

April 2014

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



OFWAT

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A1. Overview

This appendix sets out the details of the draft determination of price controls that are specific to South West Water (South West). On 4 April, we confirmed that South West was an enhanced company, this means its business plan is high quality and, as a consequence, the draft determination is largely based on the company's own business plan and forecasts. This will not necessarily be the case for standard companies receiving their draft determinations in June or August as it may be appropriate for us to intervene in these companies' plans if this is necessary to protect customers. In order for the price controls to act to protect the interests of customers, companies must act in an economic and efficient manner in all circumstances. For all avoidance of doubt, this obligation overrides any individual incentive element.

This draft determination sets out the draft allowed revenues and K factors for South West, along with what they mean for average customer bills. It also sets out:

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

Alongside the reputational and procedural benefits of being enhanced, South West will receive a financial benefit, in the form of an initial reward, of £11 million. The company is proposing to recover this through an addition to its 2015-16 regulatory capital value (RCV). It also proposes to share 50% of the award with customers through re-investment to further improve services. This draft determination explains how this financial reward has been incorporated into the draft allowed revenues and K factors for the company (see sections A2.2.4 and A3.2.4).

As part of this review, we stated in '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' (our 'final methodology statement') that we would be setting separate controls for wholesale and retail elements of the appointee business. Therefore, the draft determinations are structured on an element basis and are separated into:

- wholesale water;

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

For the non-household retail control, this document does not set out a draft determination for South West's default tariffs. As discussed in '[Draft price control determination notice: technical appendix](#)' (the 'technical appendix'), we will be doing this for all companies once they have re-submitted their proposed default tariffs to us. However, it does set out the assumptions we have made about the non-household control for the purposes of assessing the financeability of the appointed business as a whole.

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

Annexes 1 to 4 provide more detail on the following areas of our draft determination and form part of the draft price control determination notice.

- Annex 1 – outcomes, performance commitments and outcome delivery incentives.
- Annex 2 – wholesale costs.
- Annex 3 – household retail price control.
- Annex 4 – reconciling 2010-15 performance.

Written representations on this draft determination should be provided to us by **4 June 2014**.

A1.1 Bills and K factors

The table below sets out the allowed revenues we have assumed in our draft determination for the company to deliver its outcomes and associated performance commitments. It also sets out the average bills customers will face as a result of the draft determination.

The profile of revenue, and therefore average bill, reflects the profile proposed by the company in its revised business plan. The company chose to smooth the profile by adjusting its pay as you go (PAYG) ratio (see section A2.2.3 and A3.2.3). The PAYG ratio is the proportion of the total expenditure (totex) allowance that will be recovered in period (2015-20). The remainder of the totex allowance is added to the RCV and

so will be recovered over future periods. Our draft determination reflects this approach.

Table A1 South West’s draft determination allowed revenues and customers’ bills

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale water – allowed revenues (real) (£m) ¹	184.8	182.5	179.4	179.3	179.4	905.3
Wholesale water – K (%)	0.00%	-1.08%	-1.40%	0.04%	-0.04%	-
Wholesale wastewater – allowed revenues (real) (£m)	240.0	240.9	244.4	244.6	244.3	1,214.2
Wholesale wastewater – K (%)	0.00%	0.59%	1.72%	0.21%	-0.23%	-
Retail household allowed revenue (£m)	31.7	32.2	32.6	33.0	33.3	162.8
Retail non-household expected revenue (£m) ²	5.0	5.1	5.1	5.2	5.3	25.7
Average customer bill – water (£)	214	211	207	206	206	-
Average customer bill – wastewater (£)	302	301	302	300	297	-
Average customer bill – combined (£) ^{3, 4}	492	488	485	482	479	-

Notes:

1. The allowed revenue for our draft determination is based on an implied menu choice. The company will have the opportunity to change its menu choice, which will impact on its allowed revenues and customers’ bills.
2. We have not made a draft determination for the company’s non-household retail control. We will do this following the resubmission of proposed default tariffs by companies to us.
3. The average combined customer bill is not equal to the sum of the average water bill and the average wastewater bill due to the use of the economies of scope factor in the household retail price control.
4. The average combined customer bill does not reflect the £50 per customer Government contribution towards household bills in the South West Water region to address the disproportionate burden of improving bathing waters on South West Water’s customers.

A1.2 WaterShare

South West's business plan contains a Board pledge to share the benefits of success fairly between customers and investors. In line with this, it is proposing an independently monitored and transparent performance sharing framework for 2015-20 called 'WaterShare'. This framework would involve the company publishing a scorecard on an annual basis that summarises its performance and would allow for the sharing of net benefits with customers in a timely manner.

We welcome the fact that it has included this framework in its business plan, which as an enhanced company we have accepted in the round.

A2. Wholesale water

A2.1 Company outcomes, performance commitments and delivery incentives

A2.1.1 The PR14 focus on outcomes

As we set out in our final methodology statement, outcomes are one of the key innovations in PR14. Company business plans have been focused on outcomes rather than outputs. This ensures that companies are incentivised to deliver efficiently what customers and society need, want and are willing to pay for, and helps to legitimise their role in providing important public services.

Companies have engaged directly with their customers and customer challenge groups (CCGs) to develop a set of **outcomes**, together with the associated **performance commitments** and **outcome delivery incentives**. The performance commitments set out in detail the levels of performance that the companies commit to achieve within the five-year period from April 2015 to March 2020. The incentives set out what happens if companies over- or under-deliver against the committed performance levels.

The creation of delivery incentives directly linked to the outcomes encourages strong performance on a continuous basis. The incentives give the best-performing companies the opportunity to earn improved returns from financial rewards where there is evidence customers have indicated their support. The incentives also ensure that customers are protected against poor performance, with less well-performing companies held to account where performance falls below the committed performance levels, and where the incentive is financial, paying money back to customers.

Our final methodology statement set out a framework that gives companies a choice of three incentive types (financial reward and penalty; financial penalty only or reputational) and also considerable flexibility in how the incentive is calibrated. This includes the possibility to use limits on incentives (caps on rewards and collars on penalties) as well as neutral zones or deadbands within which the incentive is 'switched off'. Following our initial review of the companies' business plans, we provided further guidance on the alignment of performance commitments with effective financial incentives in ['Setting price controls for 2015-20 – risk and reward](#)

[guidance](#)’ (our ‘risk and reward guidance’). Further details of the approach to outcomes are set out in the technical appendix.

A2.1.2 Outcomes, performance commitments and incentives

The outcomes, performance commitments and outcome delivery incentives, proposed by the company, and which we are adopting for the wholesale water control are summarised in table A2 below. These reflect the company’s own business plan proposals after consultation with its customers and CCG. They include the revisions the company made in response to our risk and reward guidance and follow the general principles and process set out in the technical appendix. Annex 1 sets out the detail of the outcomes, performance commitments and incentives on which we are consulting as part of our draft determination.

Table A2 Wholesale water outcomes, performance commitments and incentives

Outcome	Performance commitment	Incentive type
Clean, safe and reliable supply of drinking water	Compliance with water quality standard (%)	Financial – penalty only
	Taste, smell and colour contacts (number/1,000 population)	Financial – reward and penalty
	Asset reliability (pipes)	Financial – penalty only
	Asset reliability (process)	Financial – penalty only
	Duration of interruptions in supply (hours/property)	Financial – reward and penalty
Available and sufficient water resources	Water restrictions placed on customers (number)	Financial – reward and penalty
	Ability to move water around the network	Future measure
	Leakage levels (MI/d)	Financial – reward and penalty
	Time taken to fix significant leaks (days)	Reputational
	Security of supply index	Reputational

Outcome	Performance commitment	Incentive type
Resilience in extreme conditions ¹	Supplies interrupted due to flooded company sites (number/year > 24 hours)	Financial – reward and penalty
Responsive to customers	Operational customer contacts resolved first time (%)	Financial – reward and penalty
Protecting the environment	Sustainable abstractions (EA/WFD classification)	Reputational
	Sustainable abstractions (EA water stress status)	Financial – penalty only
	Catchment management (acres)	Reputational
	Catchment management (number of farms)	Reputational
	Pollution incidents – category 1 and 2 (number)	Financial – penalty only
	Pollution incidents – category 3 and 4 (number)	Financial – penalty only
	Operational carbon emissions (ktCO ₂ e)	Reputational
	Energy from renewable sources (%)	Reputational
Fair charging	Customers paying a metered bill	Financial – penalty only

A2.2 Calculating the wholesale water control

A2.2.1 Structure of the wholesale water control

As we set out in our final methodology statement, the wholesale water control puts an overall limit on the revenue from charges and cash receipts from connection and

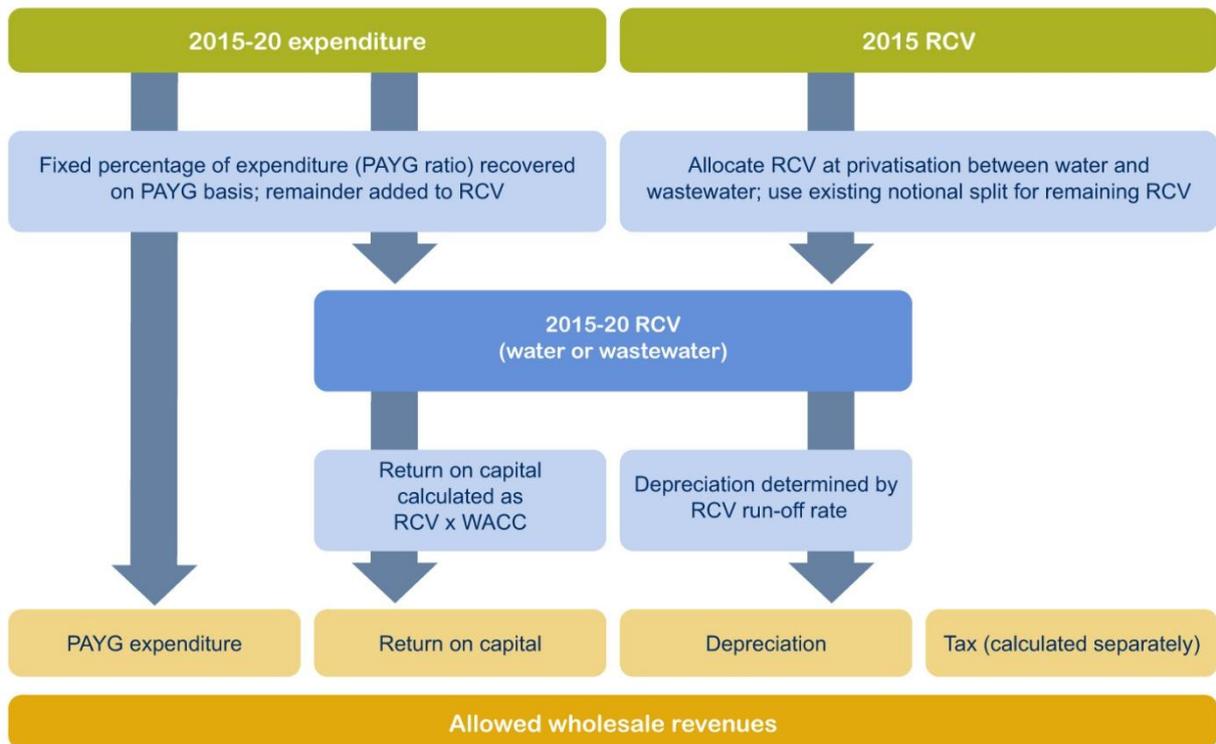
¹ The company will also track its performance against this outcome through measures of service reliability and interruption used for other outcomes, including those applying to other controls.

infrastructure charges. We also set out that we would retain an RCV approach to the setting of wholesale charges, but that we would make a number of improvements including:

- using a totex approach, where no distinction is made between operating and capital expenditure;
- introducing totex menus, which would provide an additional incentive for companies to reveal information and some scope for managing risks and rewards through the cost sharing factor; and
- providing companies with additional flexibility over cost recovery by allowing them to choose what proportion of their expenditure is recovered through the RCV, and through setting the level of depreciation (also known as the RCV run-off).

Figure A1 shows how the wholesale revenues are derived.

Figure A1 Approach to allowed wholesale revenue



The key components of the wholesale charges are as follows.

- Totex baselines for water and wastewater, which represent our own assessment of the efficient level of capital and operating expenditure for each company in the 2015-20 period.
- The PAYG ratio, which represents the allocation between totex which is recovered in the 2015 to 2020 period and that which is added to the RCV.
- The RCV, which is composed of the RCV at the start of the period plus additions from totex that is not recovered in the 2015-20 period minus depreciation.
- The return on the RCV, which reflects the vanilla wholesale weighted average cost of capital (WACC) applied to the RCV during the 2015-20 period.
- There are a number of adjustments reflecting the impact of incentive tools from the 2010-15 period such as the revenue correction mechanism (RCM) and capital expenditure (capex) incentive scheme (CIS).
- The corporation tax charge, which is calculated using the forecast accounting profits.
- 'Other operating income' and 'other income' are taken into account to reduce the revenue required from household and non-household water customers.

Capital contributions, which form the other component of the control, are cash receipts from connection and infrastructure charges.

Subject to our charging rules (as envisaged under the government's proposals in the UK Government's Water Bill) companies will have some flexibility to adjust charges within the control period to allow them to manage unexpected changes in demand.

