors over the price control period. The RoRE range reflects the company’s views and is based on an efficient company with the notional capital structure[3]. We have identified the RoRE impact separately for ODIs, totex performance, financing and the SIM. We note that Affinity Water's actual returns may differ from notional returns due to differences between notional and actual capital structure and notional and actual cost of debt and level of cost efficiency compared to allowed totex and household retail ACTS.

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

Table A5.4 Whole company RoRE range

	Lower bound (%) – appointee	Upper bound (%) – appointee
Overall	-5.2%	+3.4%
ODIs	-1.9%	+0.5%
Totex	-2.6%	+2.7%
Financing	-0.2%	+0.2%
SIM	-0.6%	+0.0%

Commentary:

In our draft determination for Affinity Water, we published the company's RoRE ranges for each element of the price control, but not at the appointee level. We continue to consider that the analysis carried out by Affinity Water was robust, for the reasons set out there. Subsequently, Affinity Water has not made any representations in this area. Affinity Water has updated this calculation to reflect the latest version of the risk assessment.

The whole company RoRE range is from 0.9% to 9.5%, with a base case of 6.1%, with overall impacts from -5.2% to +3.4%. The overall impacts are unchanged from the draft determination but the range is modified to reflect a continued allowed wholesale cost of capital of 3.7% associated with enhanced status (when the notional cost of new debt has fallen) and to exclude additional returns from non-household retail control to be consistent with approach in our risk and reward guidance. The overall impacts are broadly in line with other companies and we consider that it represents an appropriate balance of risk and reward.

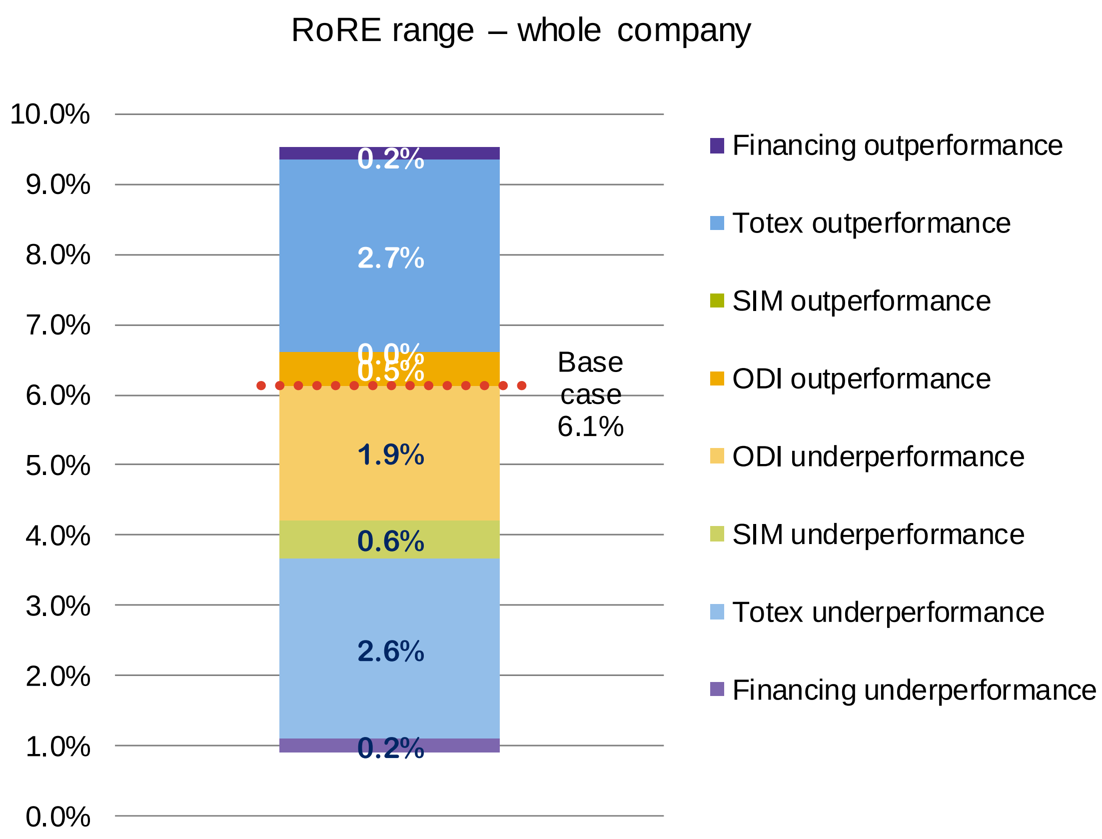
The totex risk range is -2.6% to +2.7% of notional equity. We are satisfied that Affinity Water has appropriately taken into account historic cost variability to arrive at this estimate, and therefore this represents a sufficiently considered company view of its potential totex risk.

The ODI risk range proposed by Affinity Water was from -1.9% to +0.5%. Affinity Water was awarded enhanced status so we have made no changes to its ODIs.

Affinity Water has assessed financing impacts using a scenario of ±50 basis points on the cost of new debt.

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

Figure A5.1 Affinity Water's RoRE range – appointee



Source: Ofwat calculations based on information from Affinity Water
Note: Numbers presented based on calibration of the ODIs against an assumed menu choice of a 50% sharing factor

A5.5 Financeability

Table A5.5 Representations specific to Affinity Water's financeability

Respondent	Summary of comment	Ofwat response
Affinity Water	We used our own profile in Affinity Water's draft determination. For its final determination, in line with the 'do no harm' principle, we have used the company's proposed totex profile. The company requested an opportunity to understand its final year-by-year totex and revenue profile (and tax implications), as a consequence of this change.	As Affinity Water is an enhanced company, we have used PAYG rates to target its desired final determination wholesale revenue.

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

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

A company's actual capital structure is a choice for the company and it bears the risk associated with its choices.

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

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

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on Ofwat calculations (average 2015-20)	
	Company calculation	Ofwat calculation	Draft determination	Final determination
Cash interest cover (ICR)	3.52	3.70	3.67	3.56
Adjusted cash interest cover ratio (ACICR)	2.11	2.29	2.21	2.17
Funds from operations(FFO)/debt	11.70%	12.80%	12.43%	12.08%
Retained cash flow/debt	7.31%	10.26%	9.71%	9.51%
Gearing	62.50%	62.50%	61.20%	63.49%
Dividend cover (profit after tax/dividends paid)	1.41	2.63	2.25	2.00

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on Ofwat calculations (average 2015-20)	
	Company calculation	Ofwat calculation	Draft determination	Final determination
Regulatory equity/regulated earnings for the regulated company[1]	17.48	14.33	17.02	16.61
RCV/EBITDA	8.96	8.66	9.27	9.47
Commentary:				
For the draft determination, the company satisfied itself and us that ratios remained at levels consistent with a company that is financeable. The company did not raise any issues relating to financeability in its representation on its draft determination (apart from in relation to totex phasing which we have amended as part of our final determination). The financial ratios from our final determination are at levels consistent with those at draft determination. We consider that the final determination is financeable.				

