December 2014

Setting price controls for 2015-20

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

OFWAT

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Overview

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

We published 'Draft price control determination notice: company-specific appendix – Dee Valley Water' (the 'draft determination' for Dee Valley Water) on 29 August 2014. Dee Valley Water is not an enhanced company. It has been treated in the same way as the other non-enhanced companies.

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

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

The company's revised business plan in June, which sought to close the gaps we identified during the RBR, included 15 special cost factor claims that set out reasons why we should increase our cost threshold to close the gap with the company's business plan and contained a strengthened package of outcome delivery incentives (ODIs).

In the draft determination, we intervened in a number of areas, including wholesale costs where we had not agreed with 11 of the company's special cost factor claims and its proposed wholesale expenditure was 12% above our cost threshold. We also noted a number of concerns about the quality of data and assurance the company provided as part of its revised business plan.

The company's representation on the draft determination, accompanied by third party assurance, focused mainly on:

- some of our outcome interventions, with a focus on discoloured water contacts, number of bursts and interruptions to supply;

- adjustments to costs within the wholesale water control, in particular providing evidence to support eight of its special cost factor claims;
- arguing for a company-specific uplift to the cost of capital; and
- changes to pay as you go (PAYG) rates to achieve a flat bill profile during the 2015-20 period.

We also received representations from the CCG, Natural Resources Wales, and the Consumer Council for Water (CCWater) on the draft determination, which broadly supported the determination, but expressed concern whether the company would be able to provide the services expected by customers as we had not agreed with its special cost factor claims.

In reaching the final determination, we have carefully considered representations we received on the draft determination (which was based upon the latest business plan submitted to us) and taken account of the most up-to-date information available where appropriate. As a result, this has led to changes that we consider are in the interests of customers and in line with our other statutory duties, including the following.

- We accepted further special cost factor claims that now have sufficient and convincing evidence, which has reduced the cost gap to 4% (we consider that our cost threshold already includes sufficient expenditure for the other claims).
- We have introduced two performance commitments and ODIs to protect customers if two large projects associated with agreed special cost factor claims are not delivered.
- Following updated information, we have removed the efficiency challenge for non-household retail costs.
- Following updated information, we have added a downwards adjustment (or shortfall) to reflect an aspect of performance in 2010-15.
- In line with all non-enhanced companies, we reduced the allowed return to 3.6% for the wholesale business to reflect the significant movement in the cost of new debt since the publication of our risk and reward guidance in January 2014 – we did not accept the company's proposed company-specific uplift to the allowed return.

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

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):

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

- wholesale water;
- 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.

Our approach to the final determination for Dee Valley Water reflects the different policy position of the Welsh government and the fact that those customers in Wales using less than 50 megalitres (Ml) of water a year will not be able to choose their supplier during the next five years. Dee Valley Water will therefore not be subject to the same competitive pressures as companies in England and customers will not see the same benefits or get the same protection from the market over service levels and prices. Our determinations for companies operating wholly or mainly in Wales therefore include a non-household service incentive mechanism (SIM) and a non-household cost efficiency challenge, if appropriate, to provide protection for customers. They also take into account the lower level of risk these companies are exposed to when determining remuneration to investors.

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

- the responses that we have received to our draft determination and any consequential adjustments that we have made;
- the outcomes for the company to deliver and associated 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; and
- the uncertainty mechanisms that form part of each price control.

Implementing these price limits

Dee Valley 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 Dee Valley Water's licence and the Water Industry Act 1991.

We consider that Dee Valley Water must act in an economic and efficient manner in delivering all of its obligations.

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

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

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

A1 Final determination – at a glance

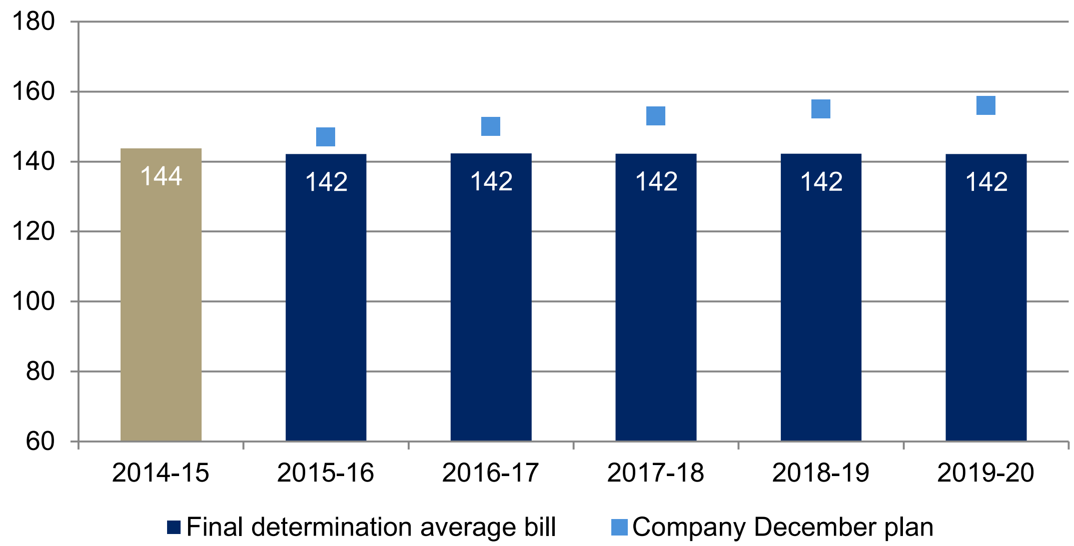
This chapter provides a summary of the final determination for Dee Valley Water. It summarises what the final determination will mean for customers, with respect to the average bills they will pay and the outcomes that the company will deliver in return, and for the company in terms of its allowed costs and revenues, return on regulatory equity and financeability ratios. We also summarise the interventions we have made to the company's revised plan in order to protect 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 £142, which is 1.4% lower than current average bill levels (of £144).

The difference between the company's December plan and our final determination is the result of the company's acceptance of our risk and reward guidance, other revisions to its plan and the interventions we have made in its plan. This represents a cumulative saving of £50 for the average customer over the 2015-20 period.



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 the revised business plan.

The outcomes committed to by Dee Valley Water

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

The table below sets out Dee Valley Water's outcomes. These outcomes reflect the priorities of customers set out in research and engagement with the CCG. We have undertaken comparative assessment of outcomes where it was possible to draw comparisons across the sector and, where necessary, we have intervened to challenge companies to deliver an upper quartile level of performance. Details of the types of incentives and level of performance commitments associated with these outcomes are set out in annex 4.

Wholesale water	
Provide excellent water quality Provide reliable and high quality customer service Minimise the environmental impact Provide a value for money service	
Household retail	**Non-household retail**
Provide reliable and high quality customer service	Provide reliable and high quality customer service

Allowed costs and revenue for Dee Valley Water

The table below shows the wholesale total expenditure (totex) we have allowed over the period from 2015 to 2020. The final determination allows Dee Valley Water to receive revenues from wholesale water and household retail of £118 million. This combines allowed revenues for the wholesale and household retail controls. For non-household retail, we have set average revenue controls per customer for each of the customer types proposed by the company. The £1.7 million of non-household revenue shown in the table below is indicative, as it does not assume any gains or losses from competition or the company charging customers at levels different to the relevant default tariffs.

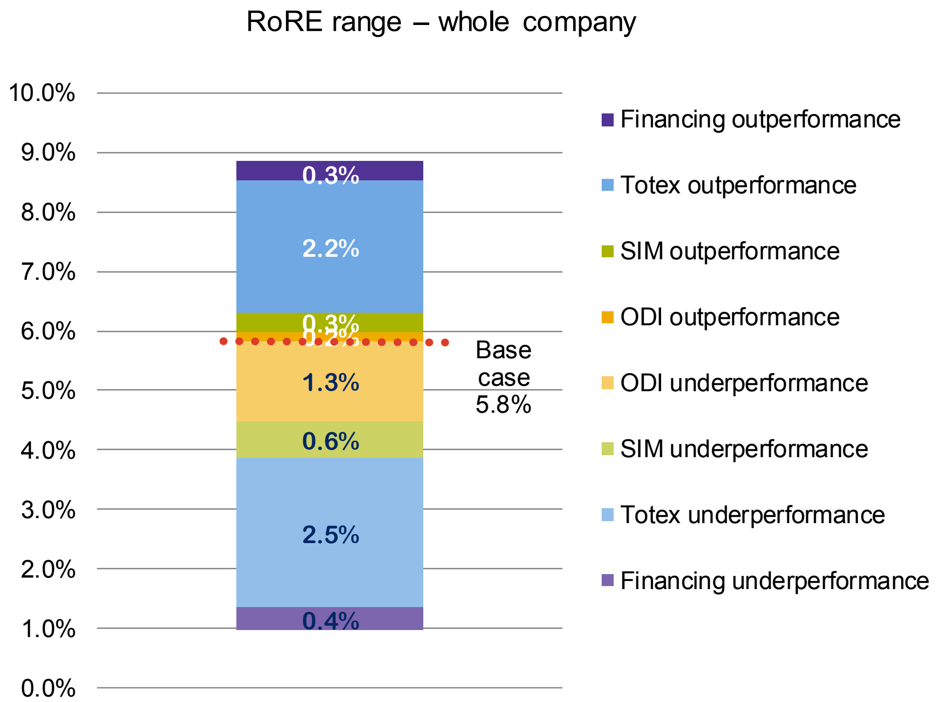
Wholesale	Water
Totex 2015-20 total (£m)	99.1
Allowed return (%)	3.60%
Allowed wholesale revenue 2015-20 (£m)	103.4

Retail	Household	Non-household
Cost allowance – 2015-20 total (£m)	13.9	
Margin (%)	1.00%	1.36%
Retail allowed revenue (£m)	14.8	1.7

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

RoRE ranges – appointee

Dee Valley 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[2]. We have identified the RoRE impact separately for outcome delivery incentives (ODIs), totex performance, financing and the SIM. We note that Dee Valley Water's actual returns may differ from notional returns due to differences between notional and actual capital structure and notional and actual cost of debt and level of cost efficiency compared to allowed totex and household retail average cost to serve (ACTS).



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

[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.

Our calculation of notional financeability ratios

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

We sought additional assurance from Dee Valley Water that its plan was financeable on the basis of a notional and an actual structure. The company subsequently provided this assurance.

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

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

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover (ICR)	3.33
Adjusted cash interest cover ratio (ACICR)	1.52
Funds from operations (FFO)/debt	10.87%
Retained cash flow/debt	8.43%
Gearing	67.59%
Dividend cover (profit after tax/dividends paid)	1.28
Regulatory equity/regulated earnings for the regulated company	15.97
Regulatory capital value (RCV)/earnings before interest, taxes, depreciation and amortisation (EBITDA)	9.39

Summary of interventions

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

Outcomes	Wholesale costs
• **Cap**: We retained the overall cap and collar on ODIs of +/- 2% of RoRE that we proposed at the draft determination, though we have excluded two performance commitments. • **Comparative assessments**: We intervened in four of the company's performance commitments (PCs) and ODIs but for three of these we also made specific adjustments to reflect the company's proposals and its current performance. • **Company-specific assessments**: We intervened to set one PC, and the associated ODI, at a level that delivers more for customers, though we also introduced a glidepath. • We added three new PCs and ODIs. Two are for delivery of two major water quality schemes determination, the other is a non-household customers SIM.	• The company proposed wholesale water totex of £103m in its plan, which is £4 million (4%) above our final determination threshold of £99 million. • We have not accepted four of the company's adjustments and partially allowed three of them. We also made some adjustments to reflect our modelling approach.
Retail	**Reconciling 2010-15 performance**
• We have used 2013-14 prices to set both the household and non-household retail control. • We have not accepted the company's proposed claim for input price pressure.	• We have intervened on the company's proposed revenue adjustments, but there is no overall impact on its proposed revenue adjustments. • We have shortfalled the company £0.7 million for its performance on discoloured water contacts. • We have increased the company's proposed RCV adjustment by £1.5 million to reflect the difference between the capital expenditure in 2009-10 that we assumed in our 2009 final determinations and actual expenditure.
Risk and reward	**Financeability and affordability**
• Based on the latest market evidence for the cost of new debt we have reduced the company's allowed return from 3.7% to 3.6%. • We have not accepted the company's proposed company-specific uplift to the allowed return of 45 basis points.	• No intervention.

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 Dee Valley 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 Dee Valley Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	Dee Valley Water CCWater	Annex 4
Outcome delivery and reporting	None	Annex 4
Calculating allowed wholesale water expenditure	Dee Valley Water, Natural Resources Wales, CCWater and CCG	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	Dee Valley Water	Section A2.3.2 and A5.5
Return on the RCV	Dee Valley Water CCWater	Section A2.3.3
Reconciling 2010-15 performance	Dee Valley Water	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

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

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

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

- comparative assessments where it was possible to compare performance commitments and incentives across the sector and so challenge companies to deliver an upper quartile level of performance so that companies are focused on delivering benefits for customers and the environment; and,
- company-specific assessments to ensure that the performance commitments proposed by each company are challenging, appropriately incentivised and supported by customer engagement.