A2.2.2 Calculation of allowed wholesale water expenditure

The wholesale water price control baseline represents our view of the efficient level of expenditure. Our approach to setting wholesale cost baselines is set out in the technical appendix. In essence, the starting point for our price control baselines is our benchmarking models, the output from which we then adjust where appropriate on the basis of well justified company-specific arguments and evidence. We then adjust this expenditure to reflect our own policies for particular cost areas, such as defined benefit pension deficit recovery costs and business rates (where we have set out a specific basis for cost recovery and risk sharing). Our menu baselines exclude

defined benefit pension deficit recovery costs, third party costs and 2014-15 market opening costs.

Further detail on our assessment of the company's price control baseline expenditure is set out in annex 2 and in '[Risk-based review initial cost threshold water model: South West Water](#)', which we have published on our website. We explain the movements in our assessment since the risk-based review in the technical appendix.

The technical appendix notes that for the risk-based review, the cost thresholds were calculated on the basis of our projections of model explanatory variables for each company. For enhanced companies, we have used the forecasts of model explanatory variables set out in their business plans to determine their wholesale water baselines (while preserving the upper quartile cost efficiency challenge used in the risk-based review for wholesale water). This is on the basis that, for these two enhanced companies, for their wholesale water service, we have relatively high confidence that these cost driver projections are aligned with the companies' delivery commitments to customers.

To convert the menu baseline to a totex allowance for the purpose of this draft determination, we have calculated an implied menu choice, which is the ratio of the company's view of cost and our menu baseline. We set out the menu we have used for the draft determination in the technical appendix. The company's implied menu choice for wholesale water is 91.5. As an enhanced company, South West will have the opportunity to finalise its menu choice within the range of 80 to 115 after we have published our draft determinations for all companies in full. This will impact the company's allowed expenditure and additional income and consequently its allowed revenue and bills. The allowed revenue is based on a weighted average of our view of the baseline (75%) and the company's menu choice (25%).

The calculation of totex allowances is shown in table A3. Separate revenue allowances are made for pension deficit recovery costs and third party costs which are excluded from the menu baselines, as are 2014-15 market opening costs. The menu approach also allows an 'additional income' component, which companies receive as part of allowed revenues. This is set out in table A9 in section A2.2.9.

Pension deficit repair allowances are calculated in line with the approach that we outlined in '[IN 13/17: Treatment of companies' pension deficit repair costs at the 2014 price review](#)'. We have allocated costs between the different controls as set out in the IN with the exception of wholesale deficit costs between water and wastewater which we have allocated using the company split per Table 7 of the August 2012

data submission. This is consistent with the allowance made in the 2009 price review (PR09), with the remaining deficit repair costs borne by shareholders.

Table A3 Wholesale water allowed expenditure (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	AMP6 total
Menu cost baseline ¹	142.9	145.8	139.7	132.4	132.8	693.6
Company's view of menu costs ²						634.9
Implied menu choice						91.5
Allowed expenditure from menu	139.9	142.7	136.8	129.6	130.0	678.9
Costs excluded from menu	9.6	9.5	9.5	9.5	9.5	47.6
Total allowed expenditure ³	149.5	152.3	146.3	139.1	139.5	726.6
Less pension deficit repair allowance	3.9	3.9	3.9	3.9	3.9	19.6
Totex for input to PAYG	145.6	148.3	142.4	135.2	135.5	706.9

Notes:

1. See table A1 in the technical appendix for the derivation of menu baselines.
2. Based on company plan totex minus costs for items excluded from the menu.
3. Includes pension deficit repair allowance.

A2.2.3 Calculation of PAYG rates and depreciation

To determine the allowed revenue, the wholesale water totex allowance is allocated between the amount recovered in 2015-20 PAYG (referred to as the pay as you go amount) and the amount added to the RCV to be recovered in future periods. A significant proportion of company expenditure is in long life assets, which benefit current and future customers. The allowed revenue will also include RCV depreciation and the return on the RCV as set out in figure A1 above.

Consistent with our methodology, we have allowed all companies to propose their own PAYG ratios and levels of RCV depreciation. The company has revised its

proposed PAYG ratios from its original business to reflect our risk and reward guidance and its position relative to the allowed wholesale cost baselines but has otherwise left its original RCV depreciation proposals unchanged.

Table A4 shows the company's updated proposed PAYG ratios and associated totex recovery for wholesale water, which we have used as the basis for this draft determination.

Table A4 South West wholesale water PAYG ratios

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£ m)	145.6	148.3	142.4	135.2	135.5	706.9
PAYG %	61.07%	56.47%	54.31%	57.00%	56.89%	57.15%
Resulting PAYG (£ m)	88.9	83.8	77.3	77.1	77.1	404.1

Table A5 shows the depreciation amounts included within the wholesale water charge. The depreciation rates reflect a run-off rate of 3.8% for the RCV as at 31 March 2015 and a totex average life of 23.9 years for the totex additions to the RCV over 2015-20.

Table A5 South West wholesale water depreciation (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Depreciation on 2015 RCV	44.6	42.9	41.3	39.7	38.2	206.7
Depreciation on totex additions	1.2	3.7	6.4	9.0	11.5	31.8
Total depreciation	45.7	46.6	47.7	48.8	49.7	238.5

A2.2.4 Return on the RCV

Companies receive a return on the RCV, equal to the vanilla WACC, to compensate them for capital value that has not been recovered prior to and in the PR14 period. Our risk and reward guidance set out a single industry cost of capital for both wholesale water and wastewater services of 3.7%. The company has accepted this guidance and so we have used a cost of capital of 3.7% in this draft determination. This results in a return on capital of around £45 million a year over 2015-20.

The return on capital is calculated by applying the cost of capital to the average RCV for the year. The company has calculated its opening RCV for the start of 2015-20 on 1 April 2015 by taking the closing RCV at the end of 2010-15 and adding its view of midnight adjustments to the RCV to reflect:

- its assessment of its performance over 2010-15; and
- its allocation of the £11 million initial award to the company as a result of it achieving enhanced status, which it has chosen to recover through an addition to its 2015-16 RCV.

We have accepted the company's calculation of its opening RCV for our draft determination (see table A6).

The average RCV, set out in table A7 below for each year, takes into account totex additions to the RCV and depreciation.

Table A6 South West wholesale water opening RCV (£ million)

	2015-16
Closing RCV 31 March 2015	1194.3
Opening RCV 1 April 2015	1188.2

Table A7 South West wholesale water return on RCV (£m)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	1188.2	1199.1	1217.1	1234.4	1243.8
RCV additions (from totex)	56.7	64.6	65.0	58.1	58.4
Less depreciation	45.7	46.6	47.7	48.8	49.7
Closing RCV	1199.1	1217.1	1234.4	1243.8	1252.5
Average RCV (year average)	1193.7	1208.1	1225.7	1239.1	1248.1
Return on capital	44.1	44.7	45.3	45.8	46.2

A2.2.5 Corporation tax

The allowed revenues of the wholesale water and wastewater services should include the recovery of the appropriate tax, taking into account complexities such as

tax losses arising at the appointee level. To help achieve this aim, wholesale tax has first been calculated at the wholesale level for both services combined, and then apportioned to the water and wastewater services for the separate allowed revenues concerned. As set out in our final methodology statement, our approach to calculating tax is similar to the method used for PR09, but with a simplified and less data-intensive approach.

We have used companies' average capital allowance writing-down rates by service for both the brought forward expenditure pools and for new expenditure. We have used South West's estimates of the proportion of base expenditure on underground assets, which is treated as operating expenditure in the statutory accounts.

We have based the tax calculation on projected corporation tax rates, profits and assumed levels of tax relief. We have taken account of debt interest payments by using the higher of:

- companies' actual proportion of debt financing; and
- the proportion of debt financing assumed in our notional capital structure.

A2.2.6 Income from other sources

Income from other sources is made up of 'Operating income', 'Other income' and third party income. These are revenues that companies charge but do not form part of the regular water and wastewater bills that customers pay. For South West, these mainly comprise rechargeable works such as mains diversions but they can also include income from services such as bulk supplies. These revenues are based on the company's forecasts and are set out in table A9 in section A2.2.9.

A2.2.7 Capital contributions from connection charges and revenue from infrastructure charges

This comprises revenue and capital contributions from connection and infrastructure charges (including requisitions and self-lay). These revenues are based on the company's forecasts and are set out in table A9 in section A2.2.9.

A2.2.8 Reconciling 2010-15 performance

We confirmed in our final methodology statement that, for a number of incentive tools, we would make appropriate adjustments to allowed revenues for 2015-20, to reflect companies' actual performance, costs and revenues when compared to our PR09 assumptions. Table A8 below summarises the revenue adjustments we are

making to the company's 2015-20 wholesale water price control to reflect its performance over 2010-15.

Annex 4 provides more detail on our draft determination in this area. It also sets out any other adjustments we are making, such as those relating to equity injections. We are not making any other adjustments for this company.

Table A8 South West revenue adjustments to reflect 2010-15 performance (£m)

£ million	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Service incentive mechanism (SIM)	-1.1	-1.1	-1.1	-1.1	-1.1	-5.6
Revenue correction mechanism (RCM)	1.5	1.5	1.5	1.5	1.5	7.3
Opex incentive allowance (OIA)	0.0	1.4	0.1	0.0	0.0	1.5
Capital expenditure incentive scheme (CIS)	-3.3	-3.3	0.0	0.0	0.0	-6.6
Other adjustments	0.0	0.0	0.0	0.0	0.0	0.0
Total	-2.9	-1.5	0.4	0.3	0.3	-3.4

A2.2.9 Calculation of allowed revenue

The calculation of the allowed revenue for South West's wholesale water control is shown in table A9. Allowed revenue is principally built up from PAYG totex, the return on RCV, depreciation and an allowance for corporation tax.

Overall, we consider that the company's wholesale water revenue allowance should be £185 million in 2015-16, decreasing by 3% to £179 million in 2019-20.

Table A9 South West wholesale water allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	145.6	148.3	142.4	135.2	135.5	706.9
PAYG ratio	61.07%	56.47%	54.31%	57.00%	56.89%	57.15%
Totex additions	56.7	64.6	65.0	58.1	58.4	302.8

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
to the RCV						
RCV (year average)	1193.7	1208.1	1225.7	1239.1	1248.1	
Wholesale allowed revenue build up:						
PAYG ¹	92.8	87.7	81.2	81.0	81.0	423.8
Return on capital	44.1	44.7	45.3	45.8	46.2	226.1
Depreciation	45.7	46.6	47.7	48.8	49.7	238.5
Tax ²	6.2	6.0	5.4	4.2	3.3	25.2
Income from other sources	-5.5	-5.5	-5.5	-5.5	-5.5	-27.6
Reconciling 2010-15 performance	-2.9	-1.5	0.4	0.3	0.3	-3.4
Ex ante additional menu income	1.6	1.6	1.6	1.5	1.5	7.8
Capital contributions from connection charges and revenue from infrastructure charges	2.7	2.8	3.2	3.2	2.9	14.8
Final allowed revenues	184.8	182.5	179.4	179.3	179.4	905.3

Notes:

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

A2.3 Uncertainty mechanisms

In our risk and reward guidance, we acknowledged that all companies face uncertainty about future costs and revenues. We consider that appropriate risk sharing mechanisms provide companies with incentives to reduce costs and provide better services.

Companies already have access to a range of uncertainty mechanisms which share risks between companies and customers. In our final methodology statement, we noted that additional risk should only be fully transferred to customers when companies are unable to influence the impact on their business. As set out in our risk and reward guidance, when a company is able to materially influence the probability or magnitude of impacts, or mitigate the effect efficiently, then the risk should remain with the company, at least in part. This provides companies with strong incentives to manage risks. In our risk and reward guidance, the one area where we did consider an uncertainty mechanism was appropriate was for the revaluation of wholesale water business rates in 2017, although we considered that companies should retain a residual incentive, in order to argue for reasonable treatment in the rating review on behalf of customers.

The company has accepted this risk and reward guidance on uncertainty mechanisms. In line with our guidance, the company proposed that water business rates should be a notified item for PR14 and, as such, could qualify for an interim determination, which allows price limits to be adjusted between periodic reviews. We have accepted this proposal. The formal interim determination mechanism is set out in each company's licence. It can only be triggered by relevant items, the value of which, in aggregate, must exceed 10% of a company's turnover. As proposed by South West, the uncertainty mechanism would pass through 80% of changes in water business rate costs to customers, with the company retaining 20% of the cost risk. We consider that this should provide a sufficient incentive on the company to minimise costs in conjunction with its WaterShare mechanism.

Relevant items are classified as either notified items or relevant changes of circumstance (RCCs).

The company withdrew its other, earlier proposals for notified items or change protocols in its revised business plan submission.

Therefore, in this draft determination, we have not provided for other uncertainty mechanisms, beyond those set out in the company's licence, in this draft determination in line with our risk and reward guidance.