Note:

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

As explained in policy chapter A8, companies have been allowed to use new tools in the form of PAYG rates (the proportion of totex recovered in the period 2015-20) and RCV run-off rates (depreciation of the RCV). Both PAYG and RCV run-off rates can be adjusted to change the proportion of costs recovered within the 2015-20 period and the amount added to the RCV and recovered over a longer period.

Table A5.7 sets out the PAYG and RCV run-off rates, which shows whether revenue has been brought forward compared to the December plan and the impact that this has on RCV growth and longer-term affordability and financeability.

As Affinity Water is an enhanced company, we have amended PAYG rates to target the company's proposed bill profile.

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

	PAYG rate	RCV run-off	RCV growth (%) – 1 Apr 2015 to 31 Mar 2020
Company December plan	76.6%	4.0%	4.2%
Company April plan	76.3%	4.0%	2.9%
Draft determination	77.4%	4.0%	4.8%
Final determination	76.2%	4.0%	5.4%

A5.6 Affordability

We set out our approach to assessing affordability in policy chapter A8. Table 5.8 sets out the change in household bill profile between the company's December business plan, its March update, the draft determination, the company's representation on targeting its proposed revenues and associated bills, and the final determination.

Table A5.8 Household bill profile

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	165	164	163	162	161	160
Company March update	165	159	158	157	155	153
Ofwat calculation for draft determination – pre-reprofiling	165	165	165	159	156	155
Ofwat calculations for draft determination	165	165	165	159	156	155
Company representations	165	165	164	160	157	156
Ofwat calculations for final determination	**165**	**165**	**164**	**160**	**157**	**156**

The final determination leads to a reduction in bills in 2015-20. As Affinity Water is an enhanced company, we have reprofiled bills in line with the company's desired profile.

The following text sets out the reasons why this final determination is assessed as affordable. It describes key changes in relation to Affinity Water's December business plan that we assessed as affordable.

A5.6.1 Acceptability

Table A5.9 Ofwat response to representations

Respondent	Summary of comment	Ofwat response
CCWater	Affinity Water should work closely with its associated sewerage companies, in particular Thames Water, to explain the impact of the Thames Tideway Tunnel and to make sure that customers are able to access any available affordability packages.	In its business plan, Affinity Water committed to devising an effective communication programme so that it could inform customers of potential price changes and take steps to mitigate the impact on vulnerable and low-income customers. We consider that this is reasonable.
CCWater[1]	CCWater conducted research on the acceptability of the draft determination to customers. CCWater did not seek to produce comparable results to the company. The CCWater research suggests 67% of customers find the draft determination acceptable after they have been provided with information on bills, inflation and what the water company will deliver.	We note that the CCWater research was not intended to be comparable. It has produced a significant difference to the research that the company undertook on its revised business plan, which was that 87% found the plan acceptable. The company's plan has been developed with input from its CCG. The CCG's role was to help ensure the business plan reflected the views and priorities of customers. We have reviewed the company's acceptability research, which included reviewing the transparency and accuracy of the bill and inflation information. We consider that the acceptability that the company reported is sufficiently robust. We also consider that the CCWater survey results indicate the importance of continued engagement with customers.

Respondent	Summary of comment	Ofwat response
CCWater	CCWater made a comment in response to the smoothing of Affinity Water's bill profile through an adjustment to its PAYG rate. CCWater want to understand over what period customers pay for the proportion of investment that has been added to the RCV following PAYG adjustments.	As set out in the draft determination, totex additions would have an average life of 25 years.
CCWater	Price adjustments via the RCM may be stored up for the next price review, because of the compulsory metering programme.	The Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) replaces the RCM in 2015-20. WRFIM incentivises a company to accurately forecast revenue by penalising the company if its forecasts are outside a predetermined range. The WRFIM revenue adjustments will be applied at a future price review after 2020. We have not found any significant effect of metering penetration on revenue forecasting error and confirmed that neither the flexibility thresholds nor the penalty rates of WRFIM are linked to metering penetration. We have therefore found no evidence that compulsory metering affects the WRFIM.

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

The company conducted customer research to support its original December 2013 business plan submission. Its research found 87% of customers supported a plan that had an associated bill increase of £1.80 before inflation. It is reasonable to assume that the reduction proposed in the final determination of £9 by 2019-20 would remain acceptable to the majority of the company's customers.

In its representations on our draft determination, the company has argued for a profiling of its totex in line with its business plan proposals. This would not impact the average reduction of bills over the period 2015-20 and so would again remain acceptable to the majority of the company's customers.

A5.6.2 Identification of affordability issues and appropriate support measures

The company has a comprehensive range of affordability measures in place, and outlines in its business plan how it is proposing to both increase the coverage of some schemes and to introduce new initiatives. The key measures are summarised in the following table.

Table A5.10 Key affordability measures

Measure	Current coverage (no of customers)	Forecast 2019-20 coverage
WaterSure	4,034	4,000
Water direct	4,400	8,000
Flexible payment plans	14,406	15,000
Debt advice – in house	Available to all customers	Available to all customers
Free water efficiency audits	New	100,000 (audits for all new metered customers)
Social Tariff	Existing scheme	30,000
Hardship cases	549	549

A5.6.3 Longer-term affordability

Affinity Water has considered future affordability in its consideration of intergenerational equity issues arising from setting PAYG rates and RCV run off. The company confirms it has not altered its RCV run off rate from its original submission. The company has also made only minor adjustments (less than 2%) to PAYG rates to reduce bill volatility up to 2019-20 (that is, to smooth the bill profile). Longer term, the company forecasts maintaining the average PAYG rate and the RCV run off rate over the period 2015-20 and 2020-25 at 75% and 4% respectively. The company highlights growth in the RCV of almost £200 million over 2015-20 and states that this represents a reflection of the atypical investments required in the period, such as metering, and strikes a fair intergenerational balance. The company has also applied the £4 million reward for enhanced status to its opening RCV to recover the cost over the long term and smooth the impact on bills.

Consistent with our original assessment there is therefore sufficient and convincing evidence that the company's use of cost recovery tools will not adversely affect current or future affordability. The minor changes apply to both 2015-20 and 2020-25 and the company has taken into account the impact on customers' bills.

A5.6.4 Longer-term affordability – ODIs

There is evidence that the company's proposals for maximum ODI rewards will not have a negative impact on overall affordability in the longer term. Results of customer research showed that when details of the company's proposed changes were presented – showing that bills would remain around £5 lower after five years (before inflation) even if maximum rewards were applied – 60% customers still agreed the company's approach was 'good'.

The company's CCG conclude that customers will accept proposed changes to rewards and penalties associated with ODIs where they are applied at PR19 if the result is that bills still decline in real terms. The CCG note this is in line with customers' preferences for 'bill certainty' over the 2015-20 period.

Therefore, there is sufficient evidence that the company's proposals on ODIs will not have a significant impact on affordability in the longer term when taken in the context of the reduction in bills in real terms.

