

December 2014

Setting price controls for 2015-20  
**Final price control determination notice:  
policy chapter A1 – introduction**



**OFWAT**

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## A1.1. Navigating the final determination documents

We have [issued letters](#) containing the notification of our final determination to each of the ten water and sewerage companies (WaSCs) and the eight water only companies (WoCs) for whom we are setting full price controls. Each notification is the legal instrument setting out our final determination of price controls for retail activities and wholesale activities for each company. In addition to the letters, we are publishing a number of documents setting out the reasons for our final determinations<sup>1</sup>. These documents include:

- [an overview](#), which provides a high-level, non-technical summary of our final determinations;
- [policy chapters](#), which set out details of the industry-wide framework that underpins our final determinations; and
- [company-specific appendices](#), which provide the detail of our final determination for each company, including any company-specific interventions we have made to business plans.

As well as this introductory policy chapter, the ‘policy chapters’ are as follows.

- A2 – outcomes.
- A3 – wholesale water and wastewater costs and revenues.
- A4 – reconciling 2010-15 performance.
- A5 – household retail costs and revenues.
- A6 – non-household retail costs and revenues.
- A7 – risk and reward.
- A8 – financeability and affordability.

Figure A1.1 below sets out the overall structure of our final determination documents.

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<sup>1</sup> We have also issued a final determination letter for Cholderton & District Water. However, as we set out in [IN 13/18, ‘2014 price review – setting price controls for Cholderton & District Water’](#), we have set a ‘simplified control’ to reflect the small size of the company and to ensure we apply proportionate regulation. As such, the approach we have applied to the final determinations of other companies, and set out in our explanatory documents, does not, in general, apply to the [final determination for Cholderton & District Water](#).

Figure A1.1 Overview of document structure



In each company’s determination, as required by condition B of its licence, we have for the first time set binding price controls for:

- retail activities; and
- wholesale activities.

This creates important benefits – it provides greater transparency, and therefore understanding, of costs. It also provides more effective incentives and supports the development of effective competition in the relevant markets where appropriate, in line with the provisions of the Water Act 2014.

Our final determination for each company has the following binding price controls<sup>2</sup>.

- Wholesale water.
- Wholesale wastewater, where applicable.
- Household retail.
- Non-household retail.

<sup>2</sup> Thames Water’s final determination also includes a fifth control, which the company proposed, that relates to the Thames Tideway Tunnel (TTT). We discuss this in more detail in the company-specific appendix for Thames Water.

The structure of the company-specific appendices provides a chapter for each price control set out above. For each price control, where applicable, the company-specific appendices set out:

- the responses that we received to our draft determinations and any consequential adjustments that we have made;
- the outcomes for the company to deliver and associated outcome delivery incentives (ODIs);
- the efficient cost levels that we consider the company can achieve;
- the adjustments we are making to the wholesale water and wastewater price controls to reflect the company's performance in 2010-15, where applicable;
- the appropriate level of reward: the weighted average cost of capital (WACC) for the wholesale water and wastewater controls, and the retail household and non-household net margins; and
- the uncertainty mechanisms proposed in addition to ODIs and cost sharing incentives.

The company-specific appendices also consider the following for the whole regulated company (that is, at an appointee level), taking account of the proposals for each price control element.

- The return on regulatory equity (RoRE) range.
- The financial ratios under the notional structure<sup>3</sup>.
- Customer affordability.

In section A1.3, we set out a list of the non-confidential respondents to the draft determinations published in April, May and August of this year<sup>4</sup>. 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.

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<sup>3</sup> Consistent with our final methodology statement, we have also assessed whether individual controls are financeable in their own right by checking they allow sufficient returns to be self-financing over the longer term. We discuss such assessments in '[Policy chapter A8 – financeability and affordability](#)'.

<sup>4</sup> This does not include responses to [Cholderton & District Water's draft determination](#).

We discuss in the relevant policy chapter any comments received that address issues common to a number of companies – and any consequential changes to our approach. We address any company-specific comments and interventions in the relevant company-specific appendix.

Throughout our final determination documents, figures are in 2012-13 financial year average prices except where otherwise stated.

## A1.2. How we have made our final determinations

We have made each company's final determination in accordance with:

- condition B of its licence; and
- our statutory duties under the Water Industry Act 1991 (WIA91), as amended.

Our main statutory duties are (in summary) to:

- protect the interests of consumers, wherever appropriate by promoting competition;
- secure that the companies properly carry out their functions;
- secure that the companies can finance the proper carrying out of their functions; and
- (in relation to English water companies) secure long-term resilience.