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

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

Consistent with our proposal at draft determination, we are intervening to impose an overall cap and collar on ODIs for the 2015-20 period, thereby limiting total rewards and penalties. The cap and collar will apply in line with the approach set out in policy chapter A2. The performance commitments that are excluded from the cap and collar are A3: Delivery of the outcomes of the Legacy treatment works major scheme and A4: Delivery of the outcomes of the service reservoir water quality risk management schemes.

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

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

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
Provide excellent water quality	Discoloured water contacts	Financial – reward and penalty	**Comparative assessment:** We confirm our draft determination interventions to change the performance commitment levels, deadband range and penalty collar to incentivise upper quartile performance. Our revised assessment of upper quartile levels and deadbands has led to minor changes as set out in annex 4. For the final determination, we also changed the penalty collar to reflect its shortfall for poor performance in 2010-15.
	Mean zonal compliance	Financial – penalty only.	**Comparative assessment:** We confirm our draft determination interventions to change the performance commitment levels, and deadband range to incentivise upper quartile performance. Our revised comparative assessments for final determination have led to a less demanding penalty deadband from 2017-18 though we have maintained the intervention to the penalty deadband in 2015-16 and 2016-17. For the final determination, we also accepted the company's proposal to target 100% compliance in every year of the period.

Company proposal			Intervention
Outcome	**Performance commitment**	**Incentive type**	
	Delivery of the outcomes of the Legacy treatment works major scheme	Financial – penalty only.	**Company-specific assessment**: We increased the incentive we introduced in our draft determination to cover non-delivery of its Legacy WTW scheme and introduced an incentive to cover any delays in delivery of the scheme.
	Delivery of the outcomes of the Service reservoir water quality risk management schemes	Financial – penalty only.	**Company-specific assessment**: For the final determination, we added this performance commitment and incentive as these schemes now pass the wholesale cost tests and so it is appropriate to protect customers against any delays in delivery of these schemes.
Provide reliable and high quality customer service	Average duration of interruptions	Reputational	**Comparative assessment:** We confirm our draft determination intervention to change the committed performance levels and introduce rewards and penalties (and associated deadbands). Our revised assessment of upper quartile levels and deadbands has led to minor changes as set out in annex 4. For our final determination, we also made a company-specific adjustment to the penalty range to reflect the low level of penalties associated with asset health commitments.

Company proposal			Intervention
Outcome	**Performance commitment**	**Incentive type**	
	Sustainable economic level of leakage target	Financial – reward and penalty	**Comparative assessment**: We confirm our draft determination intervention to increase the penalty rate.
	Security of supply index	Reputational	No intervention
	Number of bursts	Financial – reward and penalty	**Company-specific assessment:** We confirm our draft determination interventions to make the performance commitment level, deadbands, caps and collars more demanding. We also introduced a two-year glidepath and adjusted the penalty range to reflect the low level of penalties associated with asset health commitments.
Minimise the environmental impact	Gross operational greenhouse gas emissions	Reputational	No intervention
Provide a value for money service	Customers' perception based on market research	Reputational	**Company-specific assessment**: We confirm our draft determination clarification that the performance commitment is to deliver improved levels of customers' perception each year following setting the baseline in 2015-16.

A2.2.2 Outcome delivery and reporting

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

A2.3 Calculating the wholesale water price control

A2.3.1 Calculating allowed wholesale water expenditure

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

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

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

Respondent	Summary of comment	Ofwat response
Dee Valley Water	The company made representations on: • service reservoir water quality risk management; and • reservoir safety. It provided additional third party evidence for its claims, particularly where it had failed the robustness of cost test at the draft determination stage.	We have made adjustments to our cost threshold for these claims as the company provided sufficient and convincing evidence against each of assessment criteria. Further information about our assessment of the claims is set out in annex 1 of this document and the populated version of the final determination cost threshold models.

Respondent	Summary of comment	Ofwat response
	The company made representations on: • Legacy treatment works and mains cleaning; and • scale effects. It provided additional third party evidence for its claims, particularly where it had failed the robustness of cost test at the draft determination stage.	We have made partial adjustments to our cost threshold for these claims. In both cases, this is because the company only partially passed our robustness of costs assessment criteria. We also corrected for an error we made in adjusting for the Legacy water treatment works cost claims. Further information about our assessment of the claims is set out in annex 1 of this document and the populated version of the final determination cost threshold models.
	The company made representations on: • Wrexham pumping station upgrade; • sludge handling; • mains renewal programme; and • water treatment complexity. It provided additional third party evidence for its claims, particularly where it had failed the robustness of cost test at the draft determination stage.	We have not made adjustments to our cost thresholds for these claims as in each case the company did not provide sufficient and convincing against our need assessment criteria, in particular that the costs were not already reflected in our threshold. Further information about our assessment of the claims is set out in annex 1 of this document and the populated version of the final determination cost threshold models.
Natural Resources Wales and CCWater	Natural Resources Wales and CCWater were concerned that some special cost factor claims were not accepted when they were of direct relevance to outcomes that they supported.	Companies need to deliver on their statutory obligations and provide the expected level of customer service. The cost thresholds, following our adjustments, provide sufficient funds for an efficient company to deliver against these needs.

Respondent	Summary of comment	Ofwat response
CCG	The CCG confirmed its support for the special cost factor claims set out in the company's representations as they assured the delivery of services and the performance levels expected by the customers.	Companies need to deliver on their statutory obligations and provide the expected level of customer service. The cost thresholds, following our adjustments, provide sufficient funds for an efficient company to deliver against these needs.

Following representations, the company's proposed wholesale water totex is £103 million over 2015-20 (versus £102 million in its December plan). This is 4% above the final determination cost threshold of £99 million.

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Final determination cost threshold						99.0
Costs excluded from menu	0.3	0.3	0.3	0.3	0.3	1.6
Menu cost baseline[1]	20.6	24.5	21.3	15.1	15.9	97.5
Company's view of menu costs[2]						101.2
Implied menu choice						103.8
Allowed expenditure from menu	20.8	24.8	21.5	15.3	16.0	98.4
Costs excluded from menu	0.3	0.3	0.3	0.3	0.3	1.6
Total allowed expenditure[3]	21.1	25.1	21.8	15.6	16.4	100.0

	2015-16	2016-17	2017-18	2018-19	2019-20	Total 2015-20
Less pension deficit repair allowance	0.2	0.2	0.2	0.2	0.2	0.9
Totex for input to PAYG	20.9	24.9	21.7	15.4	16.2	99.1

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

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

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

Table A2.5 shows the PAYG rates and the amount of totex recovered for wholesale water, which we have used as the basis for this final determination. The 'Resulting PAYG (£m)' is the amount of money recovered from customers in the short term. Table A2.6 shows the RCV run-off amounts included within the wholesale water charge. This is the amount of money recovered in the long term through the company's RCV.

Table A2.5 Dee Valley Water's wholesale water PAYG rates

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	20.9	24.9	21.7	15.4	16.2	99.1
PAYG (%)	54.3%	45.5%	50.6%	71.1%	69.5%	58.2%
Resulting PAYG (£m)	11.4	11.3	11.0	11.0	11.2	55.9

Note:
The figures in this table reflect the company's change in PAYG rates as described in section A5.5 on financeability.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Run-off of 2015 RCV	4.0	3.8	3.6	3.3	3.1	17.9

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
RCV run-off of totex additions	0.2	0.6	1.0	1.2	1.4	4.4
Total RCV run-off	4.2	4.4	4.5	4.6	4.5	22.3

Note:
The figures in this table reflect a run-off rate of 6.1% for the RCV as at 31 March 2015 and 29 years for the totex additions to the RCV over 2015-20.

A2.3.3 Return on the RCV

As stated in policy chapter A3, the return on the RCV is a key component of allowed wholesale revenues. The return on the RCV is the wholesale 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 of 3.7%. The company accepted this guidance in its revised business plan, though it also proposed a company-specific uplift to the cost of capital. As set out in policy chapter A7, based on the latest market evidence for the cost of new debt we have set the wholesale cost of capital at 3.6%. This results in a return on capital of £14.5 million over 2015-20.

Table A2.7 Representations specific to the cost of capital wholesale water totex for Dee Valley Water

Respondent	Summary of comment	Ofwat response
Dee Valley Water	Dee Valley Water stated that due to its size it has had only one opportunity to source efficiently priced long term debt funding. It considers we should make an allowance for its higher cost of embedded debt, which it considers was efficiently incurred at the time. The total size of the uplift was equivalent to 45 basis points on the allowed return.	As set out in the annex to policy chapter A7, companies need to demonstrate that they face both a higher cost to raising finance and an offsetting benefit to customers. We accept that Dee Valley Water does have higher costs. However, we do not consider that there are benefits to customers that are sufficient to justify passing through these higher financing costs to customers. We have therefore not accepted Dee Valley Water's proposed company-specific uplift to the allowed return.
CCWater	CCWater supported our draft determination in this area, where we did not accept the company's proposed specific uplift.	See above

Table A2.8 shows our calculation of the opening RCV at 1 April 2015 taking account of the adjustments for 2010-15 performance discussed in section A2.3.4 below. The average RCV, set out in Table A2.9 for each year, takes into account the proportion of totex additions to the RCV determined by the PAYG rate and RCV run-off as set out in Table A2.5 and Table A2.6 above.

Table A2.8 Dee Valley Water's wholesale water opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	68.4
Land sales[1]	-0.1
Adjustment for actual expenditure 2009-10[2]	1.5
Adjustment for actual expenditure 2010-15[3]	-3.2
Net adjustment from logging up and logging down[3,4]	0.4
Adjustment for shortfalls[3,4]	0.0

	2015-16
Adjustment for serviceability shortfalls[5]	-0.7
Other adjustments[6]	0.0
Opening RCV 1 April 2015	66.3

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 incentive scheme (CIS) adjustment as set out in table AA3.16.
4. The net adjustment from the change protocol is set out in table AA3.8.
5. The serviceability shortfall adjustment is set out in table AA3.11.
6. Other RCV adjustments are set out in table AA3.19.

Table A2.9 Dee Valley Water's wholesale water return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	66.3	71.7	80.9	87.0	86.9
RCV additions (from totex)	9.6	13.6	10.7	4.5	4.9
Less RCV run-off	4.2	4.4	4.5	4.6	4.5
Closing RCV	71.7	80.9	87.0	86.9	87.2
Average RCV (year average)	69.0	76.3	83.9	86.9	87.1
Return on capital	2.5	2.7	3.0	3.1	3.1

A2.3.4 Reconciling 2010-15 performance

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

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

The company proposed adjustments to the opening RCV and allowed revenue for the wholesale water services to reconcile performance in 2010-15. We have intervened, however the revenue adjustments for wholesale water remain at £3.9 million. We summarise these interventions in Table A2.10 below. The impact on the opening RCV of 2010-15 adjustments is shown in Table A2.8 and we discuss our interventions in this area further in annex 3.

The main changes we have made in the final determination in reconciling the company's 2010-15 performance result from our review of the company's latest information on discolouration contacts, where we are now shortfalling the company, and our revised adjustment to the RCV for actual expenditure in 2009-10.

When making these final determinations we do not have the full information on companies' performance in 2014-15. We set 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 A2.10 Dee Valley Water's wholesale water revenue adjustments to reflect 2010-15 performance (£ million)

Area of intervention	Intervention		Total revenue adjustment 2010-15 (post intervention)	
		Company view	Draft determination	Final determination
SIM	We have increased the SIM performance penalty to take account of latest information, but this reduces revenue by less than £0.1 million.	-0.0	-0.1	-0.1
RCM	We have intervened to correct information used in the mechanism. Combined, these interventions increased revenue by £0.1 million compared with the company's revised business plan.	4.9	5.0	5.0
Opex incentive allowance (OIA)	There are no interventions in this area.	0.0	0.0	0.0
CIS	As for all companies, we have used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period. Combined these interventions reduced revenue by less than £0.01 million compared with the company's revised business plan.	-1.0	-1.0	-1.0
Other adjustments	There are no interventions in this area.	0.0	0.0	0.0

A2.3.5 Calculation of allowed revenue

We set out the calculation of the allowed revenue for Dee Valley Water's wholesale water control in Table A2.11.