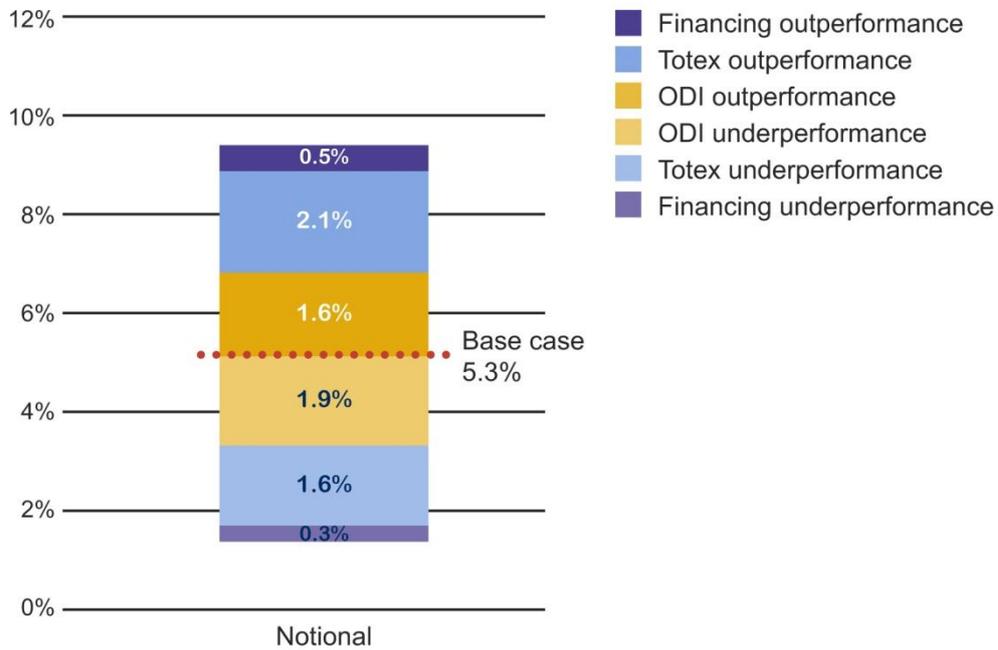
A2.4 Return on regulated equity

As set out in our final methodology statement, we are taking a systematic and quantitative approach to analysing how companies are managing their risks and its allocation between companies' investors and customers. We proposed to use an approach based on scenario modelling to analyse risk and explore the overall balance of risks to return on regulated equity (RoRE).

Consistent with our risk and reward guidance, as part of its revised business plan submission, South West conducted detailed scenario analyses to assess the potential RoRE range at the company level. Based on this, as part of our risk based review of the company's business plan, we calculated the overall RoRE range for wholesale water, shown in figure A2, split into the constituent risk components, such as totex and outcome delivery incentive under- and outperformance. The risk range is expressed on a P10/P90 basis such that there is a 10% probability of an outturn occurring below the charted range and an equal likelihood of achieving a return above the charted range.

For wholesale water, the RoRE range is from 1.4% to 9.4%, with a base case of 5.3%. This is a similar range to the overall appointee range of 2% to 10%, and reflects the lower expected return for wholesale as the remaining return is required to compensate risks in retail. Risk ranges for individual elements (totex, ODIs, SIM and financing) are consistent with our risk and reward guidance.

Figure A2 South West RoRE range – wholesale water



Source:

Ofwat's risk-based review analysis based on company business plan table A20. Analysis does not reflect changes or assumptions made since the completion of the risk-based review.

A3. Wholesale wastewater

A3.1 Company outcomes, performance commitments and delivery incentives

In section A2.2.1, we discuss how, as we set out in our final methodology statement, outcomes, and the associated performance commitments and incentives, are one of the key innovations in PR14.

The outcomes, performance commitments and outcome delivery incentives, proposed by the company, and which we are adopting for the wholesale wastewater control are summarised in table A10 below. These reflect the company's own business plan proposals after consultation with its customers and CCG. They include the revisions it made in response to our risk and reward guidance and follow the general principles and process set out in the technical appendix. Annex 1 sets out the detail of the outcomes, performance commitments and incentives that we are consulting on as part of our draft determination.

Table A10 Wholesale wastewater outcomes, performance commitments and incentives

Outcome	Performance commitment	Incentive type
Reliable wastewater service	Internal sewer flooding incidents (number)	Financial – reward and penalty
	External sewer flooding incidents (number)	Financial – reward and penalty
	Odour contacts – WWTWs (number)	Financial – reward and penalty
	Asset reliability – pipes	Financial – penalty only
	Asset reliability – processes	Financial – penalty only
	Compliance with sludge standard (%)	Reputational
Responsive to customers	Operational customer contacts resolved first time (%)	Financial – reward and penalty

Outcome	Performance commitment	Incentive type
Protecting the environment	WWTW numeric compliance (%)	Financial – penalty only
	WWTW pop. equiv. sanitary compliance (%)	Reputational
	WWTW descriptive permit compliance (%)	Financial – penalty only
	Pollution incidents – category 1 and 2 (number)	Financial – penalty only
	Pollution incidents – category 3 and 4 (number)	Financial – penalty only
	Operational carbon emissions (ktCO ₂ e)	Reputational
	Energy from renewable sources (%)	Reputational
Benefiting the community	Bathing water quality (%)	Financial – reward and penalty
	Combined sewer overflow spills (number)	Future measure
	River water quality standard (km)	Reputational

A3.2 Calculating the allowed wholesale wastewater control

A3.2.1 Structure of wholesale wastewater control

The wholesale wastewater control is structured in the same way as the wholesale water control. We have set out the structure of the wholesale water control in section A2.2.1

A3.2.2 Calculation of allowed wholesale wastewater expenditure

The wholesale wastewater price control baseline represents our view of the efficient level of expenditure. Our approach to setting wholesale cost baselines is set out in the technical appendix. In essence, the starting point for our price control baselines is our benchmarking models, which we then adjust where appropriate on the basis of well justified company-specific arguments and evidence. We then adjusted this expenditure to reflect our own policies for particular cost areas, such as defined

benefit pension deficit recovery costs and business rates (where we have set out a specific basis for cost recovery and risk sharing). Our menu baselines exclude defined benefit pension deficit recovery costs, third party costs and 2014-15 market opening costs.

Further detail on our assessment of the company's price control baseline expenditure is set out in annex 2 and in '[Risk-based review initial cost threshold sewerage model: South West Water](#)', which we have published on our website. We explain the movements in our assessment since the risk-based review in the technical appendix.

To convert the menu baseline to a totex allowance, for the purpose of this draft determination, we have calculated an implied menu choice, which is the ratio of the company's view of cost and our menu baseline. We set out the menu we have used for the draft determination in the technical appendix. The company's implied menu choice for wholesale wastewater is 99.6. As an enhanced company, South West will have the opportunity to finalise its menu choice within the range of 80 to 115 after we have published our draft determinations for all companies in full. This will impact the company's allowed expenditure and additional income and consequently its allowed revenue and bills. The allowed revenue is based on a weighted average of our view of the baseline (75%) and the company's menu choice (25%).

The calculation of totex allowances is shown in table A11. Separate revenue allowances are made for pension deficit recovery costs and third party costs which are excluded from the menu baselines, as are 2014-15 market opening costs. The menu approach also allows an 'additional income' component, which companies receive as part of allowed revenues. This is set out in table A17 in section A3.2.9.

Pension deficit repair allowances are calculated in line with the approach that we outlined in IN 13/17. We have allocated costs between the different controls as set out in the IN with the exception of wholesale deficit costs between water and wastewater which we have allocated using the company split per Table 7 of the August 2012 data submission. This is consistent with the allowance made in PR09, with the remaining deficit repair costs borne by shareholders.

Table A11 Wholesale wastewater allowed expenditure (£m)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Menu cost baseline ¹	171.6	172.4	174.4	178.3	184.2	880.8
Company's view of menu costs ²						877.1
Implied menu choice						99.6
Allowed expenditure from menu	171.4	172.2	174.2	178.1	184.0	879.9
Costs excluded from menu	3.9	3.8	3.8	3.7	3.7	18.9
Total allowed expenditure³	175.3	176.0	178.0	181.9	187.7	898.8
Less pension deficit repair allowance	3.5	3.5	3.5	3.5	3.5	17.5
Totex for input to PAYG	171.8	172.5	174.5	178.4	184.2	881.3

Notes:

1. See table A1 in the technical appendix for the derivation of menu baselines.
2. Based on company plan totex minus costs for items excluded from the menu.
3. Includes pension deficit repair allowance.

A3.2.3 Calculation of PAYG rates and depreciation

To determine the allowed revenue, the wholesale wastewater totex allowance is allocated between the amount recovered in 2015-20 (referred to as the PAYG amount) and the amount added to the RCV to be recovered in future periods. A significant proportion of company expenditure is in long life assets, which benefit current and future customers. The allowed revenue will also include RCV depreciation and the return on the RCV, as set out in figure A1 above.

Consistent with our methodology, we have allowed all companies to propose their own PAYG ratios and levels of RCV depreciation. The company has revised its proposed PAYG ratios from its original business plan to reflect the risk and reward guidance we published in January 2014 and its position relative to the allowed wholesale cost baselines but has otherwise left its original RCV depreciation proposals unchanged.

Table A12 shows the company's updated proposed PAYG ratios and associated totex recovery for wholesale wastewater, which we have used as the basis for this draft determination.

Table A12 South West wholesale wastewater PAYG ratios

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex (£m)	171.8	172.5	174.5	178.4	184.2	881.3
PAYG %	55.2%	55.2%	54.4%	53.9%	51.8%	54.1%
Resulting PAYG (£m)	94.8	95.3	94.9	96.2	95.4	476.5

Table A13 shows the depreciation amounts included within the wholesale wastewater charge. The depreciation rates reflect a run-off rate of 4.7% for the RCV as it stands on 31 March 2015 and a totex average life of 16.6 years for the totex additions to the RCV over 2015-20.

Table A13 South West wholesale wastewater depreciation (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Depreciation on 2015 RCV	75.0	71.4	68.0	64.8	61.7	341.0
Depreciation on totex additions	2.3	7.0	11.7	16.5	21.7	59.2
Total depreciation	77.3	78.4	79.7	81.4	83.4	400.2

A3.2.4 Return on the RCV

Companies receive a return on the RCV, equal to the vanilla WACC, to compensate them for capital value that has not been recovered prior to and in the PR14 period. Our risk and reward guidance set out a single industry cost of capital for both wholesale water and wastewater services of 3.7%. The company has accepted this guidance and so we have used a cost of capital of 3.7% in this draft determination. This results in a return on capital of around £58 million a year over 2015-20.

The return on capital is calculated by applying the cost of capital to the average RCV for the year. The company has calculated its opening RCV for the start of 2015-20

on 1 April 2015 by taking the closing RCV at the end of 2010-15 and adding its view of midnight adjustments to the RCV to reflect:

- its assessment of its performance over 2010-15; and
- its allocation of the £11 million initial award to the company as a result of it achieving enhanced status, which it has chosen to recover through an addition to its 2015-16 RCV.

We have accepted the company's calculation of its opening RCV for our draft determination (see table A14).

The average RCV, set out in table A15 below for each year, takes into account totex additions to the RCV and depreciation.

Table A14 South West wholesale wastewater opening RCV (£m)

	2015-16
Closing RCV 31 March 2015	1589.8
Opening RCV 1 April 2015	1581.8

Table A15 South West wholesale wastewater return on RCV (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RCV	1581.8	1581.5	1580.3	1580.2	1581.1
RCV additions (from totex)	77.0	77.2	79.6	82.2	88.8
Less depreciation	77.3	78.4	79.7	81.4	83.4
Closing RCV	1581.5	1580.3	1580.2	1581.1	1586.4
Average RCV (year average)	1581.7	1580.9	1580.3	1580.7	1583.7
Return on capital	58.5	58.5	58.4	58.4	58.6

A3.2.5 Corporation tax

The allowed revenues of the wholesale water and wastewater services should include the recovery of the appropriate tax, taking into account complexities such as tax losses arising at the appointee level. To help achieve this aim, wholesale tax has first been calculated at the wholesale level for both services combined, and then

apportioned to the water and wastewater services for the separate allowed revenues concerned. As set out in our final methodology statement, our approach to calculating tax is similar to the method used for PR09, but with a simplified and less data-intensive approach.

We have used companies' average capital allowance writing-down rates by service for both the brought forward expenditure pools and for new expenditure. We have used the company's estimates of the proportion of base expenditure on underground assets, which is treated as operating expenditure in statutory accounts.

We have based the tax calculation on projected corporation tax rates, profits and assumed levels of tax relief. We took account of debt interest payments by using the higher of:

- companies' actual proportion of debt financing; and
- the proportion of debt financing assumed in our notional capital structure.

A3.2.6 Income from other sources

Income from other sources is made up of 'Operating income', 'Other income' and third party income. These are revenues that companies charge but do not form part of the regular water and wastewater bills that customers pay. For South West's wholesale wastewater control, these reflect other appointed business revenues and reflect miscellaneous cost reflective sales. These revenues are based on the company's forecasts and are set out in table A17 in section A3.2.9.

A3.2.7 Capital contributions from connection charges and revenue from infrastructure charges

This comprises revenue and capital contributions from connection and infrastructure charges (including requisitions and self-lay). These revenues are based on the company's forecasts and are set out in table A17 in section A3.2.9.