A5.7 Financial modelling

In response to company-specific representations, we have made some adjustments to our financial model. The representations, and our response, are set out in table A5.11.

Table A5.11 Representations specific to Affinity Water's financeability

Respondent	Summary of comment	Ofwat response
Affinity Water	Affinity Water noted a variance of £4.4 million in tax liability relating to our treatment of income from infrastructure charges as an offset against capex rather than revenue (which is required by IFRS accounting).	We consider that the revised tax inputs Affinity Water provided after the draft determination are consistent with the rest of its plan and we have used them in the financial modelling for final determination.

Annex 1 Wholesale costs

Establishing final determination thresholds

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

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

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

Further information about our assessment of each claim is set out in the populated version of final determination cost threshold models.

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

Basic cost threshold	Policy additions[1]	Unmodelled costs adjustment	Deep dives	Final determination threshold	Deep dives fully or partially not added[2]
1,015.0	85.5	-9.8	0.7	1,091.3	1.3

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

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

Business rates	Pension deficit payments	Third party costs	Open market costs	Net v gross adjustments	Total
70.8	2.8	11.1	0.9	0.0	85.5

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

Plan[1]	Final determination threshold	Gap[2]	2010-15 v Plan
1,033.9	1,091.3	-57.5	13.3

Note:
1. Where the company's business plan total has been adjusted by the company as part of its representations on its draft determination, this is reflected here.
2. This gap will not equal the deep dives fully or partially not added in Table AA1.1 if the company's claims for special treatment in the costs thresholds are not equal to the gap.

Table AA1.4 Summary of wholesale water deep dive assessments (£ million)

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment	Amount allowed
Deep dives							
Karstic Water additional treatment costs	122.2	120.9	-	-	-	-	-
Universal Metering Enhancement Programme	52.6	52.6	-	-	-	-	-
River Thames water treatment works	12.8	12.8	-	-	-	-	-
Hatfield water treatment works Group	11.4	11.4	-	-	-	-	-
Grafham reservoir – water trading	11.0	11.0	-	-	-	-	-
Ardleigh reservoir – water trading	6.6	6.6	-	-	-	-	-
Lead communication pipes[1]	24.6	24.6	-	-	-	-	-

Note:
1. Deep dive not required as company variables used in modelling.

All Affinity Water's special cost factor claims were made in its draft business plan (submitted in December 2013). In the draft determination, we explained that the claims were not added as they were either covered by the implicit allowance, or the difference was immaterial. Affinity Water did not submit any further special cost factor claims after its draft determination.

Annex 2 Household retail

Details on our assessment of proposed adjustments to the ACTS

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

Affinity Water did not propose any ACTS adjustments except for pension deficit recovery costs.

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments proposed in Affinity Water's April business plan						
Pension deficit repair costs	0.140	0.140	0.140	0.140	0.140	0.698
Adjustments included in business plan	**0.140**	**0.140**	**0.140**	**0.140**	**0.140**	**0.698**
Adjustments included in draft determination						
Pension deficit repair costs	0.120	0.120	0.120	0.120	0.120	0.600
Adjustments included in draft determination	**0.120**	**0.120**	**0.120**	**0.120**	**0.120**	**0.600**
Adjustments proposed in Affinity Water's representations						
Pension deficit repair costs	0.140	0.140	0.140	0.140	0.140	0.698
Adjustments included in final determination	0.140	0.140	0.140	0.140	0.140	0.698
Adjustments included in final determination						
Pension deficit repair costs	0.120	0.120	0.120	0.120	0.120	0.600

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in final determination	0.120	0.120	0.120	0.120	0.120	0.600

Household retail revenue modification

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

Table AA2.2 sets out the amount per customer, by customer type, that allowed revenues will be modified by if outturn customer numbers differ from forecast customer numbers and table AA2.3 sets out the baseline number of customers.

Table AA2.2 Household retail allowed revenue modification factors by class of customer (£/customer)

Revenue modification per:	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only customer	16.94	16.74	16.51	16.30	16.20
Metered only water customer	25.22	24.38	23.51	22.66	22.57

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

Table AA2.3 Assumed number of customers for household retail total revenues (000s)

Number of customers	2015-16	2016-17	2017-18	2018-19	2019-20
Unmetered water only	655.5	590.4	517.6	446.5	387.7
Metered water only	705.2	778.9	860.0	939.2	1006.1

Annex 3 Reconciling 2010-15 performance

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

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

We set out our methodology for calculating the adjustments to 2015-20 wholesale price controls resulting from the company's actual performance during the 2010-15 period in policy chapter A4.

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

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

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

In this annex, we provide an overview – comparing the company's view of the required revenue adjustments included in its revised business plan for each of the incentive tools for water services, with our own view. We then consider each adjustment mechanism in turn.

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

Consideration of representations on our draft determinations

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

Where representations have addressed issues that are common to a number of companies, these comments and any consequential changes to our approach are discussed in policy chapter A4. Representations that are specific to reconciling 2010-15 performance for Affinity Water, and any consequential impact on our final determination, are summarised in the table below.

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

Area	Respondent	Summary of comment	Ofwat response
RCM	Affinity Water	The company provided an updated view of its RCM adjustments to reflect 2013-14 actuals and 2014-15 forecasts in its June submission. This reduced the RCM revenue from £2.5 million to £0.8 million.	We reviewed the company's updated data and identified inconsistencies in the forecasted 2014-15 tariff basket revenues, FD09 assumptions and outturn financial year average RPI. We raised a query with the company from which we agreed an approach to take for the final determination.
Service standard outputs	Affinity Water	The company provided evidence in its response to query AFW/LEGACY/001 to confirm that the all the service standard outputs have been achieved except for the reduction of 1000 contacts per annum. This service standard output relates to the Blackford and Roydon Manganese removal scheme, where the company is expected to clean 1080 km of distribution and trunk mains by 31 March 2015. The company noted that it had completed cleaning of 70km of trunk mains and 10km of distribution mains and provided reasons for the delay. It also stated that "The full benefit in terms of a reduction in customer contact by 1,000 per year will not be realised until completion of the cleaning programme".	Having considered the evidence provided in the company's response to query ref AFW/LEGACY/001, we are satisfied that all the service standard outputs have been achieved except for the 'reduction of 1000 contacts per annum', which would not be achieved by the required date, 31 March 2015. We have reviewed the query response and are satisfied with the explanation provided by the company in relation to the delay to the network cleaning scheme. These include the drought in 2012, which resulted in the imposition of restrictions on water use and therefore made flushing operations untenable; and a further delay caused by heavy rainfall in the 2013-14 winter, which prevented flushing activities from taking place. We also note that the serviceability performance (customer contacts – discolouration (nr / 1000 population) linked to this service standard output has already been achieved. We have therefore not applied a shortfall to this service standard. However, we require the company to report on the progress

Area	Respondent	Summary of comment	Ofwat response
			of this network cleaning scheme in 2015-16. Therefore, for the final determination, there are no shortfall adjustments for the service standard outputs.
CIS	Affinity Water	The company submitted updated 2013-14 and 2014-15 information based on our published methodology.	As explained in policy chapter A4, we have corrected a minor error in the CIS model for all companies with respect to the discount rate used when calculating the future value of the revenue adjustment in the 2010-15 period. This minor change had no material impact of the final revenue adjustments.