Overall, Dee Valley Water's wholesale revenue allowance will be £20.4 million in 2015-16, increasing by 2.7% to £21.0 million in 2019-20

Table A2.11 Dee Valley Water's wholesale water allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	20.9	24.9	21.7	15.4	16.2	99.1
PAYG rate (%)	54.3%	45.5%	50.6%	71.1%	69.5%	
Totex additions to the RCV	9.6	13.6	10.7	4.5	4.9	43.2
RCV (year average)	69.0	76.3	83.9	86.9	87.1	
Wholesale allowed revenue build up:						
PAYG[1]	11.6	11.5	11.1	11.1	11.4	56.7
Return on capital	2.5	2.7	3.0	3.1	3.1	14.5
RCV run-off	4.2	4.4	4.5	4.6	4.5	22.3
Tax[2]	0.4	0.3	0.3	0.2	0.2	1.4
Income from other sources[3,4]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Reconciling 2010-15 performance	0.8	0.8	0.8	0.8	0.8	3.9
Ex ante additional menu income	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Wholesale allowed revenue adjustments:						
Profiling adjustments[5]	0.0	0.0	0.0	0.0	0.0	0.0
Capital contributions from connection charges and revenue from infrastructure charges	1.2	1.1	1.1	1.1	1.1	5.7

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Final allowed revenues	**20.4**	**20.5**	**20.7**	**20.8**	**21.0**	**103.4**

Notes:
1. PAYG includes the PAYG calculated from totex and the pension deficit repair allowance.
2. Including tax on adjustments for reconciling 2010-15 performance and ex-ante additional menu income.
3. We have adjusted other income values to remove the deferred income element relating to IFRIC18, as this is an accounting adjustment.
4. Our assessment of income from other sources is discussed in section A3.3 of policy chapter A3.
5. Our bill profiling adjustments are discussed in section A5.6

A2.4 Uncertainty mechanisms

We have set the company's allowed revenues for the 2015-20 period. All companies face uncertainty about future costs and revenues 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 A2.12 below, we set our final assessment of Dee Valley Water's proposed wholesale water uncertainty mechanisms.

Table A2.12 Dee Valley Water's wholesale water uncertainty mechanisms

Assessment at draft determination	Our final assessment
In the draft determination we amended Dee Valley Water's proposed uncertainty mechanism for water business rates, making it a notified item and introducing a 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.

Assessment at draft determination	Our final assessment
We did not accept Dee Valley Water's proposed uncertainty mechanisms for costs associated with Traffic Management Act, supply pipes transfer and the introduction of competition.	No change to draft determination position given that we had already not accepted the mechanism and the company and third parties have not objected. This does not affect the company's responsibility to meet all statutory obligations. The final determination provides funding for the company for the 2015-20 period and it is the company's responsibility to manage any uncertainty. We note that there are a range of existing mechanisms available to companies to manage uncertainty, including: • totex sharing menu; • interim determinations of K (IDoKs); and • substantial favourable effects and substantial adverse effects clauses in Condition B of the licence.

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 Dee Valley 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 Dee Valley Water

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Outcomes, performance commitments and incentives	CCWater	Annex 4
Outcome delivery and reporting	None	Annex 4
Allocation of costs	Dee Valley Water	Section 3.3.1
Adjustments	Dee Valley Water	Section A3.3.2 and annex 2
New costs	Dee Valley Water	Section A3.3.3 and annex 2
Uncertainty mechanisms	None	Section A3.5

A3.2 Outcomes, performance commitments and incentives

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

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

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

Table A3.2 below summarises the outcomes, performance commitments and ODIs for Dee Valley Water's household retail control.

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

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

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

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
Provide reliable and high quality customer service to non-household customers	Per capita consumption and water efficiency	Reputation only	No intervention
	Service incentive[1] mechanism	Reward and penalty	No intervention

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

A3.3 Costs

Our approach to the household retail control is 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.

We received a representation from CCWater that it was concerned that the household efficiency challenge should not jeopardise customer service. It noted that higher bills were supported by customers. We considered this in the context of the overall retail methodology. The methodology specifically includes a three year glide path to make the efficiency challenge achievable and so we consider the company can meet the efficiency challenge without jeopardising customer service. We consider we have set the efficiency challenges at a rate that allows a company to provide an efficient service and be financeable.

A3.3.1 Allocation of costs

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

Table A3.3 Our assessment of Dee Valley Water's cost allocation methodology

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

Dee Valley Water provided us with a copy of its external assurance report over its cost allocations. However, we are not satisfied with the scope of the external assurance report as it does not provide us with assurance that the company has allocated its costs in accordance with our cost allocation guidance.

We have therefore scrutinised this area carefully as we could not place confidence in the assurance.

Following our review, we are satisfied that the company has addressed the cost allocation issues we highlighted in the draft determination (including reallocation of costs in line with our guidance) with the exception of its allocation of developer services and disconnection costs between retail and wholesale, which is not in line with our guidance. However, we consider that any potential misallocation of these costs is likely to be immaterial. 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.

The net impact of the reallocations for our final determination is an increase in household retail costs for 2013-14 of £0.057 million and a decrease in non-household retail costs for 2013-14 by £0.159 million.

A3.3.2 Adjustments

In its revised business plan, submitted in June 2014, Dee Valley Water sought adjustments to the ACTS for:

- pension deficit repair costs;
- customer communications costs;
- social tariffs;
- new development costs; and
- input price pressure.

Pension deficit repair costs

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

Customer communications costs

The company's proposed adjustment for customer communication costs is immaterial and has been added onto the base operating expenditure as a new cost.

Social tariffs

The company's proposed adjustment for social tariffs is immaterial and has been added onto the base operating expenditure as a new cost.

New development costs

The company's proposed adjustment for new development costs is immaterial and has been added onto the base operating expenditure as a new cost. As part of the new development costs relates to metering of new customers we have reallocated this to the additional cost to serve metered customers.

Input price pressure

In the final determination, we have not accepted the company's input price pressure adjustment. Our final assessment is unchanged from the draft determination.

We have assessed the company's proposed adjustments for customer communication costs, new development costs and social tariff costs as new costs. We set out our assessment of new costs in section A3.3.3.

Table A3.4 outlines our assessment of Dee Valley Water's proposed ACTS adjustments. The value of the adjustments we have accepted in our final determination is summarised in table A3.5. Further details on our assessment, and our response to any representations we received on our draft determination that are specific to this aspect of the company's household retail control determination, are set out in annex 2.

Table A3.4 Our assessment of Dee Valley Water's proposals for ACTS adjustments

<table>
<tr><th colspan="2"></th><th colspan="4">Adjustment assessment criteria</th></tr>
<tr><th>Adjustment</th><th>Value (£m over 2015-20)</th><th>Materiality</th><th>Beyond efficient management control</th><th>Impact company in materially different way</th><th>Value of adjustment appropriate</th></tr>
<tr><td rowspan="2">Input price pressure</td><td rowspan="2">1.5</td><td rowspan="2">Pass</td><td rowspan="2">Fail</td><td>Efficiency benchmarking evidence: Fail</td><td rowspan="2">N/a</td></tr>
<tr><td>Upper quartile: Fail</td></tr>
</table>

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.038	0.038	0.038	0.038	0.038	0.192
Adjustments included in final determination	**0.038**	**0.038**	**0.038**	**0.038**	**0.038**	**0.192**

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

A3.3.3 New costs

In the final determination we have found Dee Valley Water's new costs are not material at 0.8% of household retail operating expenditure plus depreciation over 2015-20. As the costs are not material, we have made no further assessment of the evidence to support these costs. We have therefore included these immaterial new costs in the calculation of ACTS and allowed revenues. Further details on our assessment, and our response to any representations we received on our draft determination that are specific to this aspect of the company's household retail control determination, are set out in annex 2. 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	0.14

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 accepted our draft determination intervention to set the household net margins at 1%. This is in line with our risk and reward guidance and our further consideration of margins following representations on draft determinations.

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	21.6					
Metered water only customers	24.6					
Industry ACTS (£/customer)						
Unmetered single service customers	21.47					
Metered water only customers	27.26					
Allowed cost to serve[1] (£/customer)						
Unmetered single service customers		21.4	21.4	21.4	21.4	21.4
Metered water only customers		24.4	24.5	24.4	24.4	24.4
Total allowed (£m)						
Cost to serve (excluding net margin)		2.7	2.8	2.8	2.8	2.8

	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Forecast household wholesale charge (including forecast RPI[2])[3]		17.9	18.5	19.2	19.9	20.6
Household retail revenue (including an allowance for the net margin)[4]		2.9	2.9	3.0	3.0	3.0

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

A3.5 Uncertainty mechanisms

We outline our approach to uncertainty mechanisms in policy chapter A7. Dee Valley Water did not propose any household retail uncertainty mechanisms.

A4 Non-household retail

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

In this chapter, we provide details of Dee Valley Water's non-household retail price control.

In line with Welsh Government policy, non-household customers of companies operating wholly or mainly in Wales using less than 50 Ml of water per year are not expected to be able to choose their supplier during the next five years. As such, we have taken a different approach to companies operating wholly or mainly in Wales to protect non-household customers. This includes applying a non-household SIM that applies to Dee Valley Water. We do not consider we need to apply an efficiency challenge for the company's non-household costs (see section A4.5).

A4.1 Consideration of representations on our draft determinations

In policy chapter 1, we provide a list of the respondents to the draft determinations published in April, May and August of this year. We have fully considered all of the responses received, and where appropriate, we have made either consequential adjustments to our industry-wide approach or company-specific interventions.

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

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

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

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Net margins	Dee Valley Water	Section A4.3
Cost proposals	Dee Valley Water	Section A4.4

Area	Company-specific representations	Detailed commentary in this company-specific appendix
Form of control	Dee Valley Water	Section A4.6

A4.2 Indicative non-household retail total revenue

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20
Indicative non-household retail total revenue price control including net margins	0.3	0.3	0.3	0.4	0.4

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

A4.3 Net margins

Table A4.3 Representations specific to the non-household retail control for Dee Valley Water

Respondent	Summary of comment	Ofwat response
Dee Valley Water	Since the draft determination, the company has sought to adopt Ofwat's risk and reward guidance.	We have corrected a small error that the company made in the profiling of the net margin for its contestable customers.

Respondent	Summary of comment	Ofwat response
Dee Valley Water	The company reviewed its cost allocation approaches between customer types and proposed a new allocation.	We have accepted the company's revised allocation.

Since its revised business plan the company has changed its proposed net margins to equal 1.0% in aggregate for its non-contestable customers and 2.5% in aggregate for its contestable customers. 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. However, there was an error in the profiling of the 2.5% within the company representations. We have corrected for this in our determination so that it is 2.5% for every year of the control period as per our risk and reward guidance.

A4.4 Cost proposals

In its representations, the company proposed a change to its cost allocations between different non-household retail customer types.

In the draft determination, we intervened to proportion costs between two customer types based on the contestable/non-contestable customer numbers. This was so we could apply an efficiency challenge for the non-contestable customers, and a different net margin could be applied between the two customer types.

The company's proposed changes provide an allocation between the contestable/non-contestable customer types that is not simply based on customer numbers, and seek to correct for the non-cost reflective approach the company used to allocate costs in its revised business plan. Upon reviewing the proposed changes, we did not identify any concerns with the company's proposals. We have therefore accepted the company's updated allocations.

As set out in policy chapter A6, we have adjusted companies' costs to align to the 2013-14 base year. Historical costs are therefore presented in 2013-14 prices, and all future costs and revenues in nominal prices. As set out in policy chapter A6, we expect our decisions on the total level of non-household retail costs will still apply for years 2017-18 to 2019-20 – the 2016 review will focus on the allocations between different non-household customer types. As noted in section A3.3.1, we are not satisfied with the scope of the external assurance report for retail cost allocation, and have therefore scrutinised this area carefully.

In IN 13/17: 'Treatment of companies' pension deficit repair costs at the 2014 price review' we explained how we would treat the costs associated with water companies reducing the deficits in their defined benefit pension schemes at the 2014 price review. Where companies' proposals have differed from our calculations, we have over-written their proposals in line with our overall approach. This resulted in the company's proposals being adjusted from £0.035 million over the control period, to £0.031 million. In total, this resulted in the company's proposed costs being adjusted from £1.286 million over the control period to £1.282 million (pre-efficiency challenge).

A4.5 Efficiency challenge

In our final methodology statement, we confirmed that we would set an up-front non-household efficiency challenge for companies operating wholly or mainly in Wales, by comparing their cost allocations for given customer types with equivalent costs in England.

In setting the benchmark for the company, we have compared costs across the industry for two different customer types:

- water unmeasured; and
- water measured (<50 Ml).

The implied efficiency challenge from each customer type is weighted by the number of customers the company has by each customer type to arrive at the overall efficiency challenge.

In our draft determination, this gave an efficiency challenge for Dee Valley Water of 26% by 2018-19 (from pre-efficient 2015-16 levels), or £0.365 million in total over 2015-20.

As part of its representations, the company provided us with updated cost allocations between household and non-household retail. In total, this decreased the amount of costs allocated to non-household retail by £0.422 million over 2015-20.

As would be expected, this makes the company look more efficient for non-household retail than its previous submission. Applying the same methodology as we did for the draft determination, the company's cost profile now appears slightly more efficient than industry average. We have therefore accepted the company's cost profile without applying an additional efficiency challenge.

In total, this resulted in the company's proposed costs being adjusted from £1.286 million over the control period to £1.282 million.