A3.2.8 Reconciling 2010-15 performance

We confirmed in our final methodology statement that, for a number of incentive tools, we would make appropriate adjustments to allowed revenues for 2015-20, to reflect companies' actual performance, costs and revenues when compared to our PR09 assumptions. Table A16 below summarises the revenue adjustments we are making to the company's 2015-20 wholesale wastewater control to reflect its performance over 2010-15.

Annex 4 provides more detail on our draft determination in this area. It also sets out any other adjustments we are making, such as those relating to equity injections. We are not making any other adjustments for this company.

Table A16 South West revenue adjustments to reflect 2010-15 performance (£ million)

£ million	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Service incentive mechanism (SIM)	-1.4	-1.4	-1.4	-1.4	-1.4	-6.8
Revenue correction mechanism (RCM)	-2.1	-2.1	-2.1	-2.1	-2.1	-10.6
Opex incentive allowance (OIA)	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure incentive scheme (CIS)	-4.1	-4.1	0.0	0.0	0.0	-8.1
Other adjustments	0.0	0.0	0.0	0.0	0.0	0.0
Total	-7.5	-7.5	-3.5	-3.5	-3.5	-25.5

A3.2.9 Calculation of allowed revenue

The calculation of the allowed revenue for South West's wholesale wastewater control is shown in table A17. Allowed revenue is principally built up from PAYG totex, the return on RCV, depreciation and an allowance for corporation tax.

Overall, we consider that South West's wholesale wastewater revenue allowance should be £240 million in 2015-16, increasing by 1.8% to £244 million in 2019-20.

Table A17 South West wholesale wastewater allowed revenue (£ million)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Totex	171.8	172.5	174.5	178.4	184.2	881.3
PAYG ratio	55.16%	55.24%	54.37%	53.93%	51.81%	54.10%
Totex additions	77	77.2	79.6	82.2	88.8	404.8
RCV (year average)	1,581.7	1,580.9	1,580.3	1,580.7	1,583.7	

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale allowed revenue build up:						
PAYG ¹	98.3	98.8	98.4	99.7	98.9	494.1
Return on capital	58.5	58.5	58.4	58.4	58.6	292.4
Depreciation	77.3	78.4	79.7	81.4	83.4	400.2
Tax ²	10.6	10.0	8.6	5.8	4.3	39.4
Income from other sources	-0.5	-0.5	-0.5	-0.5	-0.5	-2.5
Reconciling 2010-15 performance	-7.5	-7.5	-3.5	-3.5	-3.5	-25.5
Ex ante additional menu income	0.1	0.1	0.1	0.1	0.1	0.5
Capital contributions from connection charges and revenue from infrastructure charges	3.2	3.2	3.1	3.2	3.0	15.7
Final allowed revenues	240.0	240.9	244.4	244.6	244.3	1,214.2

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.

A3.3 Uncertainty mechanisms

In our risk and reward guidance, we acknowledged that all companies face uncertainty about future costs and revenues. We consider that good risk sharing mechanisms provide companies with incentives to reduce costs and provide better services.

Companies already have access to a range of uncertainty mechanisms which share risks between companies and customers. In our final methodology statement, we noted that additional risk should only be fully transferred to customers when companies are unable to influence the impact on their business. As set out in our risk and reward guidance, when a company is able to materially influence the probability or magnitude of impacts, or mitigate the effect efficiently, then the risk should remain with the company, at least in part. This provides companies with strong incentives to manage risks.

The company has accepted the risk and reward guidance on uncertainty mechanisms. Consistent with the guidance, it has included an uncertainty mechanism for water business rates. This does not apply to wastewater business rates. The company withdrew its earlier proposals for notified items or change protocols.

A3.4 Return on regulated equity

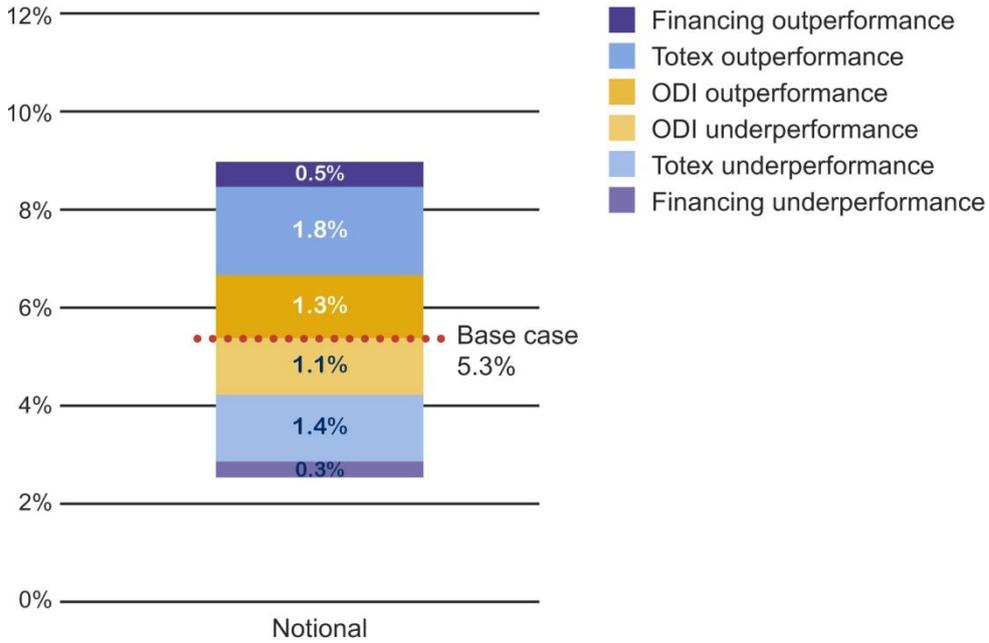
We describe our approach to analysing how companies are managing their risks and its allocation between companies' investors and customer in section A2.4.

Consistent with this, and based on South West's assessment for the overall company as part of its revised business plan submission, we have calculated the RoRE range for wholesale wastewater, shown in figure A3 and split into the constituent risk components such as totex and ODI under and out performance.

For wholesale wastewater, the RoRE range is 2.5% to 8.9%, with a base case of 5.3%. This is a slightly narrower range compared with the overall company range of 2% to 10%, with a lower base case of 5.3%. The base case reflects the lower expected return for the wholesale wastewater as the remaining return is required to compensate risks in retail. The ODI risk range is -1.1 to +1.3%, which is narrower than the whole company (albeit still consistent with the guidance) and reflects the lower level of rewards and penalties attributed to wastewater. The cost risk range is -1.4% to +1.8%, which again is narrower than the range for the overall company (and

our guidance) and reflects the company’s view that uncertainty is lower in wastewater compared to water. We consider that this range is reasonable given the overall risk range for the company.

Figure A3 South West RoRE range – wholesale wastewater



Source:

Ofwat’s risk-based review analysis based on company business plan table A20. Analysis does not reflect changes or assumptions made since the completion of the risk-based review.

A4. Household retail

A4.1 Company outcomes, performance commitments and delivery incentives

In section A2.2.1, we discuss how, as we set out in our final methodology statement, outcomes, and the associated performance commitments and incentives, are one of the key innovations in PR14.

The outcomes, performance commitments and outcome delivery incentives, proposed by the company, and which we are adopting for the company's household retail control are summarised in table A18 below. These reflect the company's own business plan proposals after consultation with its customers and customer challenge group. They include the revisions it made in response to our risk and reward guidance and follow the general principles and process set out in the technical appendix. Annex 1 sets out the detail of the outcomes, performance commitments and incentives on which we are consulting as part of our draft determination.

The outcomes we are adopting include the service incentive mechanism (SIM) that applies to all companies.

Any SIM incentive reward or penalty due will be determined by comparing company's household SIM performance over four years (2015-16 to 2018-19) to the industry performance. The reward or penalty will range between +6% and -12% of 2019-20 household retail revenues; and we will adjust retail household revenues from 2020-21. The weights attached to the SIM performance measures will comprise 75% from qualitative survey results and 25% from quantitative measures as set out in ['Service incentive mechanism \(SIM\) for 2015 onwards – conclusions'](#). The details of these are currently being tested by companies and we will confirm the final methodology before April 2015.

Table A18 Household retail outcomes, performance commitments and incentives

Outcome	Performance commitment	Incentive type
Responsive to customers	Customer overall satisfaction (%)	Reputational
	Service incentive mechanism (SIM)	Financial – reward and penalty
	Customers' satisfaction with value for money (%)	Reputational
Fair charging	Customers assisted by water poverty initiatives	Reputational

A4.2 Costs

In our final methodology statement, we confirmed that our household retail price controls would be based on setting a revenue control for each company based on the efficient costs of retail activities (as measured by the average cost to serve, or ACTS) based on customer numbers. Setting household price controls for 2015-20 on the basis of ‘average’ costs of companies is part of an evolutionary approach that we hope will enable us to move to an efficient cost to serve over future price controls. As part of this process, we confirmed that we would adjust the ACTS to account for levels of metering. We also confirmed that companies could seek additional adjustments to the ACTS if certain criteria were met, as discussed further below.

A4.2.1 Adjustments

Our final methodology statement confirmed that companies could seek additional adjustments to their ACTS where they were able to demonstrate with sufficient and convincing evidence that:

- those costs were material to their company;
- that they were driven by factors beyond efficient management control; and
- that they impacted the company in a materially different way to other companies.

Each of these criteria is of equal importance. The first criterion ensures that adjustments to the ACTS are only made for material items. The second criterion ensures that companies needed to provide sufficient and convincing evidence that the particular factor was beyond management control and that there was a clearly evidenced causal relationship between that factor and the costs of providing retail

services to household customers in their area. Similarly, companies needed to demonstrate under this criterion that their management practises in this area were efficient, or to reflect their level of inefficiency suitably in their adjustment request. The third criterion ensures that adjustments to the ACTS are only made for items that impact companies in a materially different way to other companies, given that the ACTS will generally already take account for any items that impact all companies in the same way.

South West proposed three adjustments in its business plan. They were for:

- bad and doubtful debt;
- its vulnerable customer scheme outcome; and
- pension deficit repair costs.

Of these, we have accepted the company's updated evidence to support an adjustment for bad and doubtful debt and so we have made an adjustment to the ACTS for these costs.

We did not assess the company's proposals in relation to its vulnerable customer scheme or pension deficit repair costs as adjustments. The vulnerable customer schemes falls under our assessment of new costs and South West's proposed new retail costs are not material (see section A4.2.2). The proposed pension deficit recovery costs are covered by other policies discussed in sections A2.2.2 and A3.2.3 above and IN 13/17. A portion of the allowed costs was allocated for recovery in revenues covered by the household retail control. South West has calculated an allowance of £0.703 million (in 2012-13 prices) per year of 2015-20 in accordance with the guidance set out in IN 13/17.

We set out our assessment of the company's proposed bad and doubtful debt adjustment below.

Bad and doubtful debt – company proposal

In relation to bad and doubtful debt, the company's business plan requested an adjustment to its allowed cost to serve for doubtful debt costs driven by differences in deprivation and bill size in its region versus other companies. The total value of the company's proposed bad debt charge in its original business plan was £70.45 million over the period 2015-20, of which £38.95 million was represented by the requested doubtful debt adjustment relative to the amounts that the company estimated would otherwise be allowed by our ACTS methodology (£31.5 million). This original request

included a glide path during the first three years of 2015-20 for the company to reduce its bad debt costs down to an 'efficient' level.

We assessed the evidence in the company's business plan to support this adjustment as part of our risk-based review. This included assessments of:

1. The scale of the adjustment request to understand the extent to which the adjustment is material: Where we judged the request to be material.
2. The extent to which bill size and deprivation are beyond management control: We consider that bill levels are to a great degree within management control and, indeed, we have seen many companies reduce bill levels significantly in response to feedback from their customers as part of the Price Review. However, for largely historical reasons to do with the geography of its area of appointment, South West's bill level is the highest in the country, and given this background we considered that it has relatively less influence over bill levels within its operating area. Since companies must serve customers in their area of appointment, levels of deprivation within a company area are to a greater degree outside of management control and South West's customer base includes a proportion of significantly deprived customers.
3. Whether sufficient and convincing evidence was provided on the extent to which bad debt costs were influenced by bill size and deprivation in the company's area relative to other companies: This included an independent review of the underlying econometric evidence for the requested adjustment, which was carried out by PwC, the results of which we have published alongside the draft determination. These results suggested that the evidence in this area was not sufficient and convincing, in particular because the modelling demonstrated some statistical shortcomings and because insufficient evidence was provided to support the assumptions around the impact of forecast changes in bill levels and deprivation during the next AMP period on bad debt costs.
4. The extent to which management practises were efficient and that the level of the proposed adjustment reflected those management practises: We found that South West had provided strong evidence of its management practises in relation to bad debt and that these were in line with a qualitative review of good practise in the management of bad debt costs. Similarly, in relation to bill levels our assessment in other parts of the risk-based review demonstrated that South West had costs which were efficient.

Given the issues that we identified with the underlying analysis we did not have sufficient and convincing evidence that the size of the proposed adjustment was reasonable. Similarly, South West had included a glidepath of three years to reach the 'efficient' level of bad debt for its area and we did not believe that there was sufficient customer support for such a glide path.

We concluded that the company had provided insufficient evidence to justify this requested adjustment being made.