Subject to those duties, we also have duties to (among other things):

- promote economy and efficiency; and
- contribute to the achievement of sustainable development.

We have also had regard to relevant guidance from the UK Government and the Welsh Government, and the principles of best regulatory practice under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only in cases where action is needed.

We have made each company's final determination in line with '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' (our 'final methodology statement'). We provide references to any further policy statements and guidance that we have issued since publication of our final methodology statement in each policy chapter, as appropriate.

### **A1.3. Company abbreviations**

Throughout our final determination documents, some of the company names may be abbreviated. For ease of reference, we set out these abbreviations below.

|     |                            |
|-----|----------------------------|
| AFW | Affinity Water             |
| ANH | Anglian Water              |
| BRL | Bristol Water              |
| DVW | Dee Valley Water           |
| NES | Northumbrian Water         |
| PRT | Portsmouth Water           |
| SBW | Sembcorp Bournemouth Water |
| SES | Sutton & East Surrey Water |
| SEW | South East Water           |
| SRN | Southern Water             |
| SSC | South Staffordshire Water  |
| SVT | Severn Trent Water         |
| SWT | South West Water           |
| TMS | Thames Water               |
| UU  | United Utilities           |
| WSH | Dŵr Cymru                  |
| WSX | Wessex Water               |
| YKY | Yorkshire Water            |

## A1.4. Respondents to our draft determinations

In this section, we list the non-confidential respondents to the [draft determinations published in April, May and August](#) of this year. The [representations](#) that respondents submitted are available on our website.

Each of the companies affected, and their associated customer challenge group (CCG) submitted representations on their respective draft determination.

We also received representations from the following stakeholders.

- The Consumer Council for Water.
- The Environment Agency.
- Natural England.
- Natural Resources Wales.
- One customer.

As well as the formal, published representations submitted by the parties listed above, we have also had regard to views expressed as part of ongoing dialogue with other parties such as:

- the Drinking Water Inspectorate (DWI);
- Defra;
- the Welsh Government;
- non-governmental organisations (NGOs);
- ratings agencies; and
- investors.

We have also taken into account responses to other consultations that we have conducted as part of PR14 as follows.

- [‘Wholesale and retail charges – a consultation’](#), the responses to which were addressed in appendix 7 of [‘Consultation on wholesale and retail charges for 2015-16 and charges scheme rules’](#).
- [‘Service incentive mechanism \(SIM\) for 2015 onwards – a consultation’](#), the responses to which were addressed in [‘Service incentive mechanism \(SIM\) for 2015 onwards – conclusions’](#).
- [‘Consultation on the revenue forecasting incentive mechanism’](#), the responses to which were addressed in annex 3 of the [risk and reward technical appendix to our August draft determinations](#).

- Wholesale cost modelling<sup>5</sup>, the responses to which were addressed in annex 1 of the [wholesale technical appendix to our August draft determinations](#).
- ‘[Consultation on wholesale and retail charges for 2015-16 and charges scheme rules](#)’, responses to which were addressed in section A8.4 of the [charging technical appendix to our August draft determinations](#).

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<sup>5</sup> [Letter from Sonia Brown](#), 8 May 2014.

## A1.5. Next steps

Following the publication of our final determination of price controls on 12 December 2014, we will provide further information to stakeholders on our website over the subsequent week. This information includes populated models, such as the financial model and the underlying feeder models.

Each company will then have an opportunity to consider its final determination before making menu choices (including publishing ODIs with the cost sharing rate that is implied by its menu choice) and submitting charges by 16 January 2015 (for approval by 2 February 2015).

We will then close the remaining work associated with PR14 on the following timetable.

**Overall reporting framework – 9 February 2015:** This framework will set out the reporting implications for companies, including the level of assurance that we require from all companies. It will cover two elements on which we have already consulted.

- Our conclusions following our recent consultation on the wider sector framework in '[Consultation on regulatory reporting](#)'.
- Our conclusions for 2015-16 on the graduated assurance framework on which we consulted at draft determinations ('[Draft price control determination notice: technical appendix A9 – assurance, monitoring and reporting obligations](#)'). This will include company categorisation and the associated assurance requirements.

**PR14 reconciliation rulebook – late March 2015:** This document will explain how we will take into account performance over the 2015-20 period at the 2019 price review (PR19). In particular, this document will explain how we make revenue and RCV adjustments in relation to ODIs; menu selection, RPI and other specified factors.

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



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