A4.6 Form of control

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

A4.7 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 Dee Valley 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 A4.4 Non-household retail average controls per customer

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Tariff band 01 – Unmeasured	£	28.34	28.70	28.94	29.07	29.45
	%	1.0%	1.0%	1.0%	1.0%	1.0%
	£ (r)	30.95	31.41	31.76	31.98	32.44
Tariff band 02 – Measured less than 50Ml	£	31.01	31.38	31.62	31.75	32.11
	%	1.0%	1.0%	1.0%	1.0%	1.0%
	£ (r)	37.01	37.60	38.11	38.50	39.14
Tariff band 03 – Untreated measured less than 50Ml	£	28.90	29.90	29.90	29.90	29.90
	%	1.0%	1.0%	1.0%	1.0%	1.0%
	£ (r)	148.75	153.78	159.49	165.85	170.51
Tariff band 04 – Large user	£	29.90	29.90	29.90	29.90	29.90
	%	2.5%	2.5%	2.5%	2.5%	2.5%
	£ (r)	7,926.76	8,258.20	8,613.71	8,982.94	9,343.30

Customer type	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Tariff band 05 – Measured 50ML – 250 ML	£	31.56	31.56	31.56	31.56	31.57
	%	2.5%	2.5%	2.5%	2.5%	2.5%
	£ (r)	2,424.92	2,520.35	2,631.60	2,743.88	2,856.82
Tariff band 06 – Untreated measured greater than 50 Ml	£	29.90	29.90	29.90	29.90	29.90
	%	2.5%	2.5%	2.5%	2.5%	2.5%
	£ (r)	339.53	347.11	353.23	374.99	380.99

A4.8 Company outcomes, performance commitments and delivery incentives

In policy chapter A2, we discuss our approach to outcomes.

We summarise the outcomes, performance commitments and ODIs for the non-household retail control for Dee Valley Water in Table A4.5 below. This includes the non-household SIM (Wales) that applies to companies operating wholly or mainly in Wales, such as Dee Valley Water. This additional protection is being put in place as the scope for retail competition in Wales is more limited than in England, and so some of these customers will not benefit directly from the protection afforded by competition.

Full detail of the outcome, performance commitment and incentives, and our consideration of relevant representations, is provided in annex 4.

Table A4.5 Non-household retail outcomes, performance commitments and incentives

Company proposal			Intervention
Outcome	Performance commitment	Incentive type	
Provide reliable and high quality customer service to non-household customers	Non-household SIM[1]	Reward and penalty	We confirm our draft determination intervention to apply a non-household SIM.

Notes:
1. We have required Dee Valley Water to include a performance commitment based on the non-household SIM.

A5 Appointee financeability and affordability

In this section, we discuss at an appointee level:

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

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

A5.1 Consideration of representations on our draft determinations

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

Table A5.1 lists the representations we have received that are specific to Dee Valley 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 Dee Valley Water

Area	Policy chapter	Company-specific representations	Detailed commentary in this company-specific appendix
Bills and K factors	N/a	Dee Valley Water	Section A5.2
Appointee level uncertainty and gain share mechanisms	A7	None	Section A5.3
RoRE range	A7	None	Section A5.4

Area	Policy chapter	Company-specific representations	Detailed commentary in this company-specific appendix
Financeability	A8	Dee Valley Water	Section A5.5
Affordability	A8	CCWater	Section A5.6
Financial modelling	N/a	None	Section A5.7

A5.2 Bills and K factors

Table A5.3 below sets out the allowed revenues we have assumed in our final determination for Dee Valley Water to deliver for its customers on its:

- statutory duties; and
- associated performance commitments.

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

Table A5.2 Representations specific to Bills and K factors for Dee Valley Water

Respondent	Summary of comment	Ofwat response
Dee Valley Water	Dee Valley Water has proposed amending PAYG rates to smooth the bill profile in 2015-20. This does not affect bills in 2020-25. Dee Valley Water has customer support for this proposed bill profile.	We have smoothed our final determination bill profile to reflect customer preferences from the company's research.

Table A5.3 Dee Valley Water's 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]	20.4	20.5	20.7	20.8	21.0	103.4
Wholesale water – K (%)	0.0%	1.1%	0.8%	0.5%	0.5%	-
Retail household allowed revenue (£m)	2.9	2.9	3.0	3.0	3.0	14.8

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Retail non-household expected revenue (£m)	0.3	0.3	0.3	0.4	0.4	1.7
Average household bill – water (£)[3]	142	142	142	142	142	-

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

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

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

Table A5.4 Dee Valley Water's allowed wholesale revenue

Dee Valley Water	Wholesale water
Allowed wholesale revenue 2014-15 (£ million)	21.5

A5.3 Uncertainty and gain share mechanisms

We outline our approach to uncertainty mechanisms and "pain and gain share" in policy chapter A7. In Table A5.5 below, we set out our conclusion on this.

Table A5.5 Dee Valley Water proposals for appointee level uncertainty and gain share mechanisms

Assessment at draft determination	Our assessment
In our draft determination, we did not provide for any appointee level uncertainty mechanism for Dee Valley Water, nor did Dee Valley Water propose any gain share mechanisms.	No change to draft determination position on uncertainty mechanisms given that we have not provided for any mechanism and the company has not objected.

A5.4 Return on regulatory equity range

Dee Valley 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[3]. We have identified the RoRE impact separately for ODIs, totex performance, financing and the SIM. We note that Dee Valley 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.

Table A5.6 Whole company RoRE range

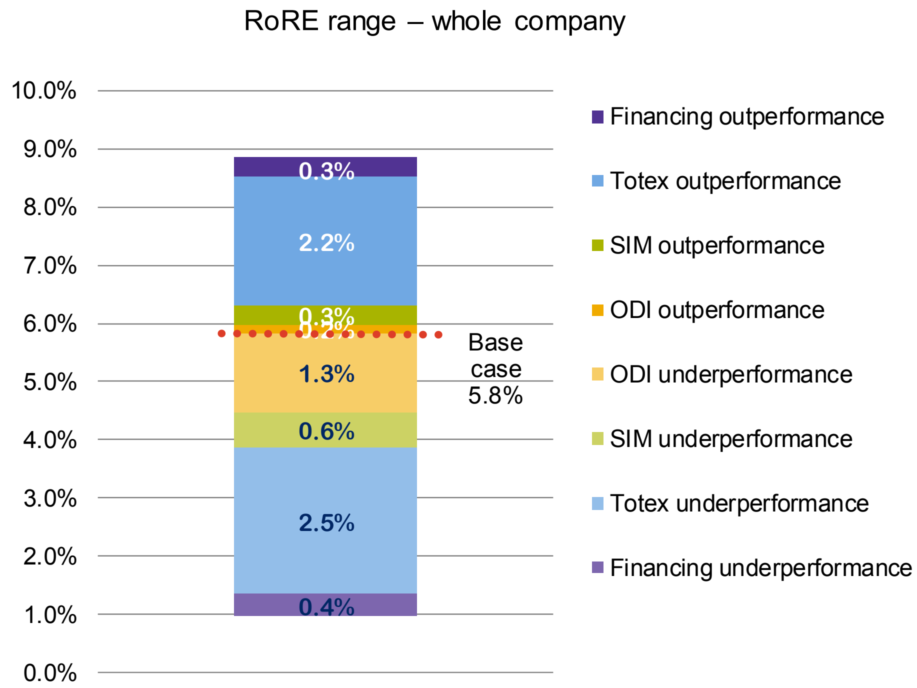
	Lower bound (%) – appointee	Upper bound (%) – appointee
Overall	-4.9%	+3.0%
ODIs	-1.3%	+0.2%
Totex	-2.5%	+2.2%
Financing	-0.4%	+0.3%
SIM	-0.6%	+0.3%
Commentary:		
The whole company RoRE range is from 1.0% to 8.9%, with a base case of 5.8%, with overall impacts from -4.9% to +3.0%.		

[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.

	Lower bound (%) – appointee	Upper bound (%) – appointee
As in our draft determination, the totex risk range is -2.5% to +2.2% of notional equity. We are satisfied that Dee Valley Water has appropriately taken into account historic cost variability to arrive at this estimate, which represents a sufficiently considered company view of its totex risk. We have adjusted Dee Valley Water's ODI risk range from -0.7% to +0.2% in our draft determination to -1.3% to +0.2% to take account of our interventions. Of this range, -0.7% to +0% is associated with delivery incentives for special cost factor claims. Dee Valley Water's financing risk and SIM risk submissions are unchanged from our draft determination. Its estimate of financing risk is based on interest rate risk of up to ±0.7% (based on work from its consultants Frontier Economics), while its SIM risk is based on the minimum and the maximum penalty the company might receive under our SIM methodology.		

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

Figure A5.1 Dee Valley Water's RoRE range – appointee



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

A5.5 Financeability

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

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

In Table A5.7, we set out the notional financeability ratios associated with Dee Valley Water's business plan, draft determination and final determination.

Table A5.7 Company and Ofwat financial ratio calculations based on the company business plan and financial ratios based on our final determination

Financial ratios for notional company	Financial ratio calculations based on the company business plan (average 2015-20)		Financial ratio calculations based on Ofwat calculations (average 2015-20)	
	Company calculation	Ofwat calculation	Draft determination	Final determination
Cash interest cover (ICR)	9.45	3.09	3.25	3.33
Adjusted cash interest cover ratio (ACICR)	6.07	1.62	1.50	1.52
Funds from operations(FFO)/debt	19.94%	11.86%	10.88%	10.87%
Retained cash flow/debt	17.15%	8.84%	8.48%	8.43%
Gearing	68.80%	67.87%	67.65%	67.59%
Dividend cover (profit	1.98	1.42	1.35	1.28

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
after tax/dividends paid)				
Regulatory equity/regulated earnings for the regulated company	7.28	12.12	16.03	15.97
RCV/EBITDA	7.04	8.29	9.28	9.39

Commentary:

Dee Valley Water targeted a credit rating of BBB (its actual credit rating) in its business plan. For the company plan, Ofwat calculated financial ratios were materially lower than the company's calculations due to errors in its submission. While our draft determination ratios were significantly below its calculated ratios, they remained comfortably above investment grade requirements and therefore we considered that the draft determination was financeable. Given the issues in the calculation of ratios in our draft determination, we required the company to provide additional Board and third party assurance on the calculation of the ratios and its financeability.

Dee Valley Water has provided Board and third party assurance from Deloitte on the calculation of its financeability ratios. However, this assurance was provided on an incorrect WACC. Following clarification, assurance on the calculation of the ratios was provided based on the correct WACC that it is financeable. In its representation to the draft determination Dee Valley Water proposed minor changes to its PAYG profile to achieve a bill profile that reflects customer preferences. This has a negligible effect on revenue in 2015-20 and is supported by customer surveys so we have accepted its proposals.

Dee Valley Water made a late representation that PAYG rates should change to reflect the impact of our interventions on totex on the split between capex and opex. Our interventions on totex have reduced considerably since the draft determinations. Consequently, we have not amended PAYG rates, as any change to the capex/opex split is small and would have a negligible impact on notional financeability.

The financial ratios from the final determination are at levels consistent with those from the draft determination. Given this and the additional assurance Dee Valley Water has provided we consider that the final determination is financeable.

As explained in policy chapter A8, companies have been allowed to use new tools in the form of PAYG rates (the proportion of totex recovered in the period 2015-20) and

RCV run-off rates (depreciation of the RCV). Both PAYG and RCV run-off rates can be adjusted to change the proportion of costs recovered within the 2015-20 period and the amount added to the RCV and recovered over a longer period.

Table A5.8 sets out the PAYG and RCV run-off rates, which shows whether revenue has been brought forward compared to the December plan and the impact that this has on RCV growth and longer-term affordability and financeability. The company has made representations to use PAYG to smooth bills. This is revenue neutral over 2015-20 and is supported by the CCG. We have therefore accepted this proposal.

Table A5.8 Impact of changes in cost recovery rates on RCV growth

	PAYG rate	RCV run-off	RCV growth (%) – 1 Apr 2015 to 31 Mar 2020
Company December plan	59.0%	6.1%	32.3%
Company June plan	59.0%	6.1%	30.3%
Draft determination	59.0%	6.1%	27.1%
Final determination	58.2%	6.1%	31.6%

A5.6 Affordability

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

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

Table A5.9 Household bill profile

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Company December plan	143	147	150	153	155	156
Company June plan	142	146	150	156	158	159
Ofwat calculation for June plan	144	146	154	159	161	162
Ofwat calculation for	144	130	135	137	140	140

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
draft determination – pre-reprofiling						
Ofwat calculations for draft determination	144	136	136	136	136	136
Ofwat calculations for final determination	**144**	**142**	**142**	**142**	**142**	**142**

Companies have not necessarily used the same method of calculating household bills as us. So the 'Ofwat' calculations are not directly comparable to the company plans (lines 1 and 2 of table A5.9).

The final determination leads to a reduction in bills in 2015-20 compared to the company's plan. Dee Valley Water has proposed a smooth (increasing) bill profile, based on the preferences of customers. As our final determination bill profile has a drop in 2015-16 followed by a subsequent increase, we have smoothed bills so that they better reflect customer preferences.

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

A5.6.1 Acceptability

Dee Valley Water carried out some additional research in May 2014 to address our concerns with its acceptability research for its December plan. The research found that 75% of those surveyed found the company's proposals acceptable.