Summary of 2010-15 adjustments

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

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

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

Table AA3.1 notes the comments that we have received that are specific to this aspect of the wholesale water control of Affinity Water and outlines how our interventions have been influenced by our consideration of these responses. The changes we have made in the final determination compared to our draft determination, are mainly as a result of including the company's updated actuals for 2013-14 and forecasts for 2014-15 and correcting data inconsistencies in the RCM model.

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

	Company view	Ofwat view
SIM	0.000	0.000
RCM	0.820	2.259
OIA – post-tax	0.000	0.012
CIS	-10.697	-10.602
Tax refinancing benefit clawback	-4.000	-4.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000
Total wholesale legacy adjustments	-13.877	-12.330

Notes:
For the CIS mechanism, there is a corresponding adjustment to the RCV made at 1 April 2015 (part of the 'midnight' adjustments'). The impact on the RCV can be seen in Table AA3.14. This adjustment is net of any logging up, logging down or shortfalls. A full reconciliation showing all of the midnight adjustments to the RCV, including the impact of logging up, logging down and shortfalls, can be seen in Table A2.7.
Totals may not add up due to rounding.

Adjustments by 2010-15 incentive mechanism

RCM

Table AA3.3 below shows the company's view and our view of the company's RCM adjustments. Table AA3.4 summarises our updates in relation to Affinity Water's proposed 2010-15 RCM adjustments.

In its revised business plan, the company updated its view of the RCM adjustment from £2.465 million to £0.820 million to reflect updated 2013-14 actuals and 2014-15 forecasts. We consider that this change is caused by an inconsistency between the 2014-15 revenues in the company's business plan table (W17) and its populated RCM model for Veolia Central. We issued a query to the company to check that it agreed that there was a data inconsistency, which they confirmed (on 29 September 2014). We have not required the company to resubmit revised data. Instead, we confirmed that we would correct the data inconsistency for the final determination. Our final determination therefore reflects the company's updated RCM adjustments following updates to 2013-14 actuals and 2014-15 forecasts, and the data correction.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.164	0.164	0.164	0.164	0.164	0.820
Ofwat view	0.452	0.452	0.452	0.452	0.452	2.259

Table AA3.4 Updates to proposed 2010-15 RCM adjustments

Area	What we did	Why we did it
Forecasted 2014-15 tariff basket revenues	Our assumption for the final determination uses the data the company submitted in business plan table W17 to calculate our view of the RCM adjustment.	There are inconsistencies with 2014-15 forecast revenues between business plan table W17 and Veolia Central's populated RCM model.

Area	What we did	Why we did it
FD09 assumptions – Measured Non-household's revenue for the Measured Non-household group immediately above and below the 50 Ml (megalitre) threshold	The final determination includes our view of the FD09 assumptions for the inputs to the RCM model. Our view of the company's revenue assumptions for the measured non-household group immediately below and above the 50 Ml tariff basket threshold originate from the company's FD09 revenue forecasts that come from the tariff basket model, which we used for PR09.	There are differences between the company's and our view of the FD09 assumptions used in the populated RCM model. The company applied different assumptions for 'FD09 Measured Non-household's revenue for the Measured Non-household group immediately above and below the 50ML threshold' compared with our view of its FD09 assumptions for Veolia Central, Veolia South East and Veolia East. Our assumptions for the final determination include the FD09 revenue forecasts as contained in the PR09 tariff basket model in accordance with our published methodology 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance'.
FD09 assumptions – number of non-household billed measured properties	The final determination includes our view of the FD09 assumptions for the inputs to the RCM model. Our view of the company's number of non-household properties is consistent with the company's FD09 revenue forecasts which come from the tariff basket model that we used for PR09.	The company applied different assumptions for the number of non-households billed measured properties for Veolia Central compared with our view of its FD09 assumptions. Our assumptions for the final determination correct the company's data inconsistencies between its FD09 and its populated RCM model.

Area	What we did	Why we did it
Outturn financial year average RPI	Our assumptions for the outturn financial year average RPI at the final determination 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. Our assumptions for the final determination correct the company's data inconsistencies.
Net revenue movement out of tariff basket in 2009-10	Our assumption for the final determination uses the data the company submitted in business plan table W17 to calculate our view of the RCM adjustment.	There are inconsistencies with the amount submitted between business plan table W17 and the Veolia South East's populated RCM model. Our assumptions for the final determination are based upon the data within the company business plan table W17.

OIA

Table AA3.5 below summarises the company's view and our view of the incentive allowances for 2015-20. There are no changes from our draft determination. Table AA3.8 summarises our updates in relation to Affinity Water's proposed 2010-15 OIA adjustments.

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

		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	0.012	0.000	0.000	0.000	0.000	0.012

Table AA3.6 Changes to proposed 2010-15 OIA adjustments

Area	What we did	Why we did it
PR09 error correction	The company included a logging up adjustment in a calculation in an attempt to correct for the error we made at PR09 in relation to logging up of metering opex. We removed this adjustment from the calculation in favour of a direct input to the overall incentive revenue allowance based on our calculations of what the incentive value should have been. This indicated that at PR09, the former Veolia Southeast company should have received an incentive revenue allowance of £0.0216 million rather than £0.0111 million (post tax and in 2007-08 prices). We have therefore included £0.0123 million (that is, the difference of £0.0105 million indexed to 2012-13 prices) as a post-tax incentive revenue adjustment in 2015-16.	At the price review in 2009 (PR09) we confirmed to the company that we would correct this error at the price review in 2014. We have made a direct input to the overall incentive allowance (post tax), which correctly acknowledges the value of the allowance that the company should have received during this period. We made this change because it is in customers' interests to ensure that the final determinations are accurate and it is important for the credibility of the price review process.

Change protocol (logging up, logging down and shortfalls)

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

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

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

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

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

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

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

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

Service standard outputs

Service standards are regulatory outputs that we set out in the FD09 supplementary reports[4]. Where companies have not reported progress on these service standards before submitting business plans, we would have expected them to do so within the price review process.

After Affinity Water's draft determination, we raised a query regarding service standards for resilience and exceptional items because the information available to us did not provide sufficient evidence that the service standards had been achieved. In October 2014, the company provided satisfactory evidence that it has achieved all of its service standard outputs except for the reduction of 1000 contacts per annum. The reduction of 1000 contacts per annum output relates to the Blackford and Roydon Manganese removal scheme, where the company was expected to clean 1080 km of distribution and trunk mains. The company provided reasons why it would not be able to complete the Manganese removal scheme by the required completion date, 31 March 2015. We have reviewed the information provided by the company and are satisfied with the limiting factors set out by the company. These include the drought in 2012, which resulted in the imposition of restrictions on water use and thus made flushing operations untenable; and a further delay caused by heavy rainfall in the 2013-14 winter, which prevented flushing activities from taking place. We have therefore not applied a shortfall. However, we require the company to report progress on this activity in 2015-16.