Bad and doubtful debt – issues raised as part of our pre-qualification assessment

Given our risk-based review assessment, as a condition attached to our pre-qualification decision, we asked the company to take the following follow-up actions to revise its business plan submission.

- Replace the proposed doubtful debt adjustment with one that was supported by sufficient and convincing evidence calculated using a suitable approach, in particular an approach that reflects the impact of changes in deprivation and bill levels over 2015-20. We asked the company that it do this after agreeing to a process for providing us with an updated adjustment by 7 April 2014. We said we would then review the revised adjustment.
- Provide sufficient and convincing evidence to support customers paying for the proposed glidepath from current costs to the efficient bad debt charge for South West.
- Set out the reasoning to support its view that doubtful debt costs will not change in outturn prices over the period in its area.

In response to our pre-qualification conditions, South West updated its econometric modelling analysis to examine how changes in deprivation and bill levels over 2015-20 would affect its proposed adjustment for doubtful debt. It modelled alternative approaches², which resulted in marginally different predictions for its proposed doubtful debt adjustment, whilst seeking to address the specific issues we raised as part of our pre-qualification assessment. South West concluded that the values

² A report describing South West's modelling approaches can be found on our website. Note that the figures in this report are in 2010-11 constant prices not 2012-13 prices.

produced by the modelling approaches were not significantly different from the value on which it based the doubtful debt adjustment it had previously proposed in its business plan.

South West also considered our requirement to provide justification for its proposed glidepath from current costs in the adjustment, and following this consideration removed the glidepath in its original business plan submission in its revised proposals, but argued that the remainder of its original doubtful debt adjustment value was still appropriate given the results of its further econometric modelling.

The removal of the proposed glidepath reduced the company's proposed bad debt charge to £67 million, of which £34 million represented the requested doubtful debt adjustment and £33 million the company's estimate of what would otherwise be allowed by our ACTS methodology. This represented a marginally different balance of the two components compared with the company's original business plan as it updated its estimate of its allowed household retail revenue in its response to our pre-qualification actions.

Removing the glidepath means that South West feels the full effect of the efficiency challenge that the company has set itself from the start of the period, instead of it being phased in during the first three years of the period. This means that the company is under pressure to realise efficiency gains in its operations earlier in the period, and this will reduce the amount of the bad debt charge that customers will bear.

PwC replicated and reviewed South West's alternative modelling approaches to check their robustness and calculations, and also performed some cross-checks using two alternative modelling approaches³. As a result of this additional analysis, we concluded that South West had broadly met the pre-qualification conditions that we had set in this area. Consequently, and taking into account the company's wider business plan revisions in response to our risk and reward guidance and pre-qualification conditions, we confirmed South West as an enhanced company on 4 April and made an adjustment to its allowed retail revenues.

³ A note describing PwC's review of SWT's modelling approaches, as well as their additional two modelling approaches (and the accompanying base data upon which the models are based), can be found on our website. Note that the figures in this report are in 2010-11 constant prices not 2012-13 prices.

ACTS adjustments – position reflected in South West’s draft determination

The table below shows the adjustments we have included in the draft determination and the adjustments included in the company’s business plan.

Table A19 Household retail adjustments (£ million)

	Units	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Bad and doubtful debt	£m	6.74	6.74	6.74	6.74	6.74	33.70
Adjustments included in draft determination	£m	6.74	6.74	6.74	6.74	6.74	33.70
Bad and doubtful debt	£m	6.80	6.80	6.80	6.80	6.80	34.00
Adjustments included in BP	£m	6.80	6.80	6.80	6.80	6.80	34.00

Note:

There will be no indexation for retail price controls from this price base. The figures in this table differ from those in the PwC note describing its review of SWT’s modelling approaches and the Oxera report describing South West’s modelling approaches as those figures are in 2010-11 prices.

A4.2.2 New costs

As set out in the technical appendix, our methodology allows for the possibility of a modification to be made to a company’s cost to serve for new costs. South West included new costs for schemes that could result in a modification being made in its business plan. However, the company has forecast a falling cost profile. Overall the new costs are offset by the falling cost profile so no modification for new costs has been made.

Table A20 New household retail costs

	Units	Value
Modification made to 2013-14 CTS for ACTS calculation	£/cust	0.00

Note:

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

A4.3 Calculating the allowed revenues

We set out our approach to calculating the average cost to serve in the technical appendix. Using the average industry allowances per customer, and the projected customer numbers in the company's business plan (see annex 3), we have calculated the total allowed household retail revenues in 2012-13 prices, including the efficiency challenge and the household retail net margin.

A4.3.1 Net margins

In our risk and reward guidance, we confirmed that our view of an appropriate net margin was 1% for household retail price controls. The table below shows the household retail net margin over 2015-20.

The retail net margin applies to total household costs and is therefore applied to wholesale charges to supply households, plus allowed household retail costs.

Table A21 Household retail net margins

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

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

Table A22 Components of the allowed household retail revenue

	Units	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Company cost to serve unmeasured single service customers	£/cust	£32.83					
Company cost to serve unmeasured water and wastewater customers	£/cust	£42.68					
Company cost to serve measured water-only customers	£/cust	£35.60					
Company cost to serve measured wastewater-only customers	£/cust	£32.83					
Company cost to serve measured water and wastewater customers	£/cust	£45.604					
Allowed cost to serve unmeasured single service customers ¹	£/cust		£28.36	£28.49	£28.55	£28.52	£28.49
Allowed cost to serve unmeasured water and wastewater customers ¹	£/cust		£36.87	£37.03	£37.11	£37.07	£37.04
Allowed cost to serve measured water-only customers ¹	£/cust		£31.12	£31.25	£31.33	£31.30	£31.16

	Units	2013-14	2015-16	2016-17	2017-18	2018-19	2019-20
Allowed cost to serve measured wastewater-only customers ¹	£/cust		£28.36	£28.49	£28.55	£28.52	£28.49
Allowed cost to serve measured water and wastewater customers ¹	£/cust		£39.80	£39.97	£40.05	£40.02	£39.92
Total allowed cost to serve (excluding net margin)	£m		28.0	28.4	28.7	28.9	29.1
Total household wholesale charge (including forecast RPI)	£m		338.6	349.5	362.4	374.9	387.1
Total household retail revenue (including net margin)	£m		31.7	32.2	32.6	33.0	33.3

Notes:

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

1. Allowed cost to serve includes pension deficit repair costs.

As we set out in our final methodology statement, we will make a modification to allowed revenues to account for the difference between actual and forecast customer numbers. The details of how this difference is calculated and the modification factors for calculating the value of this modification are set out in annex 3.

A4.4 Uncertainty mechanisms

In our risk and reward guidance, we acknowledged that all companies face uncertainty about future costs and revenues. We consider that good risk sharing mechanisms provide companies with incentives to reduce costs and provide better services.

Companies already have access to a range of uncertainty mechanisms which share risks between companies and customers. In our final methodology statement, we noted that additional risk should only be fully transferred to customers when companies are unable to influence the impact on their business. As set out in our risk and reward guidance, when a company is able to materially influence the probability or magnitude of impacts, or mitigate the effect efficiently, then the risk should remain with the company, at least in part. This provides companies with strong incentives to manage risks.

The company did not propose any specific uncertainty mechanisms for household retail and has accepted the risk and reward guidance on uncertainty mechanisms.

A4.5 Return on regulated equity

Consistent with the approach set out in our risk and reward guidance, the risk analysis conducted by South West as part of its revised business plan submission to understand the potential range of returns on equity has been expressed as a margin range for retail elements.

South West has adopted a 1% retail household margin in their base case plan, with a low case of -1.2% and a high case of +1.6% (that is, -2.2% to +0.6%). The downside risk reflects a situation which combines a significant retail cost overspend (equivalent to 0.9% of invoiced revenue) and an adverse outcome from SIM (equivalent to 1.3% of invoiced revenue).

The high case is predominantly related to the possibility of a favourable outcome from SIM accompanied by minimal retail cost underspend. We consider this to be plausible and in line with our guidance on risk and reward.

South West did not submit any financial ODIs for their retail business (apart from SIM). Given that the national SIM and GSS service quality mechanisms incentivise performance in household retail services, we consider that this is acceptable.

A5. Non-household retail

A5.1 Default tariffs

As described in the technical appendix, we have included financial assumptions for an indicative price control for non-household retail to support our appointee-level financeability assessment. This is based on the total non-household retail costs as presented in the company's own business plan table A19, and the net margin of 2.5% relevant for the company as set out in our risk and reward guidance.

The retail net margin applies to total non-household costs and is therefore applied to wholesale charges to supply non-households, plus allowed non-household retail costs.

The table below gives the indicative revenues from default tariffs that we have included in this draft determination for financeability assessment purposes. The table assumes an aggregate flat net margin profile for the overall non-household retail business. Note that companies are free to propose different net margin profiles for specific default tariffs within the overall business if they consider this to be appropriate, but the non-household margins in aggregate should not be greater than the amounts proposed in our risk and reward guidance, as discussed in '[Setting price controls for 2015-20 – guidance for companies on producing default tariffs](#)'.

Table A23 Indicative non-household retail total revenue price control including net margins

	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Indicative non-household retail total revenue price control including net margins	£m	5.0	5.1	5.1	5.2	5.3

Note:

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

A6. Appointee financeability

As we set out in our final methodology statement, one of our statutory duties is to ensure that an efficient company is able to finance its functions, in particular by securing reasonable returns on its capital.

Consistent with our wider approach to PR14, we consider that the onus is on companies to demonstrate that they are financeable. As we said in our final methodology statement, our preferred approach is that companies assure themselves of their financeability through:

- an assessment of financeability (and financial ratios) at a whole company level – using aggregated revenues, costs and cash flows associated with regulated activities across all the price controls we set;
- an assessment of financeability on the basis of the appointee having a notional capital structure and associated costs of finance as prescribed in our risk and reward guidance;
- companies demonstrating that projected financial ratios are at levels which allow them efficiently to finance their functions; and
- an assessment of whether the activities covered by the retail price controls are financeable in their own right.

As set out in our final methodology statement, we have asked companies to demonstrate their financeability by providing financial ratios in their business plans. The financial ratios are those typically reviewed by credit rating agencies for testing credit risk and the risk of default on debt. Further ratios, which are more relevant to equity investors are also considered.

The [recommendation \(enhancement\)](#) document on South West that we published on 4 April 2014 explained that we had sufficient and convincing evidence from the company that its updated business plan was financeable.

It also explained that we tested the company's updated business plan submission using our own financial model. This assessment revealed some differences between the financial ratios submitted by South West and the ratios we calculated using the company's inputs in our own financial model (the results are set out in the table below) at that time.

Our recommendation (enhancement) document explained the differences between the South West model calculations and the Ofwat model, and noted that the

differences suggest that South West was in fact more comfortably financeable than indicated by its submission.

The dividend cover and regulatory equity/regulatory earnings for the regulated company ratios calculated in our model are lower than shown in the company calculations. This difference reflects different dividend assumptions in the two calculations. In our model, dividends have been adjusted to maintain an average gearing of around 62.5%, consistent with conducting a risk-based review of financeability at our prescribed notional level of gearing. Consequently, the dividend cover ratios are suppressed and the ratio of regulatory equity to regulated earnings for the regulated company increases. In practice, the dividends assumed by South West are likely to be more reflective of the actual level of dividends that the company is expecting to pay, and therefore the ratios calculated by the company are more representative of the forecast position.

Table A24 Company and Ofwat financial ratio calculations

Financial ratios for notional company	Company calculation (average 2015-20)	Ofwat calculation (average 2015-20)
Cash interest cover	2.88	2.96
Adjusted Cash Interest Cover Ratio (ACICR) – base case (avg over five years)	1.45	1.47
Funds from operations/debt	9.62%	10.99%
Retained cashflow/debt	7.14%	5.98%
Gearing ¹	60.80%	62.87%
Dividend cover (profit after tax/dividends paid)	1.58	1.05
Regulatory equity/regulated earnings for the regulated company	16.02	23.50
RCV/EBITDA	11.20	10.51

Note:

- Both the company's and our modelling is based on assumed opening gearing (at 1 April 2015) being equal to 62.5%. Gearing then varies annually during the 5 year period as a result of the respective dividend assumptions.

We note that the cash interest cover, adjusted cash interest cover and funds from operation/debt are broadly consistent with ratios used by the Competition Commission (CC) in its final determination for Northern Ireland Electricity (NIE)⁴. South West's proposed ratios are above the target ratios set out by the CC for both adjusted cash interest cover and funds from operations/debt. The ratio for cash interest cover is below CC target ratio, but consistent with ratios calculated by CC for NIE for its final determination. Given the importance of not placing excessive weight on a single ratio, we consider that South West's proposed ratios are consistent with evidence of financeability used by CC in NIE determination.

For the draft determination, the implied menu choice for both wholesale water and wastewater are below our own baseline (see sections A2.2.2 and A3.2.2). As a result, the draft determination assumes allowed revenue marginally higher than that reflected in the ratios in the company's business plan as a result of assumed total expenditure being marginally higher than that assumed in the company's business plan. In addition, the draft determination reflects our notional assumption about dividend distribution (that is, yield of 4.0% and real growth in dividends of 1.65%).