In response to the draft determination, the company conducted research into customers' bill profile preferences. This concluded that customers preferred smooth bill profiles regardless of whether the overall profile was a rising or falling one.

In its representation, Dee Valley Water has justified an amended bill profile on these research findings. The company makes the reasonable assumption that because its revised bill profile is now lower than the one originally tested with its customers, and since there has been no reduction in the service being offered, the plan will remain acceptable. Our final determination bill profile is lower than the company's proposed bill profile and so we consider that this should be acceptable to customers. We received one third party representation on the acceptability of the company's plan.

Table A5.10 Representations specific to Dee Valley Water's affordability measures

Respondent	Summary of comment	Ofwat response
CCWater	The determination package should be improved, as the company's bills will rise faster than incomes after taking inflation into account. PAYG changes should not be used by companies to buffer themselves against a reduction in cost of capital.	Dee Valley Water's proposed changes to PAYG levels have a negligible impact on revenues in the 2015-20 period and so do not alter the pass through of the reduction in the allowed return and Dee Valley Water has not adjusted average PAYG and RCV run off rates since its December plan. Therefore, the benefits of our WACC reduction are passed through to customers in the 2015-20 period.
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 69% of customers find the draft determination acceptable after they have been provided with information on bills, inflation and what the water company will deliver.	While we note that the research was not intended to be comparable it provides similar results to the research the company conducted, which was that 75% of customers found the plan affordable.

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

A5.6.2 Identification of affordability issues and appropriate support measures

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

Table A5.11 Key affordability measures

Measure	Current coverage (no. of customers)	Forecast 2019-20 coverage
WaterSure	988	1,049

Measure	Current coverage (no. of customers)	Forecast 2019-20 coverage
Water direct	1,722	1,781
Flexible payment plans	7,445	7,817
Debt advice – in house	10,007	17,160
Water efficiency advice/audits	61 ytd	104 p.a.
Social tariff	In development – planned for 2016	

A5.6.3 Longer-term affordability

In our analysis of Dee Valley Water's December plan, we concluded that the company had not provided enough evidence to convince us that its use of the PAYG and RCV run-off levers would not lead to a risk of affordability problems for customers in the long term. In its revised plan, both the PAYG and RCV run-off ratios were unchanged, and the company provided an explanation that its cost recovery tools would not lead to affordability problems in the longer term.

In response to the draft determination, Dee Valley Water updated its PAYG rates in order to smooth customer's bills to reflect the findings of the new phase of bill profile research. This does not affect overall revenue in 2015-20 and so does not affect longer term affordability.

A5.6.4 Longer-term affordability – ODIs

Dee Valley Water provided sufficient and convincing evidence that it had updated its package of ODI's in order to reflect the revised risk and reward guidance. In particular, in the case of four existing performance measures, the company replaced reputational incentives with penalty/reward incentives. In addition, an entirely new measure has been added which has also been allocated a penalty/reward incentive. The CCG expressed its support for these revisions to the ODI package.

In the draft determination, we recommended that companies incorporate a range of 'comparative' indicators into their ODI packages. Dee Valley Water broadly accepted our proposals.

Annex 1 Wholesale costs

Establishing final determination thresholds

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

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

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

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

Basic cost threshold	Policy additions[1]	Unmodelled costs adjustment	Deep dives	Final determination threshold	Deep dives fully or partially not added[2]
73.1	6.7	-1.4	20.6	99.0	3.8

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
5.1	0.9	0.7	0.0	0.0	6.7

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

Plan[1]	Final determination threshold	Gap[2]	2010-15 v plan
102.8	99.0	3.8	20.8

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							
Representation: legacy treatment works and mains cleaning	18.1	5.2	Partial pass	Pass	Partial pass	Partial pass	12.1
Representation: service reservoir water quality risk management	8.3	2.4	Pass	Pass	Pass	Pass	5.9
Ofwat adjustment: supply demand balance (metering costs)	1.1	1.0	-	-	-	-	0.5
Permit Scheme for Road and Street Activities in Chester West and Chester area	1.0	0.3	Pass	Pass	Partial pass	Partial pass	0.4
Representation item: reservoir safety	1.2	0.4	Pass	Pass	Pass	Pass	0.9
Representation: Wrexham pumping station upgrade	0.8	0.2	Fail	N/a	N/a	Fail	-

Company proposal		Assessment				Final determination allowance	
Claim	Amount sought	Implicit allowance	Need	Cost-benefit analysis	Robust costs	Assessment	Amount allowed
Representation: sludge handling	1.0	0.3	Fail	N/a	N/a	Fail	-
Representation: mains renewal programme	2.8	0.8	Fail	N/a	N/a	Fail	-
Representation: water treatment complexity	0.9	0.2	Fail	N/a	N/a	Fail	-
Representation: scale effects	2.3	0.4	Pass	N/a	Partial pass	Partial pass	0.9

Annex 2 Household retail

Details on our assessment of proposed adjustments to the ACTS

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

Below we provide information on our assessment of the company-specific adjustments to the ACTS, and our response to the representations specific to the household retail adjustments for Dee Valley Water.

Input price pressure – summary

- In its revised business plan, Dee Valley Water sought an adjustment for input price pressure of £1.6 million over 2015-20.
- We did not accept the company's proposal in the draft determination.
- Our position is unchanged at final determination.

Input price pressure – our final assessment

Materiality

The adjustment is material at 10.1% of household retail operating expenditure plus depreciation over 2015-20.

Beyond efficient management control

Dee Valley Water did not provide convincing evidence of management practices applied to retail costs.

Impact company in materially different way

Dee Valley Water did not provide convincing evidence on relative efficiency, including benchmarking.

- Its evidence relied on a narrow comparison of its wages with regional pay rates and wages at equivalently sized utilities in Northern Ireland. These were insufficient comparators to indicate it is an efficient retailer.
- Also, our assessment for ACTS shows that the company is not upper quartile efficient for unmetered retail costs.

Therefore the company has not demonstrated that it is affected in a materially different way to other companies as the company has not demonstrated that it is efficient relative to other companies in the industry and could not absorb further input price pressures through efficiency gains.

Value of proposed adjustment

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

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

Table AA2.1 Representations specific to the household retail adjustments for Dee Valley Water

Respondent	Summary of comment	Ofwat response
Dee Valley Water	The company retained its input price pressure claim but did not provide additional evidence.	We have not accepted the claim as there was insufficient evidence to support it.

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

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments proposed in Dee Valley Water's June business plan						
Input price pressure	0.204	0.269	0.332	0.388	0.437	1.630
Customer communications costs	0.052	0.052	0.051	0.051	0.051	0.258
New development costs	0.024	0.031	0.038	0.045	0.051	0.190
Social tariffs costs	0.052	0.045	0.069	0.066	0.066	0.300
Pension deficit repair costs	0.040	0.040	0.040	0.040	0.040	0.201

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Adjustments included in business plan	**0.373**	**0.438**	**0.531**	**0.591**	**0.646**	**2.579**
Adjustments included in draft determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Customer communications costs	Not included as adjustment – forms part of new cost					
New development costs						
Social tariffs costs						
Pension deficit repair costs	0.038	0.038	0.038	0.038	0.038	0.192
Adjustments included in draft determination	**0.038**	**0.038**	**0.038**	**0.038**	**0.038**	**0.192**
Adjustments proposed in Dee Valley Water's representations						
Input price pressure	0.194	0.254	0.314	0.367	0.414	1.543
Pension deficit repair costs	0.041	0.041	0.041	0.041	0.041	0.206
Social tariffs	0.054	0.046	0.071	0.068	0.068	0.307
Customer communication costs	0.054	0.052	0.052	0.052	0.052	0.263
New development costs	0.025	0.032	0.039	0.046	0.052	0.194
Adjustments included in representation	**0.367**	**0.426**	**0.518**	**0.575**	**0.628**	**2.513**
Adjustments included in final determination						
Input price pressure	0.000	0.000	0.000	0.000	0.000	0.000
Pension deficit repair costs	0.038	0.038	0.038	0.038	0.038	0.192
Social tariffs	Not included as adjustment – forms part of new costs					

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Customer communication costs						
New development costs						
Adjustments included in final determination	**0.038**	**0.038**	**0.038**	**0.038**	**0.038**	**0.192**

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

Details on our assessment of proposed new costs

Summary

- At the draft determination, we disallowed the company's proposed new costs above the materiality threshold as it provided insufficient evidence to support them.
- Following a correction to the household retail feeder model, discussed in policy chapter A5, we found the new costs are not material at 0.8% of household retail operating expenditure plus depreciation over 2015-20 and have therefore included them in the calculation of ACTS and allowed revenues.

Customer communications costs and social tariffs

In the final determination we have assessed the customer communication costs and social tariff costs as immaterial at 1.7% and 1.9% of household retail operating expenditure plus depreciation over 2015-20 respectively – therefore we have added both costs onto base operating expenditure.

New development costs

In the final determination, we have assessed the new development costs as immaterial at 1.2% of household retail operating expenditure plus depreciation over 2015-20 – we have split these costs between base costs and the additional cost to serve metered customers in line with information provided by Dee Valley Water in response to a query received on 3 July 2014.

We considered one representation specific to this part of the household retail control, which is set out in table AA2.3 below.

New costs

The customer communications costs, costs related to social tariffs and new development costs discussed above are offset by forecast changes in the overall cost base. Following a correction to the household retail feeder model, discussed in policy chapter A5, we therefore found the new costs are not material at 0.8% of household retail operating expenditure plus depreciation over 2015-20 and have therefore included them in the calculation of ACTS and allowed revenues.

Table AA2.3 Representations specific to the new costs for households for Dee Valley Water

Respondent	Summary of comment	Ofwat response
Dee Valley Water	The company provided additional evidence concentrating on establishing the need for the costs.	We have not assessed the new costs as material and so have included them in the calculation of ACTS and allowed revenues.

Household retail revenue modification

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

Table AA2.4 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 AA2.5 sets out the baseline number of customers.

Table AA2.4 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	22.83	22.88	22.89	22.90	22.93
Metered only water customer	26.03	26.10	26.13	26.15	26.21

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

Table AA2.5 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	47.8	46.3	44.8	43.4	42.0
Metered water only	69.4	71.9	74.3	76.7	79.1

Annex 3 Reconciling 2010-15 performance

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

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

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

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

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

However, we first consider the responses to our draft determinations that are specific to Dee Valley Water in these areas below.

Consideration of representations on our draft determinations

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

Where representations have addressed issues that are common to a number of companies, these comments, and any consequential changes to our approach, are discussed in policy chapter A4. Representations that are specific to reconciling 2010-15 performance for Dee Valley 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 Dee Valley Water

Area	Respondent	Summary of comment	Ofwat response
SIM	There were no representations in this area.		
RCM	There were no representations in this area.		
Operating expenditure incentive allowance	There were no representations in this area.		
Change protocol	There were no representations in this area.		
Service standard outputs	Dee Valley Water	The company provided evidence in its representation to confirm achievement of service standard outputs relating to Llwyn Onn Water Treatment Works (Exceptional Items) and Sesswick Pumping Station (Flood Resilience). A further flood resilience output at Barrelwell Pumping Station is planned for completion by 2014-15.	Having considered the evidence provided in the company's representation, we are satisfied that the service standard outputs will be achieved by the end of 2014-15. There are therefore no interventions for the final determination.

Area	Respondent	Summary of comment	Ofwat response
Serviceability performance	Dee Valley Water	The company provided evidence of reductions in manganese from treatment works and annual discolouration contacts. Following a query, the company then provided monthly discolouration contact data for 2014 performance and details of mains cleaning activities that were undertaken to further reduce discolouration contacts. The company also made a late representation on 5 December that it considered that this indicator is under control and this would be demonstrated by the indicator being below the upper control limit on a twelve-month rolling basis by 31 March 2015.	The data provided shows performance above the upper control limit in every year during the period including predicted performance in 2014-15. The activities undertaken by the company to reduce discoloration contacts have not improved performance sufficiently to demonstrate stable serviceability. We have therefore raised a shortfall for this indicator. Our assessment of the company's specific representations is set out in table AA3.12

Area	Respondent	Summary of comment	Ofwat response
		The company provided further evidence of its compliance with the standards prescribed in the Water Supply (Water Quality) Regulations 2000 for coliforms at water treatment works showing its current and future stable performance in this indicator.	The new information confirmed that previously submitted data for failures in 2012-13 were at the same treatment works and should only be recorded once. This revised data and latest predicted performance in 2014-15 shows stable serviceability in this indicator. We have therefore made no interventions on this indicator.
			We have conducted a full review of our methodology for calculating serviceability shortfalls in light of companies' representations. Details and the implications of this review can be found in policy chapter A4.
2009 agreed overlap programme	There were no representations in this area.		
2014-15 transition programme	There were no representations in this area.		

Area	Respondent	Summary of comment	Ofwat response
CIS	There were no representations in this area.		As explained in policy chapter A4, we have 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.
Other adjustments	There were no representations in this area.		

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 revised business plan, and
- our own view.