Serviceability performance

Table AA3.9 below summarises our serviceability assessments for Affinity Water and Table AA3.10 quantifies the value and impact of any serviceability shortfall on the RCV. Table AA3.11 summarises our changes in relation to Affinity Water’s proposed adjustments for serviceability.

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

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

Table AA3.9 Serviceability assessments for 2010-15

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

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

Table AA3.10 Impact of serviceability shortfalls on the RCV (£ million)

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

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

Area	What we did	Why we did it
Discolouration contacts per 1,000 population	For the purposes of the final determination, there is no intervention for this indicator. This is conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We will consider a shortfall adjustment if this is not achieved. Serviceability performance in AMP5 is due to be reviewed in 2015 once actual data is available for the whole of the 2010-15 period. Any shortfalls arising from this review will be applied at the next price control.	The company (South East region) has had two breaches of the upper control limit in 2011-12 and 2012-13. However, 2013-14 was below the upper control limit and 2014-15 performance is expected to improve to below the reference level. The company has provided evidence on mitigation measures taken to improve performance. We consider that the improvement can be sustained and have therefore not applied shortfall adjustment for the final determination. However, we would expect projected 2014-15 performance to be achieved. If this is not achieved, we will consider a shortfall adjustment.

The 2009 agreed overlap programme

Table AA3.12 below confirms the 2009 agreed overlap programme assumptions relating to combined operational security included in the final determination. These are unchanged from our draft determination and there are no interventions in this area.

Table AA3.12 PR09 agreed overlap programme adjustments and assumptions (£ million)

	2010-15		2015-20	
	Two-sided adjustments for inclusion in the CIS		Expenditure forecasts to complete the projects	
	Capex	Opex	Capex	Opex
Company view	0.000	0.000	7.355	2.651
Ofwat view	0.000	0.000	7.355	2.651

The 2014-15 transition programme

Table AA3.13 below confirms Affinity Water's proposed transition programme. There are no interventions in this area.

Table AA3.13 Transition programme in 2014-15

2014-15 (£ million)	Proportion of forecast in 2014-15	Proportion of capital programme in 2015-20
5.0	5.5%	0.9%

CIS

Table AA3.14 provides details of the CIS ratios and performance incentive. It also gives the:

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

Table AA3.15 then sets out the profiled values of the revenue adjustments in each year 2015-20, Table AA3.16 shows the components of the opening RCV which are included in the CIS adjustment, and Table AA3.17 summarises our minor update to Affinity Water's proposals.

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

Table AA3.14 CIS true-up adjustments

		Veolia Water Central	Veolia Water East	Veolia Water Southeast	Total
Restated FD09 CIS bid ratio[1]	Company view	131.482	142.558	118.681	N/a
	Ofwat view	131.482	142.506	118.681	N/a
Out-turn CIS ratio	Company view	116.655	102.382	125.419	N/a
	Ofwat view	116.669	102.400	125.431	N/a
Incentive reward/penalty (%)[2]	Company view	-4.822	-3.235	-6.124	N/a
	Ofwat view	-4.824	-3.235	-6.126	N/a
Reward/penalty (£m)	Company view	-16.861	-0.434	-2.071	-19.367
	Ofwat view	-16.863	-0.434	-2.071	-19.368
Adjustments to 2015-20 revenue (£m)[3]	Company view	-7.134	-0.380	-2.419	-9.933
	Ofwat view	-7.070	-0.375	-2.400	-9.845
RCV adjustment (£m)[4]	Company view	11.284	-1.481	5.035	14.838
	Ofwat view	11.278	-1.481	5.031	14.829

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 (Table AA3.12).
2. The reward/(penalty) is adjusted for the additional income included in the 2010-15 determination and the financing cost on the difference between actual spend and capital expenditure assumed in the 2010-15 determination to derive the value of the adjustment to 2015-20 revenue.
3. The adjustment to 2015-20 revenue values shown in this table assume a single year adjustment in the first year, and do not include the NPV profiling used for the final determination.
4. In Table AA3.16, we show how the components of this agree to those shown in Table A2.7.

Table AA3.15 Profiled revenue adjustments from the CIS reconciliation (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-1.987	-2.060	-2.136	-2.215	-2.297	-10.695
Ofwat view	-1.969	-2.042	-2.118	-2.196	-2.277	-10.602

Table AA3.16 CIS components of the opening RCV adjustment (£ million)

	Total
Adjustment for actual expenditure 2010-15	14.829
Net adjustment from logging up and logging down	0.000
Adjustment for shortfalls	0.000
RCV adjustment	14.829

Table AA3.17 Adjustments to proposed CIS adjustments

Update	What we did	Why we did it
Methodology	We have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period.	As explained in policy chapter A4, to address these issues we have changed the CIS model.
Change protocol adjustments	N/a	N/a
Data inconsistencies	While the pre-tax discount rate has not been used in the final determination, we have corrected the input values for the PR09 pre-tax cost of capital.	The company applied the published Ofwat methodology using its updated 2013-14 and 2014-15 information, however we noticed the pre-tax cost of capital values used by the company for calculating the future value in its CIS assessments were not aligned with the PR09 values.

Other adjustments

Table AA3.18 below confirms the assumptions included in this final determination with respect to the following revenue adjustments:

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

These are unchanged from our draft determination and there are no interventions in this area.

Table AA3.18 Other revenue adjustments 2015-20 (£ million)

	Company view	Ofwat view
Tax refinancing benefit clawback	-4.000	-4.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000

Table AA3.19 and Table AA3.20 below confirm the assumptions included in this final determination with respect to other adjustments to the opening RCV.

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

Table AA3.19 Other adjustments to the opening RCV (£ million)

	Company view	Ofwat view
Land sales	0.000	-5.181
2009-10 adjustment	0.000	24.366
Enhanced rewards	4.000	4.000
Other adjustments	-21.359	0.000

Table AA3.20 Updates to proposed adjustments to the opening RCV

Area	What we did	Why we did it
Land sales	We calculated land sales using the business plan sales figures in our RCV midnight adjustment model.	This provided a consistent approach with all companies.
2009-10 adjustment	The company did not show an adjustment in its business plan for this. We have made this adjustment.	This provided a consistent approach with all companies.
Other adjustments	We calculated the component parts of the midnight adjustment as if the company was non-enhanced. Therefore, this balancing figure was irrelevant for the final determination.	This provided a consistent approach with all companies.

Annex 4 Outcomes, performance commitments and ODIs

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

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

The company has used a cost-sharing rate of 50% to calibrate the reward and penalty rates included in this annex. On 4 April, we stated that the company had achieved enhanced status and that its cost-sharing rate at 100 would be 55% rather than 50%. Once the company has chosen its position on the enhanced menu we are requiring it, in line with the methodology, to recalibrate its ODIs with the cost-sharing rate associated with that position, and provide us with the updated incentive rate calculations. The company must do this alongside its menu choice on 16 January 2015 so that the recalibrated ODIs can be included in the regulatory reporting framework for 2015-16.