A minor amendment was made to the calculation of regulatory earnings used in the financial indicators in the financial model between the version used for the risk-based review and the version used for the draft determination. This change was made as it was identified that in the version of the model used for the risk-based review of South West, regulatory earnings included a revenue allowance in respect of pension deficit repair costs, but did not reflect the associated costs. Therefore, the calculation of regulated earnings was amended to include the allowed pension deficit repair costs. Following this change, the regulated earnings are lower and so the ratio of regulated equity to regulated earnings is higher.

The updated results with these new assumptions are set out below.

⁴ <https://assets.digital.cabinet-office.gov.uk/media/534cd495ed915d630e00003f/final-determination.pdf>

Table A25 Ofwat financial ratio calculations

Financial ratios for notional company	Ofwat calculation (average 2015-20)
Cash interest cover	3.23
Adjusted Cash Interest Cover Ratio (ACICR)	1.56
Funds from operations/debt	10.37%
Retained cashflow/debt	7.63%
Gearing ¹	59.11%
Dividend cover (profit after tax/dividends paid)	1.49
Regulatory equity/regulated earnings for the regulated company	83.35
RCV/EBITDA	10.42

The financeability ratios are based on a target gearing of 62.5% at the beginning of the regulatory period, but these fall over the 2015-20 period, reflecting the dividend rates and retained earnings by the company over the period.

However, the ratios in table A25 above are at levels consistent with those submitted by the company in its business plan and at levels that the company has satisfied itself and us are consistent with a company that is financeable.

Annex 1 Outcomes, performance commitments and outcome delivery incentives

This chapter sets out in detail the performance commitments and outcome delivery incentives we are proposing for the company's wholesale water, wholesale wastewater and household retail outcomes. The performance commitments and outcome delivery incentives reflect the company's own business plan proposals, including the revisions it made in response to our risk and reward guidance, following the general principles and process set out in the technical appendix.

The chapter is organised with the wholesale water outcomes and associated performance commitments and delivery incentives presented first, followed by the wastewater outcomes and then the household retail outcomes. It provides the following information on each performance commitment.

- The name and detailed definition of the performance commitment.
- The type of incentive.
- The performance commitment level.
- The limits on rewards and penalties (caps and collars) and neutral zones (deadbands) as applicable.
- The incentive rates, if applicable.
- Additional details on the measure.

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

The company has calibrated its ODIs to take account of the interaction with totex efficiency sharing as it is required to do by the price review methodology. In its business plan and subsequent revisions the company has used a 50% cost sharing rate. This was the example cost sharing rate we used in appendix 1 to our final methodology statement. On 4 April, we stated that the company had achieved enhanced status and that its cost sharing rate at 100 would be 55% rather than 50%. We have not asked the company to recalibrate its ODIs using a cost sharing rate of 55%. Once the company has chosen its position on the enhanced menu, it will then need to recalibrate its ODIs with the cost sharing rate associated with that position.

We currently anticipate that South West – as an enhanced company – will be able to finalise its proposed menu choice and ODI calibrations in the light of our full draft determinations for all companies, so that these can be reflected in the final determination published on 12 December.

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

Performance commitment: compliance with water quality standard

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	99.98	99.98	99.98	99.98	99.98	99.98
Penalty collar	%		90	90	90	90	90
Penalty deadband	%		99.9	99.9	99.9	99.9	99.9

Incentive rates

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

Additional details

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

Performance commitment: taste, smell and colour contacts

Detailed definition of performance measure

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

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

Incentive type

Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./1,000 pop	4.5	4.2	3.9	3.6	3.3	3.0
Penalty collar	No./1,000 pop		8.0	8.0	8.0	8.0	8.0
Penalty deadband	No./1,000 pop		4.2	3.9	3.6	3.3	3.0
Reward deadband	No./1,000 pop		2.02	2.02	2.02	2.02	2.02
Reward cap	No./1,000 pop		1.5	1.5	1.5	1.5	1.5

Incentive rates

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

Additional details

Necessary detail on measurement units	Discoloured (brown/black/orange) contacts plus taste/odour contacts per 1,000 resident population.
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	Reward or penalty applied annually for each calendar year.

Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The penalty incentive rate of £0.869m applies from 4.5 to the penalty deadband within each year. An average value of the deadband has been used to complete the table.

Performance commitment: asset reliability (pipes)

Detailed definition of performance measure

Serviceability assessment of either stable/marginal/deteriorating as defined for the Ofwat KPIs in 'IN 13/03, 'Regulatory reporting for 2012-13 – process'.

Incentive type

Financial – penalty only.

Performance commitments

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

Incentive rates

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

Incentive type	Performance levels (status)		Incentive rate
Penalty	Deteriorating	Marginal	0.458m

Additional details

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

Performance commitment: asset reliability (process)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: duration of interruptions in supply

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	The measurement unit includes both planned and unplanned supply interruptions. Ofwat KPI as defined in IN 13/03 .
Frequency of PC measurement and any use of averaging	Performance commitment measured and reported on an annual basis and reviewed through the WaterShare independent panel. The incentive will be assessed based on an average performance.
Timing and frequency of rewards/penalties	Reward or penalty applied at the end of period.
Form of reward/penalty	RCV adjustment.
Any other information	Due to the phasing of the plan average target is 0.23 hours per

or clarifications
relevant to correct
application of incentive

property. As the company is using an average, the neutral deadbands are set equal to the committed performance level (CPL) in each year.

Wholesale water outcome: available and sufficient resources

Performance commitment: water restrictions placed on customers

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: ability to move water around the network

Detailed definition of performance measure

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

Incentive type

Future incentive post-2020.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: leakage levels

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	MI/d	84	84	84	84	84	84
Penalty collar	MI/d		97	97	97	97	97
Penalty deadband	MI/d		84	84	84	84	84
Reward deadband	MI/d		84	84	84	84	84
Reward cap	MI/d		64	64	64	64	64

Incentive rates

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

Additional details

Necessary detail on measurement units	The measurement of leakage is rounded to the nearest MI/day in line with standard leakage measurement detailed in the performance measure definition.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The company will apply the incentive to annual performance.

Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	The incentive applies to performance based on leakage performance calculated from the previous calendar year. Rounding the volume of leakage to the nearest MI/d creates an effective deadband of 1MI/d.

Performance commitment: time taken to fix significant leaks

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: security of supply index

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Wholesale water outcome: resilience in extreme conditions

Performance commitment: supplies interrupted due to flooded South West sites

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Wholesale water outcome: responsive to customers

Performance commitment: operational customer contacts resolved first time

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Wholesale water outcome: protecting the environment

Performance commitment: sustainable abstractions (EA/WFD classification)

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	The number of abstraction sites where the Environment Agency have identified improvements for sustainability as being required and that are not completed at the end of the report year.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

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

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	Status	Moderate	Moderate	Moderate	Moderate	Moderate	Moderate
Penalty collar	Status		Severe	Severe	Severe	Severe	Severe
Penalty deadband	Status		Moderate	Moderate	Moderate	Moderate	Moderate

Incentive rates

Incentive type	Performance levels (status)		Incentive rate (£/status change/year)
	Lower	Upper	
Penalty	Severe	Moderate	0.930m

Additional details

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

Performance commitment: catchment management

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: pollution incidents (category 1 and 2)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: pollution incidents (category 3 and 4)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	2	2	2	2	2	2
Penalty collar	No./yr		4	4	4	4	4
Penalty deadband	No./yr		2	2	2	2	2

Incentive rates

Incentive type	Performance levels (No./yr)		Incentive rate (£/no./year)
	Lower	Upper	
Penalty	4	2	0.009m

Additional details

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

Performance commitment: operational carbon emissions

Detailed definition of performance measure

Greenhouse gas emissions in ktCO₂e for the financial year calculated according to the Ofwat KPI definition in [IN 13/03](#).

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: energy from renewable sources

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Any other information or clarifications relevant to correct application of incentive	n/a
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Wholesale water outcome: fair charging

Performance commitment: customers paying a metered bill

Detailed definition of performance measure

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

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	79	80.4	81.6	82.8	83.8	84.7
Penalty collar	%		79	79	79	79	79
Penalty deadband	%		79.4	80.6	81.8	82.8	83.7

Incentive rates

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

Additional details

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

Wholesale wastewater outcome: reliable wastewater services

Performance commitment: internal sewer flooding incidents

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	157	153	148	144	139	135
Penalty collar	No./yr		212	212	212	212	212
Penalty deadband	No./yr		193	188	184	179	175
Reward deadband	No./yr		153	148	144	139	135
Reward cap	No./yr		107	107	107	107	107

Incentive rates

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

Additional details

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

Performance commitment: external sewer flooding incidents

Detailed definition of performance measure

The number of incidents of external flooding caused by hydraulic overload (including extreme weather) and other causes from the company's sewers (including those

from the private sewer transfer) in the report year. The number of flooding incidents is produced in accordance with the JR11 regulatory reporting requirements for table 3a.

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: odour contacts (wastewater treatment works)

Detailed definition of performance measure

The number of contacts received relating to odours originating from our wastewater treatment works in the report year.

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: asset reliability (pipes)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

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

Incentive rates

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

Additional details

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

Any other information or clarifications relevant to correct application of incentive

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

Performance commitment: asset reliability (process)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: compliance with sludge standard

Detailed definition of performance measure

Satisfactory sludge disposal complying with Ofwat KPI definitions in [IN 13/03](#).

Calculation details:

$$100 \times (C - D) / C$$

where:

C is total sewage sludge disposed of measured in thousand tonnes of dry solids; and

D is total sewage sludge disposed of which cannot be confirmed as complying with the safe sludge matrix and other relevant regulations to be considered satisfactory.

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	Satisfactory sludge disposed (dry solids) as a percentage of total sewage sludge disposed (measured as dry solids).
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel. The performance is based on end of year performance.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

Wholesale wastewater outcome: responsive to customers

Performance commitment: operational customer contacts resolved first time

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Wholesale wastewater outcome: protecting the environment

Performance commitment: wastewater treatment numeric compliance

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	97.5					100
Penalty collar	%						80
Penalty deadband	%						99

Incentive rates

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

Additional details

Necessary detail on measurement units	Percentage wastewater treatment numeric compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 1.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported on an annual basis and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	The incentive is applied once to performance in 2020.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	% of wastewater treatment works with numeric consents complying with those consents. Measure applies to performance at the end of the 2019 calendar year.

Performance commitment: wastewater population equivalent sanitary compliance

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: wastewater descriptive works permit compliance

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	%	95	100	100	100	100	100
Penalty collar	%		<92	<92	<92	<92	<92
Penalty deadband	%		92	92	92	92	92

Incentive rates

Incentive type	Performance levels (%)		Incentive rate (£/%/year)
	Lower	Upper	
Penalty	<92	92	0.250m

Additional details

Necessary detail on measurement units	Percentage wastewater treatment descriptive compliance as reported by the Environment Agency to Ofwat in MD109 for the relevant calendar year in table 1, line 13.
Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each calendar year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	A penalty is applied each calendar year for service levels below the existing (2012-13) level of service. The incentive will be applied to each year separately and the whole annual penalty will apply when performance drops below 92%. This incentive therefore represents a penalty for deterioration in performance.
Form of reward/penalty	Adjustment to revenue.
Any other information or clarifications relevant to correct application of incentive	<p>% of wastewater treatment works with descriptive consents complying with these consents.</p> <p>Measure applies to performance in the previous calendar year.</p> <p>A penalty is triggered when performance drops below 92% when the maximum annual penalty of £0.25 million is incurred.</p>

Performance commitment: pollution incidents (category 1 and 2)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	2	0	0	0	0	0
Penalty collar	No./yr		8	8	8	8	8
Penalty deadband	No./yr		2	2	2	2	2

Incentive rates

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

Additional details

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

Performance commitment: pollution incidents (category 3 and 4)

Detailed definition of performance measure

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

Incentive type

Financial – penalty only.

Performance commitments

	Unit	Starting level	Committed performance levels				
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Performance commitments	No./yr	248	238	228	218	208	198
Penalty collar	No./yr		262	262	262	262	262
Penalty deadband	No./yr		238	228	218	208	198

Incentive rates

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

Additional details

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

Performance commitment: operational carbon emissions

Detailed definition of performance measure

Greenhouse gas emissions in ktCO₂e for the financial year calculated according to the Ofwat KPI definition in [IN 13/03](#).

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: energy from renewable sources

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Any other information or clarifications relevant to correct application of incentive	n/a
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Wholesale wastewater outcome: benefiting the community

Performance commitment: bathing water quality

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty.

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: combined sewer overflow spills

Detailed definition of performance measure

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

Incentive type

Future incentive post-2020.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	n/a – measurement units will be defined as the incentive is developed.
Frequency of PC measurement and any use of averaging	n/a – frequency of measurement will be defined as the incentive is developed.
Timing and frequency of rewards/penalties	n/a – timing and frequency of any rewards or penalties will be defined as the incentive is developed.
Form of reward/penalty	n/a – the form of the reward or penalty will be defined as the incentive is developed.

Any other information or clarifications relevant to correct application of incentive

n/a

Performance commitment: river water quality improved

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

The length in kilometres of the waterbody into which the treatment works improved under the programme discharges. It includes the length of all subsequent downstream waterbodies down to the tidal limit.