Our view reflects our understanding of the company's performance using these incentives, based on information provided in its revised business plan, subsequent query responses and representations on our draft 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.

The main changes we have made in the final determination compared to our draft determination, is applying a serviceability shortfall for discolouration contacts as described in Table AA3.1 and revising our adjustment to the RCV for actual expenditure in 2009-10.

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

	Company view	Ofwat view
SIM	-0.035	-0.113
RCM	4.900	5.009
OIA – post-tax	0.000	0.000
CIS	-1.005	-1.013
Tax refinancing benefit clawback	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000
Total wholesale legacy adjustments	3.860	3.883

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 A2.8.
Totals may not add up due to rounding.

Adjustments by 2010-15 incentive mechanism

Service incentive mechanism

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

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

Table AA3.3 SIM annualised rewards (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.007	-0.007	-0.007	-0.007	-0.007	-0.035
Ofwat view	-0.023	-0.023	-0.023	-0.023	-0.023	-0.113

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

Area of intervention	What we did	Why we did it
Survey data error	Our final determination includes a penalty of -0.1% which takes into account the survey data error that occurred in the fourth quarter of 2013-14.	We consider that this survey data error was beyond the company's control and should be appropriately recognised. Ofwat's view of the scale of this error is smaller than the company has stated.

RCM

Table AA3.5 below shows the company's view and our view of the company's RCM adjustments. Table AA3.6 summarises our interventions in relation to Dee Valley Water's proposed 2010-15 RCM adjustments.

For the RCM, we apply the wholesale WACC as the discount rate between 2015 and 2020. As set out in section 2.3.3, for the final determination we have reduced it from 3.7% to 3.6%. This has contributed to a small movement in the RCM from the draft determination.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	0.980	0.980	0.980	0.980	0.980	4.900
Ofwat view	1.002	1.002	1.002	1.002	1.002	5.009

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

Area of intervention	What we did	Why we did it
Forecast 2014-15 tariff basket revenue	We have restricted the revenue shortfall in 2014-15 to the level recorded in 2013-14.	The company did not explain the reasons for a widening difference between its 2014-15 forecasted revenue and its final determination 2009 (FD09) revenues forecast compared to previous years variances seen in 2013-14 and earlier years.
FD09 assumptions – Measured Non-household's revenue for the Measured Non-household group immediately above and below the 250ML threshold	Our assumptions include our view of the FD09 assumptions. Our view of the company's revenue assumptions for the measured non-household group immediately below and above the 250 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 company's populated RCM model. The company applied different assumptions for 'FD09 Measured Non-household's revenue for the Measured Non-household group immediately above and below the 250ML threshold' compared with our view of its FD09 assumptions. Our assumptions for the final determination include the FD09 revenue forecasts as contained in the PR09 tariff basket model in accordance with our published methodology 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance'.
Number of	Our assumptions for the final determination uses the data the	There were inconsistencies with the number households billed

Area of intervention	What we did	Why we did it
households billed	company submitted in business plan table R3 to calculate our view of the RCM adjustment.	between business plan table R3 and the company's populated RCM model. Our assumptions for the final determination are based upon the data within the company business plan table R3.
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 were inconsistencies with the amount submitted between business plan table W17 and the company's populated RCM model. Our assumptions for the final determination are based upon the data within the company business plan table W17.
Number of non-households billed	Our assumptions for the final determination use the data the company submitted in business plan table W17 to calculate our view of the RCM adjustment.	There were inconsistencies with the number of non-households billed between business plan table W17 and the company's populated RCM model. Our assumptions for the final determination are based upon the data within the company business plan table W17.

Operating expenditure incentive allowance

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

Table AA3.7 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	0.000	0.000	0.000	0.000	0.000	0.000

Change protocol (logging up, logging down and shortfalls)

Table AA3.8 Table AA3.8 and Table AA3.9 below summarise Dee Valley 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 AA3.8 Summary of post-efficiency capex for logging up, logging down and shortfalls included in the CIS reconciliation (£ million)

2009-10 to 2014-15 – post-efficiency capex	Company view	Ofwat view
Logging up (two-sided)	0.370	0.370
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 AA3.9 Summary of post-efficiency opex for logging up, logging down and shortfalls included in the OIA calculation (£ million)

2009-10 to 2014-15 – post-efficiency opex	Company view	Ofwat view
Logging up	0.206	0.206
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.

The company provided satisfactory evidence that it will achieve all of its service standards relating to exceptional items and flooding resilience by 2014-15 as set out in the 2009 final determination and therefore we have not applied a shortfall.

[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."

Serviceability performance

Table AA3.10 below summarises our serviceability assessments for Dee Valley Water and Table AA3.11 quantifies the value and impact of any serviceability shortfall on the RCV. Our serviceability shortfall value has changed from the draft determination as we have applied a shortfall for deteriorating performance in discolouration contacts.

Table AA3.12 summarises our interventions in relation to Dee Valley Water's proposed adjustments for serviceability.

Table AA3.10 Serviceability assessments for 2010-15[1]

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

Notes:
1. 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.
2. Our assessment of deteriorating performance is explained in table AA3.12.

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

2009-10 to 2014-15		Total
Amount subtracted from RCV	Company view	0.0
	Ofwat view	-0.7

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

Area of intervention	What we did	Why we did it
Discolouration contacts (orange/brown/black)	For the final determination, we have applied a shortfall adjustment of £0.7m (post efficiency) for deteriorating performance in this indicator. In accordance with our shortfall calculation methodology the shortfall (which has been applied for the years 2011-12, 2012-13, 2013-14, 2014-15) has been capped to 1 standard deviations for each of those years. The overall scale of the shortfall does not exceed 50% of the subservice capital expenditure and therefore no further cap has been applied.	The company has experienced discolouration contacts above the upper control limit for the whole of the 2010-15 period. The cause of this discolouration has been linked to raw water deterioration at the input to the treatment works (in the village of Legacy) resulting in increased manganese levels being output from the treatment works. The company has entered into an undertaking with the Drinking Water Inspectorate (DWI) to respond to this issue within the 2010-15 period. The company has undertaken trunk main and distribution main cleaning in accordance with the DWI undertaking and completed this by December 2013. We have recognised this activity through the change protocol and have logged up this expenditure.

Area of intervention	What we did	Why we did it
		At the draft determination, we did not apply a serviceability shortfall for this indicator, as there was insufficient time series performance data available to determine whether the activity undertaken by the company was sufficient to return performance below the upper control limit. There was evidence that improvements had occurred but it was unclear whether these improvements would be sufficient to achieve a stable position. Our decision at draft determination was caveated upon the performance of discolouration being improved to stable within the 2014-15 period. Based upon the latest information provided by the company (up to the end of September 2014), while there has been an improvement in discolouration performance from January 2014 onwards, performance in 2014 is forecast to out-turn above the upper control limit. Therefore, we do not consider that these improvements have been sufficient to achieve stable serviceability. In response to the company's late representation, we note that the definition of the indicator clearly refers to calendar years. The company has been above the upper control limit for every calendar year in the price review process. We do not consider that the indicator can be judged stable on the latest

Area of intervention	What we did	Why we did it
		information we have in any year in the 2010 to 2015 period. We therefore consider a serviceability shortfall is appropriate. For the final determination, we have therefore applied a shortfall adjustment for this indicator.

The 2009 agreed overlap programme

As the company did not propose an overlap programme at PR09, our 2009 final determination did not contain any agreed projects that would need to be reviewed in this price review. Therefore, we have not assessed any scheme progress or costs under this mechanism.

The 2014-15 transition programme

Table AA3.13 below confirms Dee Valley 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
0.5	10.2%	1.0%

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 interventions in relation to Dee Valley Water's proposals.

There are no representations in this area from Dee Valley Water. The only change from our draft determination relates to use of the post-tax cost of capital as the discount rate when calculating the future value of revenue adjustments.

Table AA3.14 CIS true-up adjustments

		Total
Restated FD09 CIS bid ratio[1]	Company view	98.958

		Total
	Ofwat view	98.956
Out-turn CIS ratio	Company view	96.541
	Ofwat view	96.763
Incentive reward/penalty (%)[2]	Company view	1.075
	Ofwat view	1.006
Reward/penalty (£m)	Company view	0.381
	Ofwat view	0.356
Adjustments to 2015-20 revenue (£m)[3]	Company view	-0.934
	Ofwat view	-0.945
RCV adjustment (£m)[4]	Company view	-2.815
	Ofwat view	-2.817

Notes:
1. The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol (Table AA3.8)
2. The reward/(penalty) is adjusted for the additional income included in the 2010-15 determination and the financing cost on the difference between actual spend and capital expenditure assumed in the 2010-15 determination to derive the value of the adjustment to 2015-20 revenue.
3. The adjustment to 2015-20 revenue values shown in this table assume a single year adjustment in the first year, and do not include the NPV profiling used for the final determination.
4. In Table AA3.16 we show how the components of this agree to those shown in Table A2.8.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Company view	-0.201	-0.201	-0.201	-0.201	-0.201	-1.005
Ofwat view	-0.203	-0.203	-0.203	-0.203	-0.203	-1.013

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

	Total
Adjustment for actual expenditure 2010-15	-3.187
Net adjustment from logging up and logging down	0.370
Adjustment for shortfalls	0.000
RCV adjustment	-2.817

Table AA3.17 Interventions on proposed CIS adjustments

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

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.

There are no changes 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	0.000	0.000
Other tax adjustments	0.000	0.000
Equity injection clawback	0.000	0.000
Other adjustments	0.000	0.000

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

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

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

	Company view	Ofwat view
Land sales	0.000	-0.090
2009-10 adjustment	0.000	1.466
Other adjustments	0.000	0.000

Table AA3.20 Interventions on proposed adjustments to the opening RCV

Area of intervention	What we did	Why we did it
Land sales	We calculated land sales using the business plan sales figures in our RCV midnight adjustment model.	This provided a consistent approach with all companies.
2009-10 adjustment	We calculated the 2009-10 adjustment using the capex figures from the June return. For some companies there was an incomplete dataset with regard to historic grants and contributions, we have corrected this for FD. This means that for those companies, the adjustment included in the DD overstated the positive impact on the RCV. After the correction, the actual net capex being used in the 2009-10 calculation for FD is lower than that used in DD.	This provided a consistent approach with all companies.

Annex 4 Outcomes, performance commitments and ODIs

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

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

The company has used a cost-sharing rate of 50% to calibrate the reward and penalty rates included in this annex. Companies are required to notify us of their menu choices by 16 January 2015. This might result in the company having a cost-sharing rate higher or lower than 50%. Once the company has chosen its position on the menu we are requiring it, in line with the methodology, to recalibrate its ODIs with the cost-sharing rate associated with that position, and provide us with the updated incentive rate calculations. The company must do this alongside their menu choice on 16 January 2015 so that the recalibrated ODIs can be included in the regulatory reporting framework for 2015-16.

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

Consideration of representations on our draft determinations

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

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

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

- Tables AA4.2 considers representations received on the interventions we proposed in our draft determination as a result of our company-specific assessments for wholesale water.
- Table AA4.3 considers representations received on the interventions we proposed in our draft determination as a result of our company-specific assessments for household retail.
- Table AA4.4 considers representations received on the interventions we proposed in our draft determination as a result of our company-specific assessments for non-household retail.
- Table AA4.5 lists performance commitments excluded from the commentary tables above because we received no representations on them and we made no interventions at draft determination or through the comparative assessments.