However, we first consider the responses to our draft determinations in relation to the PCs and ODIs for Affinity Water.

Consideration of representations on our draft determinations

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

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

Where representations have addressed issues that are common to a number of companies, these comments and any consequential changes to our approach are discussed in policy chapter A2. Representations that are specific to PCs and ODIs for Affinity Water, and any consequential impact on our final determination, are summarised in the tables below as follows.

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

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

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
Unplanned interruptions to supply over 12 hours	No intervention	In its representation, Affinity Water said that it considered whether to align its PC definition with Ofwat's analysis, based on the comparative assessment of interruptions. It decided not to make any changes, but to keep this PC under review.	No intervention	The comparative assessments were carried out after the enhanced draft determinations. As an enhanced company, Affinity Water is not affected by our comparative assessments as we consider that it is appropriate to accept the enhanced companies' business plans in the round in order to maintain the incentive on companies to produce the highest quality business plans. The company decided not to change the definition of the PC and we have not intervened.

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

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
Asset health index[5]	No intervention	Affinity Water provided further detail on how the index will operate by monitoring availability and criticality of failure at an asset, community and company level.	Accepted the company's developed proposals (no intervention)	The company demonstrated that its asset health index, combined with its ongoing monitoring of PC and a further suite of KPIs, is sufficient to ensure appropriate maintenance of its assets.
Water available for use	No intervention	The Environment Agency considers that Affinity Water needs to re-align its PCs for water available for use (WAFU) with the water resources management plan.	Confirmed our draft determination position	Affinity Water has a PC for water available for use (WAFU) that is more stretching than its water resources management plan proposals. This is in line with its customers' priorities to reduce the impact on the environment.

[5] The company has proposed this is a KPI, but as it was part of the pre-qualification actions, we have included in the table of PCs for completeness.

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
Leakage	No intervention	The Environment Agency considers that Affinity Water needs to re-align its PCs for leakage with the water resources management plan.	Confirmed our draft determination position	Affinity Water has a PC for leakage that is more stretching than its water resources management plan proposals. This is in line with its customers' priorities to reduce the impact on the environment.
Average water use	No intervention	The Environment Agency would like to see a financial reward associated with this PC.	Confirmed our draft determination position	Affinity Water's proposals were in line with the water resources management plans. We did not see sufficient evidence, either from the Environment Agency or Affinity Water's own willingness to pay data, that it was in customers' interests to intervene and introduce a reward mechanism to drive average water use down further.

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

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
No representations in this area.				

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

Performance commitment	Reason for its removal
Wholesale water and household retail	
N/a	N/a

Table AA4.5 Performance commitments excluded from the commentary tables because we received no representations to our draft determinations on them

Wholesale water	Household retail
AIM	SIM
Sustainable abstraction reduction	Value for money survey
Compliance with water quality standards	
Unplanned interruptions to supply over 12 hours	
Number of burst mains	

Wholesale water	Household retail
Affected customers not notified of planned interruptions	
Planned work taking longer to complete than notified	

Summary of ODIs

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

Companies also had to propose ODIs. Where customers were willing to pay for higher levels of performance and companies could demonstrate that performance was at a high level relative to its peers, then the financial incentives could contain rewards for over delivery as well as penalties for under delivery.

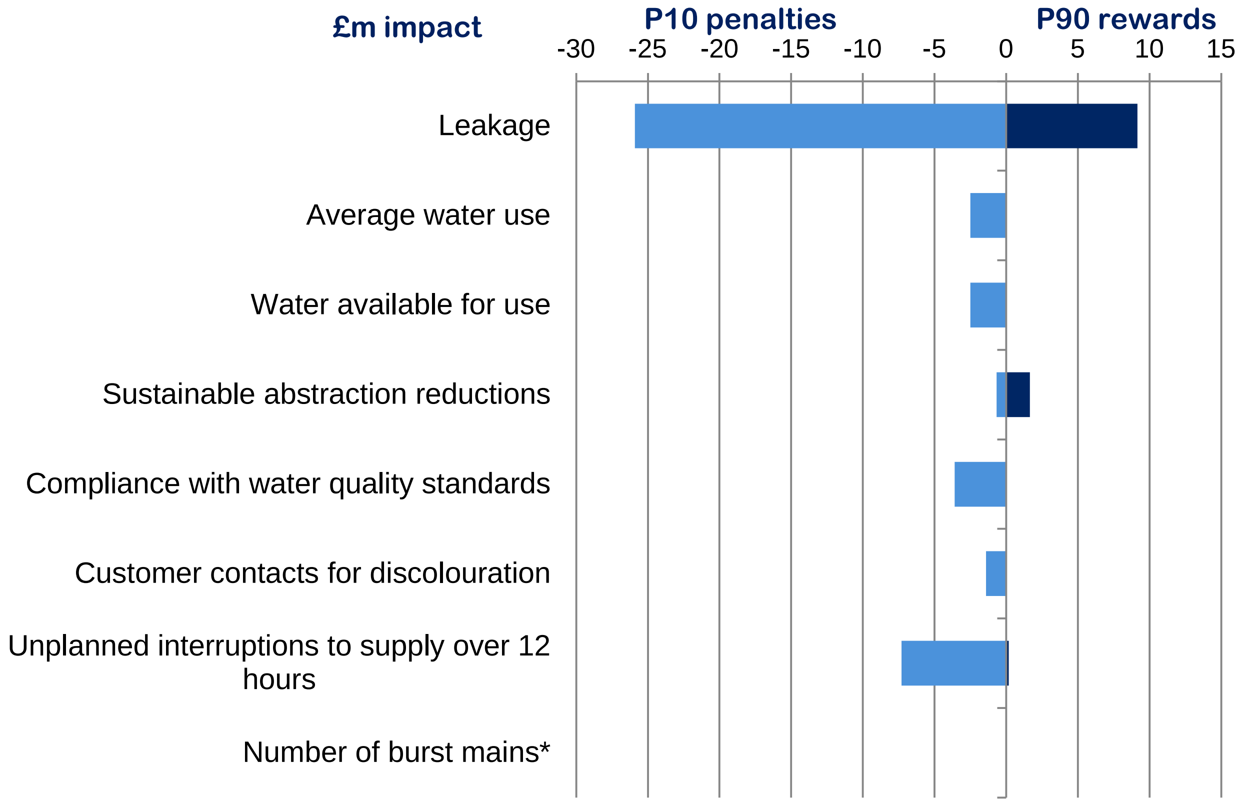
Table AA4.6 shows the balance between reward and penalty, penalty only and reputational incentives in the package of incentives for the company, and Figure AA4.1 shows the potential financial impact of each of the financial incentives proposed.

Table AA4.6 The composition of the package of ODIs

	Reward and penalty	Penalty only	Non-financial incentive
Wholesale water	3	5	3
Household retail	1	0	1
Total	4	5	4

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

Figure AA4.1 Overview of financial ODIs



Note: ODIs marked with * are financial ODIs but there is a less than 10% chance of these occurring.