Incentive rates

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

Additional details

Necessary detail on measurement units	The length in kilometres of the waterbody into which the treatment works improved under the programme discharges. It includes the length of all subsequent downstream waterbodies down to the tidal limit.
Frequency of PC measurement and any use of averaging	Performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

Household retail outcome: responsive to customers

Performance commitment: customer overall satisfaction

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	Measurement units are the average percentage of customers saying they are satisfied or very satisfied with our overall service in the financial year as measured through the company's long-term customer satisfaction tracking survey.
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Frequency of PC measurement and any use of averaging	Average performance commitment reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

Performance commitment: Service incentive mechanism (SIM)

Detailed definition of performance measure

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

Incentive type

Financial – reward and penalty

Performance commitments

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

Incentive rates

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

Additional details

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

Performance commitment: customer satisfaction with value for money

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

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

Household retail outcome: fair charging

Performance commitment: customers assisted by water poverty initiatives

Detailed definition of performance measure

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

Incentive type

Reputational.

Performance commitments

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

Incentive rates

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

Additional details

Necessary detail on measurement units	The cumulative number of customers assisted by the company's water poverty initiatives WaterCare+ and Restart at 31 March in the report year.
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Frequency of PC measurement and any use of averaging	Performance commitment measured, reported at the end of each financial year and reviewed through the WaterShare independent panel.
Timing and frequency of rewards/penalties	n/a
Form of reward/penalty	n/a
Any other information or clarifications relevant to correct application of incentive	n/a

Annex 2 Wholesale costs

We have developed cost models that explain the patterns of historical costs across companies, and have combined these with forecasts/projections of the model explanatory variables and efficiency assumptions to derive basic cost thresholds (BCTs) for each company. Further details can be found in the BCT model overview, the technical appendix and the BCT feeder models published alongside this draft determination.

We have then made three categories of adjustments to these basic cost thresholds.

- **Policy additions** – which reflect areas of costs excluded from the base modelling across all companies or adjustments necessary to ensure comparisons with business plan forecasts of totex are made on a like-for-like basis (such as the third party cost and gross/net adjustments).
- **Unmodelled allowances** – to cover areas of enhancement spending not covered by the enhancement modelling (but implicitly included in two out of the three approaches to water cost modelling that are based on a totex approach – hence, the final adjustment to the water cost threshold is $\frac{1}{3}$ of the total).
- **Deep dive adjustments** – to capture those special aspects of business plans not provided for in the base cost thresholds, policy additions and unmodelled allowances. These are explained in more detail in the cost templates published alongside this document.

Taken together, these adjustments translate the BCT to draft determination thresholds.

Where companies made arguments in business plans for special aspects of their plans and we assessed these in detail but decided that it was not appropriate to adjust the cost thresholds, then these have been categorised as ‘deep dives not added’.

We have summarised the above in the tables that follow – together with business plan forecast totex and the difference between the forecast and the draft determination threshold.

Table A26 Movement from basic cost threshold to draft determination threshold for wholesale water totex

Basic cost threshold (£m)	Policy additions (£m)	Unmodelled costs adjustment (£m)	Deep dive (£m)	DD threshold (£m) ¹	Deep dives not added	Deep dives not added	Deep dives not added
591	142	0	18 (North Plymouth WTW)	752	Upstream innovation (£14m unmodelled ²) – not added due to insufficient evidence	Raw water deterioration (£24m unmodelled ²) - £14m of £24m not added due to insufficient evidence (£10m already reflected in models)	CRC (£4m) – already reflected in models

Notes:

- 1 The price control baseline set out in the technical appendix is £741 million rather than £752 million shown above because the £11 million Net v Gross adjustment within policy additions (see table A27 below) is made only for comparison with the company's plan and is excluded from the baseline.
2. Any potential adjustment may be only a third of that claimed as a result of triangulation of the three models.

Table A27 Policy additions to the wholesale water basic cost threshold

Business rates (£m)	Pension deficit payments (£m)	Third party costs (£m)	Open market costs (£m)	Net v gross adjustments (£m)	Total £m
83	20	28	1	11	142

Table A28 Comparison of company wholesale water totex with the draft determination threshold and 2010-15 totex

Plan (£m)	DD threshold (£m)	Gap (£m)	Plan v 2010-15
697	752	-55 (-7%)	+9%

Table A29 Movement from basic cost threshold to draft determination threshold for wholesale wastewater totex

Basic cost threshold (£m)	Policy additions (£m)	Unmodelled costs adjustment (£m)	Private sewers (£m)	NEP5 (£m)	Deep dive (£m)	DD threshold (£m) ¹	Deep dives not added	Deep dives not added
790	61	-10	19	49	n/a	910	CRC (£7m) – already reflected in models	Downstream thinking (£9m) – already reflected in models

Note:

1. The price control baseline set out in the technical appendix is £900 million rather than £910 million shown above because the £10 million Net v Gross adjustment within policy additions (see table A30 below) is made only for comparison with the company's plan and is excluded from the baseline.

Table A30 Policy additions to the wholesale wastewater basic cost threshold

Business rates (£m)	Pension deficit payments (£m)	Third party costs (£m)	Open market costs (£m)	Net v gross adjustments (£m)	Total (£m)
32	18	1	1	10	61

Table A31 Comparison of company wholesale wastewater totex with the draft determination threshold and 2010-15 totex

Plan (£m)	DD threshold (£m)	Gap (£m)	Plan v 2010-15
908	910	-2 (0%)	+13%

Annex 3 Household retail price control

Revenue modification

Total allowed revenues are based on the number of customers and meter penetration set out in companies' business plans. If actual customer numbers or meter penetration differ from forecast values, then a modification will be made to allowed revenues to account for this.

Table A32 below sets out the amount per customer that allowed revenues will be modified by if outturn customer numbers differ from forecast customer numbers. This is set for each of the customer types.

These modification factors include an allowance for the net margin. This allowance is based on forecast nominal wholesale charges. These modification factors will not be updated for differences between forecast and actual nominal wholesale charges. This is because doing so would make the calculation of these modification factors each year considerably more complex and less transparent. We consider that setting these modification factors out in advance and not varying them for changes in wholesale is a more proportionate and appropriate approach.

For example, consider the case where the number of unmetered water only customers is lower than forecast, and the number of metered water only customers is higher than forecast as a result of an unanticipated more rapid meter roll out. We would make a downward adjustment for revenue for unmetered water only customers, and a more than offsetting upward adjustment for metered water only customers.

The first table sets out what these modification factors are; the second sets out the baseline number of customers.

Table A32 Household retail allowed revenue modification factors by class of customer

	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Revenue modification per unmetered water only customer	(£/customer)	£32.12	£32.32	£32.48	£32.54	£32.60
Revenue modification per unmetered wastewater only customer	(£/customer)	£32.12	£32.32	£32.48	£32.54	£32.60
Revenue modification per unmetered water and wastewater customer	(£/customer)	£41.75	£42.02	£42.22	£42.30	£42.38
Revenue modification per metered water only customer	(£/customer)	£35.24	£35.45	£35.65	£35.72	£35.66
Revenue modification per metered wastewater only customer	(£/customer)	£32.12	£32.32	£32.48	£32.54	£32.60
Revenue modification per metered water and wastewater customer	(£/customer)	£45.07	£45.35	£45.56	£45.66	£45.69

Note:

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

Table A33 Assumed number of customers for household retail total revenues

	Units	2015-16	2016-17	2017-18	2018-19	2019-20
Number of unmetered water only customers	'000s (3 d.p.)	30.221	29.224	28.206	27.180	26.161
Number of unmetered wastewater only customers	'000s (3 d.p.)	2.439	2.395	2.356	2.322	2.292
Number of unmetered water and wastewater customers	'000s (3 d.p.)	120.356	112.687	105.905	99.907	94.605
Number of metered water only customers	'000s (3 d.p.)	30.427	31.881	33.356	34.827	36.299
Number of metered wastewater only customers	'000s (3 d.p.)	2.236	2.299	2.357	2.41	2.459
Number of metered water and wastewater customers	'000s (3 d.p.)	542.249	555.907	568.636	580.417	591.572

Annex 4 Reconciling 2010-15 performance

Wholesale adjustments

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

In our risk-based review, we considered the company's proposals for adjustments to reconcile 2010-15 performance using a test based on two assessments. The first examined to what extent it had demonstrated clear evidence that it had made adjustments to 2015-20 price controls based upon its performance in 2010-15 in line with our guidance and tools. The second examined how fairly the company's proposals reflected its performance in 2010-15, including the scale of difference between its view and the Ofwat view for each of the five tools. For enhanced companies, where the company's view was within 5% of Ofwat's view (or was in customers' favour), we have accepted the company position for the purposes of this draft determination.

In [appendix 2 of 'Setting price controls for 2015-20 – pre qualification decisions'](#), we confirmed our risk-based review scores for the company's adjustments submitted in its business plan. Tables A34 and A35 below compare the company's view of the required revenue adjustments included in its final business plan for each of the incentive tools for water and wastewater services, with our own view. The tables also show other adjustments such as those relating to tax. For the purposes of setting this draft determination, we have used the company's proposed adjustments.

Table A34 Revenue adjustments in the water service 2015-20

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Service incentive mechanism (SIM)	Company view	-1.1	-1.1	-1.1	-1.1	-1.1	-5.6
	Ofwat view	-1.1	-1.1	-1.1	-1.1	-1.1	-5.6
Revenue correction mechanism (RCM)	Company view	1.5	1.5	1.5	1.5	1.5	7.3
	Ofwat view	1.5	1.5	1.5	1.5	1.5	7.3
Opex incentive allowance – post-tax (OIA)	Company view	0.0	1.4	0.1			1.5
	Ofwat view	0.0	1.4	0.1			1.5
Capital expenditure incentive scheme (CIS)	Company view	-3.3	-3.3	0.0	0.0	0.0	-6.6
	Ofwat view	-3.3	-3.3	0.0	0.0	0.0	-6.6
Tax refinancing benefit clawback	Company view						0.0
	Ofwat view						0.0
Other tax adjustments	Company view						0.0
	Ofwat view						0.0
Equity injection clawback	Company view						0.0
	Ofwat view						0.0

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Other adjustments	Company view						0.0
	Ofwat view						0.0
Total wholesale water legacy adjustments	Company view	-2.9	-1.5	0.4	0.3	0.3	-3.4
	Ofwat view	-2.9	-1.5	0.4	0.3	0.3	-3.4

Note:

Totals may not add up due to rounding.

Table A35 Legacy revenue adjustments in the wastewater service 2015-20

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Service incentive mechanism (SIM)	Company view	-1.4	-1.4	-1.4	-1.4	-1.4	-6.8
	Ofwat view	-1.4	-1.4	-1.4	-1.4	-1.4	-6.8
Revenue correction mechanism (RCM)	Company view	-2.1	-2.1	-2.1	-2.1	-2.1	-10.6
	Ofwat view	-2.1	-2.1	-2.1	-2.1	-2.1	-10.6
Opex incentive allowance (OIA)	Company view						0.0
	Ofwat view						0.0

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Capital expenditure incentive scheme (CIS)	Company view	-4.1	-4.1				-8.1
	Ofwat view	-4.1	-4.1				-8.1
Tax refinancing benefit clawback	Company view						0.0
	Ofwat view						0.0
Other tax adjustments	Company view						0.0
	Ofwat view						0.0
Equity injection clawback	Company view						0.0
	Ofwat view						0.0
Other adjustments	Company view						0.0
	Ofwat view						0.0
Total wholesale wastewater legacy adjustments	Company view	-7.5	-7.5	-3.5	-3.5	-3.5	-25.5
	Ofwat view	-7.5	-7.5	-3.5	-3.5	-3.5	-25.5

Note:

Totals may not add up due to rounding.

These adjustments reflect our understanding of the company's performance using these incentives at the time of this draft determination. As part of the PR14 process, the company is required to update its performance for 2013-14 and re-forecast its performance for 2014-15. We will reassess the company's performance in these years following that submission. Should its performance result in changes to the amounts arising from these incentive mechanisms (and the overall effect of all changes is material to price limits), then we will reflect these in our final determination. We will communicate any material changes in sufficient time for stakeholders to make appropriate representations on these matters can be made before the final determination in December 2014.

Service incentive mechanism (SIM)

This draft determination includes the company's predicted SIM reward/penalty of -0.5%.

It arrived at this prediction by comparing its actual SIM performance during 2011-12 and 2012-13 and its predicted performance in 2013-14, to the industry two-year average performance during 2011-13.

Tables A34 and A35 above confirm the monetary amounts of the SIM adjustments.

Revenue correction mechanism (RCM)

For PR09, we introduced the RCM as part of the package to correct for differences between expected and actual tariff basket revenue between 2010 and 2015 at PR14. This mechanism provided companies with a financial incentive to encourage consumers to use water wisely. We confirmed the details of our revenue correction mechanism in [PR09/31, 'Revenue correction mechanism'](#) (July 2009).

Using the revenue correction mechanism that we described in our PR09 methodology paper, we will make an adjustment at this price review to take account of each company’s revenue outperformance or underperformance relative to the assumptions we made in our final determinations for 2010-11 to 2014-15. This adjustment will be annualised over the five years in net present value (NPV) terms.

In IN 11/04, ‘[Simplifying the revenue correction mechanism](#)’, we summarised our decision to simplify two areas of the RCM; in particular, the ‘billing incentive’ and ‘back billing’. The [supporting information](#) to IN11/04 provides the technical detail to these changes.