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

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
A1 – Discoloured water contacts	Lowered the PC level to 0.93 complaints per 1,000 population from 2017-18 with linear glidepath in intervening years. Reward deadband set at 0.93 complaints per 1,000 population in 2015-16 and 2016-17 and removed thereafter. Penalty deadband removed from 2017-18. Caps and collars adjusted to maintain reward and penalty range as proposed by company.	Dee Valley Water proposes to deliver the UQ level by 2018-19 rather than 2017-18, with a penalty deadband at 1.8 contacts per 1,000 population from 2018-19 balanced by removing the associated reward. CCWater support the more stretching and ambitious targets for reducing discolouration complaints, as a key customer issue, evidenced by the company's research.	Increase PC level from 0.93 to 1.01 complaints per 1,000 population from 2017-18, with linear glidepath in intervening years. Increase the reward deadband from 0.93 to 1.01 complaints per 1,000 population in 2015-16 and 2016-17 and remove thereafter. Increase the penalty deadband from the company's proposal to 3.69 complaints per 1,000 population in 2015-16 and 2016-17 and remove thereafter. Revise the penalty collar for all years to 4.94 complaints per 1,000 population.	We revised our comparative assessments for final determination based on stakeholder representations on all companies' draft determinations, including those on Dee Valley Water's draft determination. The impact of our updates on Dee Valley Water is to increase the UQ level slightly to reflect the proportion of water quality contacts that relates to discoloured water and therefore small adjustments have been made to PC levels and deadbands. In addition to this, we have made a specific change to Dee Valley Water. As it is being shortfalled for poor performance in 2010-15, it is

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
				appropriate to ensure customers have a similar level of redress if performance remains poor. We changed the penalty collar to reflect the worst performance in 2010-15 for which it is being shortfalled.
A2 – Mean zonal compliance	Increased the PC level to 100% from 2017-18. Penalty deadband increased to 99.93% in 2015-16 and 2016-17 and increased to 99.96% from 2017-18.	Dee Valley Water proposes to increase its PC level to 100% from year 1 rather than year 3. However, it also proposes to reduce the penalty deadband to 99.92% in year 1 rising to 99.94% in year 5. CCWater supports a 100% compliance target for mean zonal compliance on water quality and an increase in the penalty deadband to 99.96% for the last three years of AMP6.	Revise the performance measure to that of Mean Zonal Compliance. Increase PC level to 100% from 2015-16, rather than 2017-18. Lower the penalty deadband from 99.96% to 99.95% from 2017-18 but maintain at 99.93% in 2015-16 and 2016-17.	We revised our comparative assessments for final determination based on stakeholder representations on all companies' draft determinations, including those on Dee Valley Water's draft determination. Overall, the changes are to increase the penalty deadband slightly. In addition to this we have accepted Dee Valley Water's proposal to target 100% compliance in every year rather than from 2017-18. We have not accepted its

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
				proposal to lower the penalty deadband in 2015-16 and 2016-17 from 99.93% to 99.92% as this would not offer sufficient protection to customers against non-delivery or provide appropriate incentives to the company to deliver.
B1 – Average duration of interruptions	Clarified performance commitment definition. Changed from non-financial incentive to reward and penalty financial incentive. Lowered the PC level to 0.17 hours from 2017-18 with linear glidepath in intervening years. Reward deadband introduced at 0.17 hours in 2015-16 and 2016-17 and removed thereafter. Penalty deadband introduced	Dee Valley Water accepts the amendments to the PC level to align with upper quartile performance. However, it proposes the introduction of a penalty deadband at 0.25 hours/property from 2017-18 to allow for natural variability. CCWater support the more stretching and ambitious targets for reducing average duration of supply interruptions as a key customer issue, evidenced by the company's PR14	Increase the PC level from 0.17 hours to 0.20 hours (12 minutes) in 2017-18 with linear glidepath in intervening years. Increase reward deadband from 0.17 hours to 0.20 hours in 2015-16 and 2016-17 and remove thereafter. Maintain penalty deadband at 0.33 hours in 2015-16 and 2016-17 and remove thereafter. Revise penalty collar so	We revised our comparative assessments for final determination based on stakeholder representations on all companies' draft determinations, including those on Dee Valley Water's draft determination. Overall, the changes are to increase the upper quartile estimate slightly and therefore adjustments have been made to PC levels and deadbands slightly. In addition to these, we have

PC/ODI affected	What we did at draft determination/subsequent comparative assessments	Representations	What we did at final determination	Why we did it
	at 0.33 hours in 2015-16 and 2016-17 and removed thereafter.	research.	penalty range covers 0.20 hours in each year	made a specific adjustment to Dee Valley Water's penalty range. This reflects the low level of penalties associated with Dee Valley Water's asset health-related PCs which would not offer sufficient protection to customers against non-delivery or provide appropriate incentives to the company to deliver.
B2 – Sustainable Economic Level of Leakage target	Increased the penalty incentive rate to £5,150/(l/property/day)/yr.	Dee Valley Water accepts the higher penalty rate.	Confirm approach in DD.	Dee Valley Water accepted the adjustment. No other representations were received on this PC/ODI.

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

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
A3 – Delivery of the outcomes of the Legacy treatment works major scheme	Introduced PC and ODI related to delivery of improvements at Legacy Treatment Works based on recovering the costs from the deep dive.	Dee Valley Water accepts the PC/ODI. CCWater support the addition of a penalty for late delivery of improvements to the Legacy water treatment works to help prevent failure or delay.	Increase the ODI for Legacy treatment works non-delivery from £5.7m to £19m. Include an ODI for delay in delivery of the improvements set at £0.51m/year delayed from 2018-19.	Dee Valley Water and CCWater supported the introduction of this PC/ODI to protect customers. We have calculated the incentive rate for non-delivery to reflect the full costs plus an additional amount to reflect benefits foregone consistent with the methodology for setting ODIs. We have introduced a timing delay ODI to compensate customers for the benefits foregone if completion of the improvements is delayed.
A4 – Delivery of the outcomes of the Service reservoir water quality risk management	N/a – failed the wholesale cost assessment tests.	N/a	Include Service Reservoir Water Quality Risk Management scheme PC/ODI. ODI penalty for non-delivery set at £9m, proportioned across the four schemes according to the costs.	With the service reservoir scheme now passing cost assessment tests it is appropriate to include a PC to cover these schemes. We have calculated the incentive rates to reflect the full costs plus an additional

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
schemes				amount to reflect benefits foregone consistent with the methodology for setting ODIs.
B4 – Number of bursts	Lowered the PC level to the average number of bursts over 2010-15 (222), with accompanying incentives and deadbands adjusted by an equivalent amount.	Dee Valley Water proposes to deliver our proposed PC level in year 3 with a 2 year glidepath, rather than from year 1 onwards as per the draft determination. Dee Valley Water also proposes adjustments to deadbands in years 1 and 2 to reflect the increase in PC. However, Dee Valley Water states that if the special cost claim relating to mains renewal is not accepted the PC level should be increased to 258 as per its June business plan. CCWater support the more stretching and ambitious targets for reducing number of bursts, as key customer issues evidenced by the company's	Maintain PC level of 222 from 2017-18 but introduce two year linear glidepath from 258. Increase deadbands in 2015-16 and 2016-17 to reflect increase in PC level. Increase penalty collar so that the penalty range covers 222 bursts in every year.	Dee Valley Water commits to deliver the performance commitment level as set out in its draft determination in a time period commensurate with the comparative assessments measures. It has provided sufficient and convincing evidence as to why this is appropriate so we have accepted its proposed glidepath. We have not reverted to Dee Valley Water's June business plan proposals despite the special claim failing the wholesale cost assessment. We concluded that the implicit allowance covers existing levels of service/performance rolled forward and we have seen no

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
		PR14 research.		evidence that the PC does not represent this. We have also made an additional adjustment to Dee Valley Water's penalty range. This reflects the low level of penalties associated with Dee Valley Water's asset health-related PCs which would not offer sufficient protection to customers against non-delivery or provide appropriate incentives to the company to deliver.
D1 – Customers' perception based on market research	Clarified that performance commitment is to deliver improved levels of customer perception each year following setting the baseline in 2015-16.	CCWater notes that it will work with the company when it commences the process of setting a target for perceived customer value for money for services.	Confirm approach in DD	We welcome CCWater's commitment to work with Dee Valley Water to develop the survey for this measure. This provides additional assurance around setting the survey after final determination. No changes are required to the PC.

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

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
E2: SIM	N/a	CCWater propose that we should continue to apply SIM to the wholesale business to ensure that the monopoly wholesale business is incentivised to resolve problems quickly and effectively for customers and retailers.	Confirm approach in DD	We are not requiring the company to include a SIM PC in the wholesale water control – the PR14 methodology confirmed that we would use the SIM as a standard minimum national incentive for customer service for 2015-20. We also confirmed that its likely scale and scope would be similar to the current SIM, and that it would apply to both retail controls in Wales (because of the Welsh Government's policy decision not to introduce choice for non-household customers).

Table AA4.4 Representations specific to the company-specific assessments on non-household retail

PC/ODI affected	What we did at draft determination	Representations	What we did at final determination	Why we did it
F1: Non-household SIM	Set out that we will be designing a non-household SIM for companies operating wholly or mainly in Wales.	CCWater is broadly supportive of Ofwat's draft determination for Dee Valley Water in terms of a new non-household SIM within the company's ODI package.	We applied a non-household SIM.	The approach was in line with our methodology and we were not presented with any evidence to change our approach.

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

Wholesale water	Household retail
B3: Security of supply index	E1: Per capita consumption and water efficiency
C1: Gross operational Green House Gas Emissions	

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

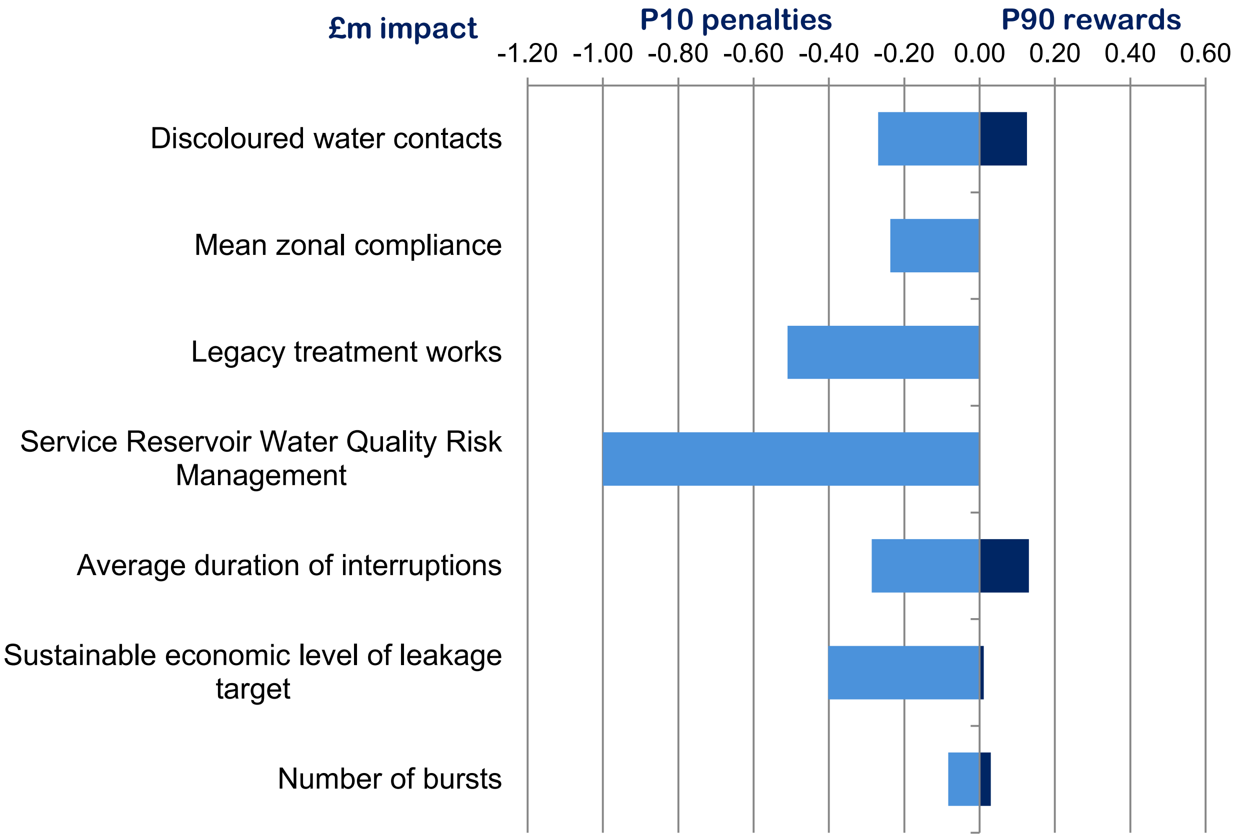
Table AA4.6 shows the balance between reward and penalty, penalty only and reputational incentives in the package of incentives for the company.

Table AA4.6 The composition of the package of ODIs

	Reward and penalty	Penalty only	Non-financial incentive
Wholesale water	4	3	3
Household retail	1	0	1
Non-household retail	1	0	0
Total	6	3	4

Figure AA4.1 shows the potential financial consequences of the individual financial ODIs. The figures represent the penalties and rewards associated with the p10 and p90 scenarios over the five years (2015-16 to 2019-20). This means there is a 10% chance of performance being higher or lower than these assumed levels. In most cases, the potential maximum will be bigger but is very unlikely to occur. The p10 and p90 therefore represent a more realistic estimate of potential financial consequences.

Figure AA4.1 Overview of financial ODIs



As explained in policy chapter A2, we are introducing an aggregate cap on rewards and collar on penalties from the ODIs. Details of how the cap/collar will operate are set out in section A2.6 of policy chapter A2.

There are a small number of specific exclusions from the cap/collar. For Dee Valley Water, the exclusions are as follows.

- A3: Delivery of the outcomes of the Legacy treatment works major scheme.
- A4: Delivery of the outcomes of the Service reservoir water quality risk management schemes.

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

- the name and detailed definition of the performance commitment;
- the type of incentive;
- the performance commitment level;
- for financial incentives:

  - the limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable[5]; and
  - the incentive rates;
- additional details on the measure; and
- where Ofwat has not accepted the company's proposals, the nature of the intervention made is also explained.

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

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

Performance commitments and ODIs in detail

Wholesale water outcome 1: Provide excellent water quality

Performance commitment A1: Discoloured water contacts

Detailed definition of performance measure: The number of contacts received per 1,000 population regarding orange, brown or black discolouration of their water supply.