As explained in the policy chapter A2, we are introducing an aggregate cap on rewards and collar on penalties from the ODIs for the non-enhanced companies. As an enhanced company, this cap and collar does not apply to Affinity Water. Details of how the cap and collar will operate are set out in section [A2.4] of policy chapter A2

In the remainder of this chapter, we provide the following information on each PCs included as part of this final determination:

- the name and detailed definition of the PC;
- the type of incentive;
- the PC level;
- for financial incentives:
  - the limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable[6]; and

[6] 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.

  - the incentive rates; and
- additional details on the measure.

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

Performance commitments and ODIs in detail

Wholesale water outcome: making sure our customers have enough water, whilst leaving more water in the environment

Performance commitment: leakage

Detailed definition of performance measure: Leakage is measured on an average megalitres per day (Ml/d) a year basis. This is consistent with the Ofwat item reference BN2345.

Incentive type: Financial reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Ml/d	189.3	183.9	178.5	173.1	167.7	162.2
Penalty collar	Ml/d	N/a	211.9	206.5	201.1	195.7	190.3
Penalty dead band	Ml/d	N/a	N/a	N/a	N/a	N/a	N/a
Reward dead band	Ml/d	N/a	170.2	170.2	170.2	167.7	162.2
Reward cap	Ml/d	N/a	155.9	150.5	145.1	139.7	134.3

Incentive rates

Incentive type	Performance levels (Ml/d)		Incentive rate (£/Ml/d/year)
	Lower	Upper	
Penalty	162.3	211.9	0.241 million
Reward 1	170.1	162.2	0.075 million
Reward 2	162.1	134.3	0.112 million

Additional details

Necessary detail on measurement units	The measurement units are average Ml/d a year basis – Ofwat item reference BN2345.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Rewards and penalties will apply annually.
Form of reward/penalty	Adjustment to revenue.

Performance commitment: average water use

Detailed definition of performance measure: This measure is combined measured and unmeasured per capita consumption including changes to underlying occupancy rates. The unit of measurement is post- maximum likelihood estimation (MLE) weighted average litres per person per day on average over the year.

Reducing consumption in all conditions is most closely aligned with the normal year annual average (NYAA) condition as this reflects the underlying cumulative effect of change in consumption. Therefore, this is the most suitable scenario under which to report progress towards the outcome targets.

Incentive type: Financial penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	l/p/d	158.4	156.3	155.6	153.3	150.3	147.4
Penalty collar	l/p/d	N/a	N/a	N/a	N/a	N/a	N/a
Penalty deadband	l/p/d	N/a	N/a	N/a	N/a	N/a	N/a

Incentive rates

Incentive type	Performance levels (l/p/d)		Incentive rate (£/year)
	Lower	Upper	
Penalty 1	153.4	153.4	0.750 million
Penalty 2	147.5	147.5	1.750 million

Additional details

Necessary detail on measurement units	The unit of measurement is post-MLE weighted average litres per person per day on average over the year
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually
Timing and frequency of rewards/penalties	Penalties will be applied based upon a pass/fail assessment in year 3 (2017-18) and year 5 (2019-20) against our PC for that year.
Form of reward/penalty	Adjustment to revenue

Performance commitment: water available for use

Detailed definition of performance measure: Water available for use (WAFU) is made up of deployable output (the amount that works can produce and include any imports/exports) minus an amount for climate change, sustainability reductions and outages (planned and unplanned site failures). The units for WAFU are Ml/d average over the year.

The company will use its dry year annual average (DYAA) baseline forecast to monitor its performance in achieving its outcome as this is the scenario that influences capacity investment and corresponds to environmental benefits and these will be most obvious in a dry year condition. The company will measure changes in its baseline each year compared to the end year of 2010-15.

Incentive type: Financial penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Ml/d	1114.7	1110.4	1103.5	1100.8	1068.1	1067.0
Penalty collar	Ml/d	N/a	N/a	N/a	N/a	N/a	N/a
Penalty dead band	Ml/d	N/a	N/a	N/a	N/a	N/a	N/a

Incentive rates

Incentive type	Performance levels (Ml/d)		Incentive rate (£/year)
	Lower	Upper	
Penalty 1	1100.7	1100.7	0.590 million
Penalty 2	1066.9	1066.9	1.910 million

Additional details

Necessary detail on measurement units	The units for WAFU are Ml/d average over the year. Performance will be measured based on change from our DYAA baseline for end of 2010-15.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Penalties will be applied based upon a pass/fail assessment in year 3 (2017-18) and year 5 (2019-20) against the PC for that year.
Form of reward/penalty	Adjustment to revenue.

Performance commitment: sustainable abstraction reductions

Detailed definition of performance measure: This performance measure is the cumulative reduction of the company's average deployable output required by the end of the year. This is line with the company's water resources management plan.

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
PCs	Ml/d	0.0	-6.7	-12.5	-14.1	-42.1	-42.1
Penalty collar	Ml/d	N/a	0.0	0.0	0.0	0.0	0.0
Penalty deadband	Ml/d	N/a	N/a	N/a	N/a	N/a	N/a
Reward deadband	Ml/d	N/a	N/a	N/a	N/a	N/a	N/a
Reward cap	Ml/d	N/a	-6.7	-15.5	-35.7	-42.1	-42.1

Incentive rates

Incentive rate	Incentive rate (£/Ml/d/year)
Penalty	0.068 million
Reward	0.068 million

Additional details

Necessary detail on measurement units	Measurement units are Ml/d based upon the cumulative reduction of the company's average annual deployable output over 2015-20.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Rewards and penalties will apply annually.

Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	This ODI is related to the pace of delivery, rather than over- or under-performance of a service level. There is a single incentive rate of £0.068 million per Ml, which will apply as either a penalty or a reward depending on whether the company has over- or under-delivered against its PC in any given year.

Performance commitment: abstraction incentive mechanism (AIM)

Detailed definition of performance measure: Measure the effect of abstractions on specific water sources within the communities Affinity Water serves

Incentive type: Reputational

Performance commitments

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

Additional details

Necessary detail on measurement units	AIM is a reputational target for 2015-20 to reflect substantial progress with sustainability reductions.
Frequency of PC measurement and any use of averaging	Performance will be measured once at the end of the 2015-20 period.
Timing and frequency of rewards/penalties	Reputational incentive
Form of reward/penalty	N/a

Any other information or clarifications relevant to correct application of incentive	This incentive is in line with the proposals by Ofwat for a strong reputational incentive for abstraction reductions. This PC will be developed during 2015-20.

Wholesale water outcome: supplying high quality water you can trust

Performance commitment: compliance with water quality standards

Detailed definition of performance measure: The performance measure is mean zonal compliance. Mean zonal compliance is the average of the compliance rates (at zone level) for 39 parameters that are tested to establish the quality of water and is the main measure used by Drinking Water Inspectorate to demonstrate compliance.