This draft determination includes the company’s RCM annualised adjustment amount as detailed in table A36 below. We have accepted the company’s view of the RCM adjustments.

Table A36 RCM annualised adjustments to 2014 price review requirement

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water	Company view	1.5	1.5	1.5	1.5	1.5	7.3
	Ofwat view	1.5	1.5	1.5	1.5	1.5	7.3
Sewerage	Company view	-2.1	-2.1	-2.1	-2.1	-2.1	-10.6
	Ofwat view	-2.1	-2.1	-2.1	-2.1	-2.1	-10.6

Operating expenditure incentive allowance (OIA)

In accordance with the methodology set out in PR09/04, ‘[The opex incentive allowance and the outperformance multiplier for 2005-10](#)’, the company demonstrated the year-on-year outperformance needed to qualify for an incentive allowance in price limits in the water service only. Table A37 below summarises the company’s view and our view of the incentive allowances for 2015-20.

Table A38 Operating expenditure incentive allowances for 2015-20

£ million		2015-16	2016-17	2017-18	2018-19	2019-20	Total
Water service							
Incentive allowance (pre-tax)	Company view	0.1	2.0	0.1	0.0	0.0	2.1
	Ofwat view	0.1	2.0	0.1	0.0	0.0	2.1
Incentive allowance (post-tax)	Company view	0.0	1.4	0.1	0.0	0.0	1.5
	Ofwat view	0.0	1.4	0.1	0.0	0.0	1.5
Sewerage service							
Incentive allowance (pre-tax)	Company view	0.0	0.0	0.0	0.0	0.0	0.0
	Ofwat view	0.0	0.0	0.0	0.0	0.0	0.0
Incentive allowance (post-tax)	Company view	0.0	0.0	0.0	0.0	0.0	0.0
	Ofwat view	0.0	0.0	0.0	0.0	0.0	0.0

We identified an error in how the company had applied the methodology and calculated the retention of outperformance in future years for the water service. Our calculated view is greater than the company's view as we have correctly calculated the retention of outperformance in future years in line with the methodology set out in PR09/04. But since the company's view is to the benefit of its customers, we accepted this in both the risk-based review and in this draft determination.

In the water service, to calculate our view of its operating expenditure incentive allowance, we agreed with the company's assessment that no adjustments for logging up, logging down or shortfalls were necessary as it had provided comprehensive evidence that it had delivered all of its FD09 water service outputs. We discuss this in more detail in the section on the change protocol. We also accepted the company's view that no adjustments were required to actual water operating expenditure for atypical and exceptional costs.

In the wastewater service, we agreed with the company's assessment that the only adjustments necessary were those logging up adjustments for private sewers, as it had provided comprehensive evidence that it had delivered all of its FD09 wastewater service outputs. We also accepted its view that no adjustments were required to actual wastewater operating expenditure for atypical and exceptional costs.

Although there was a small difference in the effective tax rate figure input compared with our records, we accepted the company's figure of 26.29% in our calculation.

We did not necessarily agree with the company's approach of adjusting actual operating expenditure by the pension contributions assumptions included at FD09. Such an approach does not take account of the ongoing cash charge or the actual cash contributions it has made to deficit recovery.

Our risk-based review highlighted differing approaches by companies in calculating pension adjustments and we have set out our expectations for the revised business plans in '[Setting price controls for 2015-20 – further information on reconciling 2010-15 performance](#)'. We expect the company to review the basis of its pension adjustments and be satisfied that these are fair and appropriate for the purposes of calculating any outperformance incentive allowance.

However, for the purposes of the risk-based review and this draft determination, we have accepted the company's pension adjustments in both our water and wastewater calculations because we accepted its overall view of the incentive allowances as these were to the benefit of its customers.

But, on receiving the company's updated 2010-15 information in June 2014, we will update the analysis to take account of actual operating expenditure for 2013-14, the associated adjustments and the actual effective tax rate for 2013-14. We will also review in more detail the fairness and appropriateness of its pension adjustments in light of the 2013-14 actuals and response to our feedback.

Finally, as confirmed in our final methodology statement, we are not implementing enhanced outperformance multipliers for the most efficient (frontier) companies in this price review.

Change protocol (logging up, logging down and shortfalls)

The change protocol for 2010-15 is a process by which a company can request a logging up of capex costs as a result of a new or changed output obligations during the current price control period or a logging down of capex costs for outputs no longer required. We take account of the financial implications of these changes at the beginning of the next price control period. Where a company fails to deliver on time any outputs which are required and were included in price limit assumptions, a shortfall adjustment is made.

The company's business plan tables W13 and S13 contained only two logging up claims in the wastewater service. These were associated with private sewer adoptions and additional bathing water requirements and had a combined totex value of £42.6 million (pre-efficiency). Both claims passed the triviality threshold of representing 2% or more of service turnover.

We have assessed the company's proposed costs for these claims and have accepted these in our CIS reconciliation for this draft determination.

We have not initiated any additional counter-claims in either service. The evidence the company provided in its business plan enabled us to confirm delivery of practically all its FD09 outputs. There were two exceptions in the water service relating to 'Exceptional items outputs' and 'Summary of water infrastructure enhancement projects'⁵ but overall, we considered these were trivial items.

Therefore, we support the company's view that in the water service:

- no adjustments are required to baseline capex included within the CIS reconciliation; and
- no adjustments are required to the FD09 opex assumptions in calculating the opex incentive revenue allowance.

In the wastewater service, we support the company's view that:

⁵ FD09 supplementary report tables 2.1.3 and 2.2.1b, respectively.

- logging up adjustments are required to baseline capex included within the CIS reconciliation for private sewers and additional bathing water requirements delivered in the period; and
- the FD09 opex assumptions used in calculating any opex incentive revenue allowance should be increased to reflect the additional opex it has incurred on private sewers.

Table A39 below summarises the company's view and our baseline view of total adjustments to capex included in the CIS reconciliation. These are expressed post efficiency and have been indexed to 2007-08 prices using the inflation measures from table A9 of the company's business plan.

Table A39 Summary of post efficiency capex for logging up, logging down and shortfalls included in the CIS reconciliation

2009-10 to 2014-15 £m – post-efficiency capex [2007-08 prices]	Water service		Sewerage service		Total service	
	Company view	Baseline view	Company view	Baseline view	Company view	Baseline view
Logging up (two sided)	0.0	0.0	29.3	29.3	29.3	29.3
Logging down (two sided)	0.0	0.0	0.0	0.0	0.0	0.0
Shortfalls (one sided)	0.0	0.0	0.0	0.0	0.0	0.0
Shortfalls for serviceability (one sided)	0.0	0.0	0.0	0.0	0.0	0.0

Table A40 below summarises the company's view and our baseline view of the total adjustments made to the FD09 opex assumptions used in the calculation of the opex incentive revenue allowances.

There is an inconsistency that exists between table S13 and table S16 of the company's business plan with regard to the net change to opex costs associated with private sewers. The logging up/down table S13 requires adjustments to be presented pre-efficiency, whereas for the purposes of calculating any outperformance incentive in table S16, the adjustments should be expressed post-efficiency. Therefore, the opex figures in these two tables should not be the same.

However, as the company had not demonstrated the year-on-year outperformance needed to qualify for an incentive allowance in price limits in the wastewater service, for the purposes of the risk-based review and this draft determination we accepted the company’s pre-efficiency adjustments in the opex incentive allowance without further adjustment.

Table A40 Summary of post efficiency opex for logging up, logging down and shortfalls included in the opex incentive allowance calculation

2009-10 to 2014-15 £m – post-efficiency opex	Water service		Sewerage service		Total service	
	Company view	Baseline view	Company view	Baseline view	Company view	Baseline view
Logging up (two sided)	0.0	0.0	6.1	6.1	6.1	6.1
Logging down (two sided)	0.0	0.0	0.0	0.0	0.0	0.0
Shortfalls (one sided)	0.0	0.0	0.0	0.0	0.0	0.0
Shortfalls for serviceability (one sided)	0.0	0.0	0.0	0.0	0.0	0.0

Serviceability performance

Our PR09 final determination expected the company to deliver and maintain ‘stable’ serviceability for all of its asset systems throughout the 2010-15 period. To deliver this output, we expected it to monitor, manage and maintain its assets so that the serviceability indicators set out in the company’s supplementary report remain within a set range of control limits around a central reference level. Failure to deliver and maintain stable serviceability could lead to a shortfall up to the value of 50% of the company’s water service capital maintenance expenditure assumed at the previous price control and the associated financing costs.

We have reviewed both the company’s actual and forecast performance information provided in its business plan for the defined serviceability measures and its overall assessments.

We agree that the company has delivered stable serviceability of its water and wastewater infrastructure and non-infrastructure assets during the period 2010-13 and, based on its forecast information, will continue to maintain stable serviceability until the end of the period. Therefore, we have not included any shortfall adjustments for serviceability in this draft determination. Table A41 below confirms our assessments and table A42 confirms the value and impact of any serviceability shortfall on the RCV.

Table A41 Serviceability assessments for 2010-15⁶

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

Table A42 Impact of serviceability shortfalls on the RCV

2009-10 to 2014-15 (£m)		Water	Wastewater	Total
Amount subtracted from RCV (£m)	Company view	0.0	0.0	0.0
	Ofwat view	0.0	0.0	0.0

⁶ Assessments are based on actual and forecast performance submitted in the company's business plans.

The revised business plan information requirements contain specific tables seeking more detailed information on the serviceability performance of companies' water and wastewater service assets during 2010-15. We will carry out a full review of this information, focusing on companies' updated actuals for 2013-14 and revised forecasts for 2014-15, and reassess our judgements if required.

The 2009 agreed overlap programme

As the company did not propose an overlap programme at PR09, our FD09 did not contain any agreed projects that would need to be reviewed in this price review. Therefore, we have not assessed any scheme progress or costs under this mechanism. Table A43 below confirms the zero assumptions included in this draft determination.

Table A43 PR09 agreed overlap programme adjustments and assumptions

£m		2010-15		2015-20	
		Two-sided adjustment for inclusion in the CIS		Expenditure forecasts to complete the projects	
		Capex	Opex	Capex	Opex
Water service	Company view	0.0	0.0	0.0	0.0
	Baseline view	0.0	0.0	0.0	0.0
Wastewater service	Company view	0.0	0.0	0.0	0.0
	Baseline view	0.0	0.0	0.0	0.0

The 2014-15 transition programme

For this price review, we introduced the transition programme to enable companies to bring forward any type of planned capital expenditure from 2015-16 into 2014-15, in order to make more efficient use of resources and the supply chain.

In its business plan, South West identified a small amount of transition capital expenditure relating to the following activities.

- To guarantee completion of works at North Plymouth WTW by the deadline of 31 March 2019.
- Allow stakeholder engagement and detailed design to commence associated with Plymouth Bathing Waters and IUDM.
- Chemical investigations programme.
- Investigations, optimisation and project scoping of works at Tiverton WWTW in order to complete the project by 31 December 2015.
- Communicating outline plans to stakeholders and completing detailed design of work required at Countess Wear Flood Defence by April 2016.

We have accepted the company's proposals for all of its transition expenditure. This capital expenditure is excluded from the CIS reconciliation but is included in the baseline for 2015-20. Table A44 below confirms the proposed programme for the water and wastewater services.

Table A44 Transition programme in 2014-15

Net capital expenditure	2014-15 (£m)	Proportion of forecast in 2014-15	Proportion of capital programme in 2015-20
Water service	1.2	2.40%	0.35%
Wastewater service	1.0	1.18%	0.19%

Capital expenditure incentive scheme (CIS)

This draft determination includes the company's predicted capital incentive scheme (CIS) adjustments that arise from its assessment of its performance under the CIS mechanism in the 2010-15 period. The company has arrived at this prediction by comparing its actual capital expenditure performance during 2010-11 to 2012-13 and its predicted expenditure in 2013-14 to 2014-15 to the assumptions for 2010-15 we used in our final determination at PR09 and reflecting, where necessary, the adjustments the company acknowledges under the change protocol.

Table A45 confirms the monetary amounts of the CIS performance reward or penalty, the true-up adjustment to 2015-20 allowed revenues and the midnight adjustment to the closing 2014-15 RCV.

Table A45 Water and sewerage legacy true-up adjustments

	Incentive reward/(penalty) %		Reward/(penalty) £m		Adjustment to 2015-20 revenue £m		Adjustment to RCV £m	
	Company view	Ofwat view	Company view	Ofwat view	Company view	Ofwat view	Company view	Ofwat view
Water service	0.3	0.3	1.0	1.0	-6.2	-6.2	-26.4	-26.4
Wastewater service	-0.7	-0.8	-3.0	-3.4	-7.6	-8.2	6.1	6.1
Total service	n/a	n/a	-2.0	-2.5	-13.8	-14.4	-20.3	-20.3

Note:

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.

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

Tax refinancing benefit clawback

The company did not include a tax refinancing benefit clawback adjustment because of in-period changes in its capital structure. We have therefore made no adjustment for this item.

Other tax adjustments

The company did not propose any other tax adjustments in its business plan.

Equity injection clawback

The company did not receive an allowance for an equity injection for 2010-15. Therefore, we have made no adjustment for this item.

Other adjustments

The company did not propose any other adjustments in its business plan.

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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