Incentive type: Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Number of complaints per 1,000 population	3.69	2.80	1.90	1.01	1.01	1.01
Penalty collar	Number of complaints per 1,000 population		4.94	4.94	4.94	4.94	4.94
Penalty deadband	Number of complaints per 1,000 population		3.69	3.69	1.01	1.01	1.01
Reward deadband	Number of complaints per 1,000 population		1.01	1.01	1.01	1.01	1.01
Reward cap	Number of complaints per 1,000 population		0.00	0.00	0.00	0.00	0.00

Incentive rates

Incentive type	Incentive rate (£/complaint per 1000 population/year)
Penalty	30,586
Reward	24,934

Additional details

Necessary detail on measurement units	The Drinking Water Inspectorate, a regulator dedicated solely to the objective of drinking water quality, monitors the company's performance closely and reports publicly on the company's performance along with other companies.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the company's key performance indicator report.
Timing and frequency of rewards/penalties	Annual
Form of reward/penalty	AMP7 Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	Performance measured to two decimal places

Performance commitment A2: Mean zonal compliance

Detailed definition of performance measure: The Mean Zonal Compliance percentage, based on current regulations and standards and as reported to the Drinking Water Inspectorate (DWI).

Incentive type: Financial – penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	%	99.96	100	100	100	100	100
Penalty collar	%		99.92	99.92	99.94	99.94	99.94
Penalty deadband	%		99.93	99.93	99.95	99.95	99.95

Incentive rates

Incentive type	Incentive rate (£/year)
Penalty	47,400

Additional details

Necessary detail on measurement units	Score measured as percentage. Reported to two decimal places.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	Annual
Form of reward/penalty	2020-25 Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	This is a pass/fail incentive type. In each year where performance drops below the penalty deadband the full penalty will apply.

Performance commitment A3: Delivery of the outcomes of the Legacy treatment works major scheme

Detailed definition of performance measure: Completion of improvements at Legacy treatment works in respect of the related special claim.

Incentive type: Financial – penalty only.

Performance commitments

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

Incentive rates

Incentive type	Incentive rate (£m)
Penalty 1 Timing delays	0.51/year
Penalty 2 Non-delivery	19

Additional details

Necessary detail on measurement units	Performance to be measured as pass/fail in each year until completion.
Frequency of PC measurement and any use of averaging	Progress to be reported annually with project completion to be assessed annually from the end of 2017-18
Timing and frequency of rewards/penalties	Incentives to be determined at PR19 based on the extent of completion and, if relevant, expected date of completion. If improvements not delivered at this point timing delay penalties will apply for each year's delay until expected completion. If substantive progress towards delivery cannot be demonstrated at this point the full non-delivery penalty will apply.
Form of reward/penalty	RCV adjustment
Any other information or clarifications relevant to correct application of incentive	Any incentives incurred through performance commitment A1 (discoloured water contacts) due to delay in the delivery of Legacy treatment works should be netted off this incentive.

Performance commitment A4: Delivery of the outcomes of the Service reservoir water quality risk management schemes

Detailed definition of performance measure: Completion of improvements in respect of the service reservoir water quality risk management special claim.

Incentive type: Financial – penalty only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC						Progress milestone	Completion of 4 schemes

Incentive rates

Incentive type	Incentive rate (£m)
Penalty 1 Membranes	1
Penalty 2 Berwyn	1
Penalty 3 Llwyn Onn	5.5
Penalty 4 Sugn-y-Pwll	1.5

Additional details

Necessary detail on measurement units	Performance to be measured as pass/fail for each scheme.
Frequency of PC measurement and any use of averaging	Progress to be reported annually with project completion to be assessed at PR19 and where relevant at the end of 2019-20.

Timing and frequency of rewards/penalties	Incentives to be determined at the PR19 milestone based on the extent of completion of each scheme and, if relevant, expected date of completion of each. If substantive progress towards delivery cannot be demonstrated at this point, such that any scheme is not expected to be completed by the end of 2019-20 the full non-delivery penalty will apply for each relevant scheme.
Form of reward/penalty	RCV adjustment
Any other information or clarifications relevant to correct application of incentive	This is a pass/fail incentive type. If any scheme is not complete by the end of 2019-20 the full incentive will apply for that scheme.

Wholesale water outcome 2: Provide reliable and high quality customer service

Performance commitment B1: Average duration of interruptions

Detailed definition of performance measure: The total hours lost due to interruptions for three hours or longer, per property within the company's supply area (includes both planned and unplanned interruptions)

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Hrs/property	0.33	0.29	0.24	0.20	0.20	0.20
Penalty collar	Hrs/property		0.53	0.53	0.40	0.40	0.40
Penalty deadband	Hrs/property		0.33	0.33	0.20	0.20	0.20
Reward deadband	Hrs/property		0.20	0.20	0.20	0.20	0.20
Reward cap	Hrs/property		0.10	0.10	0.10	0.10	0.10

Incentive rates

Incentive type	Incentive rate (£/0.01hrs/year)
Penalty	4,178.36
Reward	2,087.04

Additional details

Necessary detail on measurement units	The calculation of reward or penalty will use the actual number of minutes calculated to 2 decimal places. Total hours interruption (planned and unplanned) is divided by the number of properties (domestic and non-domestic) connected for water supply.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	Annually
Form of reward/penalty	AMP7 Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment B2: Sustainable economic level of leakage target

Detailed definition of performance measure: The total level of leakage, including customer supply pipe leakage, expressed in litres/prop/day for the calendar year; calculation as defined for the Ofwat key performance indicator (KPI) in IN 13/03.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/prop/day	90.8	90.8	90.8	90.8	90.8	90.8
Penalty collar	l/prop/day		121.6	121.6	121.6	121.6	121.6

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Penalty deadband	l/prop/day		90.8	90.8	90.8	90.8	90.8
Reward deadband	l/prop/day		76.1	76.1	76.1	76.1	76.1
Reward cap	l/prop/day		60.0	60.0	60.0	60.0	60.0

Incentive rates

Incentive type	Incentive rate (£/l/prop/day/year)
Penalty	5,150.43
Reward	1,976.38

Additional details

Necessary detail on measurement units	
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	Annual
Form of reward/penalty	AMP7 Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment B3: Security of supply index

Detailed definition of performance measure: Indicates the extent to which the company is able to guarantee provision of its levels of service for restrictions of supply. The indicator measures security of supply for two scenarios (where relevant) – under dry year annual average conditions and peak demand conditions.

Incentive type: Reputation only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Index (%)	100	100	100	100	100	100

Additional details

Necessary detail on measurement units	Maintain the security of supply index at 100 over 2015-20
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment B4: Number of bursts

Detailed definition of performance measure: Number of bursts per year.

Incentive type: Financial – reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Bursts	211	246	234	222	222	222
Penalty collar	Bursts		538	526	514	514	514
Penalty deadband	Bursts		316	304	292	292	292
Reward deadband	Bursts		176	164	152	152	152
Reward cap	Bursts		154	142	130	130	130

Incentive rates

Incentive type	Incentive rate (£/burst/year)
Penalty	1,301.36
Reward	650.68

Additional details

Necessary detail on measurement units	Mains bursts is as defined in previous Ofwat reporting requirements with a reference of “BN 1225” (for example it was reported in June return table 11).
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the company’s key performance indicator report.
Timing and frequency of rewards/penalties	Annual
Form of reward/penalty	AMP7 Revenue adjustment
Any other information or clarifications relevant to correct application of incentive	N/a

Wholesale water outcome 3: Minimise the environmental impact

Performance commitment C1: Gross operational greenhouse gas emissions

Detailed definition of performance measure: Measurement of the annual operational greenhouse gas emissions of the regulated business.

Incentive type: Reputation only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	tCO_2e	9889	9783	9762	9752	9740	9727

Additional details

Necessary detail on measurement units	Greenhouse gas emissions based on the UKWIR carbon accounting workbook used to populate June Return Table 42
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Wholesale water outcome 4: Provide a value for money service

Performance commitment D1: Customers' perception based on market research

Detailed definition of performance measure: Customer scores for value for money and affordability of bills.

Incentive type: Reputation only.

Performance commitments

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

Additional details

Necessary detail on measurement units	Customer satisfaction surveys to be carried out in accordance with Market Research Society (MRS) Code of Conduct and Social Research Association (SRA) ethical guidelines. The market research will be undertaken in 2015-16 to set the baseline
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Household retail outcome 1: Provide reliable and high quality customer service

Performance commitment E1: Per capita consumption and water efficiency

Detailed definition of performance measure: Average per capita consumption.

Incentive type: Reputation only.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	l/hd/day	132.39	131.44	130.45	129.44	128.37	127.28

Additional details

Necessary detail on measurement units	Per capita consumption as measured by household consumption divided by household occupancy (Table 10b(i) Line 31
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the Company's Key Performance Indicator report.
Timing and frequency of rewards/penalties	N/a
Form of reward/penalty	N/a
Any other information or clarifications relevant to correct application of incentive	N/a

Performance commitment E2: SIM

Detailed definition of performance measure: SIM score as defined in Ofwat's SIM guidance April 2012 and updated by information note IN 13/03.

Incentive type: Reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Industry score	80	80	80	80	80	80
Penalty collar	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Penalty deadband	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Reward deadband	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Reward cap	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology

Incentive rates

Incentive type	Incentive rate (£m/Score/year)
Penalty	Ofwat-led price control adjustments that are implemented at price reviews
Reward	Ofwat-led price control adjustments that are implemented at price reviews

Additional details

Necessary detail on measurement units	All companies report and Ofwat publish an annual industry SIM score.

Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the company's key performance indicator report.
Timing and frequency of rewards/penalties	Any reward or penalty will be applied at the end of the regulatory period 2015-20.
Form of reward/penalty	Adjustment to revenue
Any other information or clarifications relevant to correct application of incentive	N/a

Non-household retail outcome 1: Provide reliable and high quality customer service to non-household customers

Performance commitment F1: Non-household SIM

Detailed definition of performance measure: SIM score as defined in Ofwat's SIM guidance April 2012 and updated by information note IN 13/03.

Incentive type: Reward and penalty.

Performance commitments

		Starting level	Committed performance levels				
	Unit	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
PC	Industry score	80	80	80	80	80	80
Penalty collar	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Penalty deadband	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Reward deadband	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology
Reward cap	Industry score		Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology	Ofwat methodology

Incentive rates

Incentive type	Incentive rate (£m/Score/year)
Penalty	Ofwat-led price control adjustments that are implemented at price reviews
Reward	Ofwat-led price control adjustments that are implemented at price reviews

Additional details

Necessary detail on measurement units	All companies report and Ofwat publish an annual industry SIM score.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis through the company's key performance indicator report.
Timing and frequency of rewards/penalties	Any reward or penalty will be applied at the end of the regulatory period 2015-20.
Form of reward/penalty	Adjustment to revenue
Any other information or clarifications relevant to correct application of incentive	N/a

Outcome delivery and reporting

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

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

Table AA4.7 Dee Valley Water's proposals for outcome delivery and reporting

Dee Valley Water's proposals	Our assessment
Dee Valley Water sets out full details of its approach to outcome delivery and reporting in section 2.2 of its business plan 'ODI governance arrangement' as well as providing ODI-specific reporting throughout section 2 'Consultations, obligations and outcomes' In order to ensure transparent reporting of results Dee Valley Water states that "we will publish, on an annual basis, our progress on achieving our performance commitments. This report will be published on our website and, in order to maximise the awareness of	In our methodology statement, we set out our expectation that companies should demonstrate that their PCs can be measured and recorded consistently and that they will have the appropriate governance and quality assurance processes in place to achieve this. We also expect companies to be transparent with customers about their performance against their outcomes and commitments. Dee Valley Water has provided sufficient evidence demonstrating the approach it will undertake to ensure the PCs will be

Dee Valley Water's proposals	Our assessment
our performance commitment reporting, we will include an appropriate message on our bills." To ensure appropriate governance and quality assurance Dee Valley Water states that "Prior to publication we will ensure that our performance commitment measurement and reporting is subject to audit by our Technical Auditor… [and] will report to the Audit committee… The Audit committee will ensure it meets with the Technical Auditor without any executive directors present in order to discuss any areas of concern on a confidential basis." Dee Valley Water also proposes that "we will review our progress on achieving them with our Customer Challenge Panel. We will also ensure that our key stakeholders, including Ofwat, Welsh Government, CCWater, DWI and Natural Resources Wales, are fully informed of our progress on achieving our performance commitments." To ensure accountability Dee Valley Water states that "Ultimately the Chief Executive, supported by his senior management team, is accountable to the Board and external stakeholders for meeting our performance commitments. He will be responsible for ensuring that progress on achieving our performance commitments is reported at each scheduled Board meeting… the Board's remuneration committee has developed and implemented an executive bonus scheme for executive directors and other senior executives which directly links their remuneration to the standards of performance experienced by customers".	measured and reported consistently, and the proposed governance and assurance processes. Therefore, we have accepted the company's proposal. In time, we may develop further information requirements with regard to outcomes, as we review and change current requirements relating to performance indicators and each company's annual risk and compliance statement.

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.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

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Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gsi.gov.uk.