Incentive type: Financial penalty only.

Performance commitments

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

Incentive rates

Incentive rate	Incentive rate (£/year)
Penalty	0.720 million

Additional details

Necessary detail on measurement units	The unit is percentage compliance with standards a year on a calendar year basis.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.

Timing and frequency of rewards/penalties	This will be a pass/fail annual assessment against the PC.
Form of reward/penalty	Adjustment to revenue.

Performance commitment: customer contacts for discolouration

Detailed definition of performance measure: This is a measure of customer contact for discolouration calculated as the weighted average (as per the current 2010-15 reference level). The unit is the number of contacts per 1,000 of population – an index score a year (calendar year).

Incentive type: Financial penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Number/ 1000/ population.	0.66	0.66	0.66	0.66	0.66	0.66
Penalty collar	Number/ 1000/ population.	N/a	1.30	1.30	1.30	1.30	1.30

Incentive rates

Incentive rate	Incentive rate (£/nr/1000/popn./year)
Penalty	0.438 million

Additional details

Necessary detail on measurement units	The unit is the number of contacts per 1,000 of population served – an index score a year (calendar year).

Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Penalties will be assessed annually.
Form of reward/penalty	Adjustment to revenue.

Wholesale water outcome: minimising disruption to you and your community

Performance commitment: unplanned interruptions to supply over 12 hours

Detailed definition of performance measure: This is the number of properties affected by an unplanned interruption to supply of over 12 hours. The definition is in line with Ofwat item reference BN1008, as used for the DG3 infrastructure serviceability measure through the 2010-15 period.

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
PCs	Number of properties	320	320	320	320	320	320
Penalty collar	Number of properties.	N/a	775	775	775	775	775
Penalty dead band	Number of properties.	N/a	505	505	505	505	505
Reward dead band	Number of properties.	N/a	135	135	135	135	135
Reward cap	Number of properties.	N/a	0	0	0	0	0

Incentive rates

Incentive rate	Incentive rate (£/property/year)
Penalty	5,410
Reward	975

Additional details

Necessary detail on measurement units	Measurement units are number of properties affected a year basis. The exact definition is in line with Ofwat item reference BN1008.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Rewards and penalties will apply annually.
Form of reward/penalty	Adjustment to revenue.

Performance commitment: number of burst mains

Detailed definition of performance measure: This is measured on number of mains bursts a year – Ofwat item reference BN1225. The number of mains bursts (excludes ferrule bursts FE2 and FE3) to enable consistent measurement on a unified single company basis.

Incentive type: Financial penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Number	3,100	3,100	3,100	3,100	3,100	3,100
Penalty collar	Number	N/a	4,350	4,350	4,350	4,350	4,350
Penalty deadband	Number	N/a	3,500	3,500	3,500	3,500	3,500

Incentive rates

Incentive rate	Performance levels (nr)		Incentive rate (£/nr/year)
	Lower	Upper	
Penalty	3,500	4,350	2,665

Additional details

Necessary detail on measurement units	The unit of measurement is number of mains bursts a year – Ofwat item reference BN1225.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.
Timing and frequency of rewards/penalties	Penalties will apply annually.
Form of reward/penalty	Adjustment to revenue.

Performance commitment: affected customers not notified of planned interruptions

Detailed definition of performance measure: This is a Guaranteed Standards of Service (GSS) measure – Ofwat item reference GSS00010. The definition is the number of customers not notified of a planned interruption to supply of over 4 hours' duration. The definition for 'customer' is that given in the Water Supply and Sewerage Services (Customers Service Standards) Regulations 2008.

Incentive type: Non-financial.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Number of GSS events	110	110	110	110	110	110

Incentive rates

While there is no financial ODI, every property, both domestic and non-domestic, that is affected will receive an enhanced GSS compensation payment of £50. Entitlement to payment will be assessed in accordance with the regulations and subject to the same limitations and exclusions.

Additional details

Necessary detail on measurement units	The measurement units are the number of GSS events – as defined by Ofwat item reference GSS00010.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.

Performance commitment: planned work taking longer to complete than notified

Detailed definition of performance measure: This is a Guaranteed Standards of Service (GSS) measure and is based on the overruns of planned and warned interruptions to supply – Ofwat item reference GSS00012.

Incentive type: Non-financial.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PCs	Nr. GSS events	550	550	550	550	550	550

Incentive rates

While there is no financial ODI, every property, both domestic and non-domestic, that is affected will receive an enhanced GSS compensation payment of £50. Entitlement to payment will be assessed in accordance with the regulations and subject to the same limitations and exclusions.

Additional details

Necessary detail on measurement units	The measurement units are the number of GSS events – as defined by Ofwat item reference GSS00012.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.

Household retail outcome: providing a value for money service

Performance commitment: SIM service score

Detailed definition of performance measure: Ofwat defined

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
SIM service score	SIM score	TBC	TBC	TBC	TBC	TBC	TBC

Additional details

Necessary detail on measurement units	Ofwat measure
Frequency of PC measurement and any use of averaging	Annually
Any other information or clarifications relevant to correct application of incentive	Incentive is comparative

Performance commitment: value for money survey

Detailed definition of performance measure: A quantitative value for money customer survey to support the specific assessment of the company's value for money measure. The survey will be complementary to the assessment of customer service delivered through SIM.

The survey will be developed in detail over the next few months with the input of CCWater, community groups and other relevant customer representative bodies such as the Citizens' Advice Bureau. The first survey will establish the company's baseline PC against which it will measure its performance during 2015-20.

Incentive type: Non-financial.

Performance commitments

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

Incentive rates

This is a non-financial ODI.

Additional details

Necessary detail on measurement units	To be confirmed following engagement with key stakeholders.
Frequency of PC measurement and any use of averaging	Performance will be measured against the PC annually.

Outcome delivery and reporting

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

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

Table AA4.7 Affinity Water's outcome delivery and reporting

Affinity Water's proposals	Our assessment
Affinity Water has a vision to be the leading community-focused water company and has split its region into eight local communities. To ensure it remains accountable to the communities it serves, it will report its operational performance at a community level. Affinity Water has developed a reporting tool (Navig-8) to reflect unique local issues and report on the condition of local assets. This tool offers communities the ability to view historical service as well as forecasts of expected future performance against levels of investment. Affinity Water will provide its communities with a clear picture of performance against its commitments within their local area and the ability to compare performance across the eight communities. The company has also developed a performance measurement framework, which incorporates the PCs and ODIs, a wider suite of KPIs (including customer, performance and financial indicators) as well as the newly developed asset health index. All performance data and recording processes will be subject to audit by an independent Reporter and challenged by a customer representative group. Overall, the company will, therefore, provide customers and stakeholders with sufficient information to form a rounded view of the company performance to ensure it is held to account.	We were impressed by the innovative approach Affinity Water is undertaking to engage better at a community level. We consider this has significant potential to increase customer understanding of the service they receive and further strengthen the customer voice. We also consider it ensures that the company is held directly accountable by, and maintains its focus on, its customers and not just its regulators.

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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