April 2014

Setting price controls for 2015-20 – decisions on enhanced companies and next steps

Corrections
Table A9 on page 38 and table A10 on page 40 were corrected on 11 April 2014.

Overview

In our pre-qualification decision document ('Setting price controls for 2015-20 – pre-qualification decisions', published on 10 March 2014), we explained the outcome of our risk-based review of the companies' business plans. We said that the companies' plans were generally of a higher quality than in previous price reviews – particularly in the way that companies are engaging with customers to deliver their priorities. The customer challenge groups (CCGs), along with the regulatory incentives, have played an important role in delivering higher-quality plans.

While all companies had delivered business plans which showed a step change in focus and approach, two companies – **South West Water** and **Affinity Water** – produced high-quality business plans that stood apart from the other companies. This led us to pre-qualify these companies for enhancement.

We said that South West Water and Affinity Water could choose to accept our risk and reward guidance, which we published on 27 January, and address a limited number of other actions we identified with their business plans and so attain enhanced status. These companies had until 17 March to decide whether to accept our risk and reward guidance and to submit updated business planning tables. Recognising that the companies might need longer than one week to address all of the actions, the deadline for complying with these is 11 April.

We are delighted to confirm that both South West Water and Affinity Water are enhanced.

Both South West Water and Affinity Water have now accepted our risk and reward guidance, including the cost of capital. On 17 March, both companies also confirmed that they would comply with the required actions by 11 April. So, both companies are therefore enhanced, although Affinity Water's enhanced status is subject to it finalising one remaining action by 11 April.

In accepting our risk and reward guidance, both companies have:

- adopted a wholesale weighted average cost of capital (WACC) of 3.7%, with a household net margin of 1% and a non-household net margin of 2.5%;
- recalibrated the range of the financial incentives within their business plans and provided a return on regulated equity (RoRE) range which is broadly consistent with our guidance;
- adopted a narrow definition of uncertainty mechanisms, only proposing new uncertainty arrangements where the probability of an event cannot be influenced by the company;
- provided evidence that they will be able to finance their functions, that their proposals for each control allow sufficient returns to be self-financing over the longer term and represent a fair balance between the company and customers;
- proposed a reduction in customer bills compared with their original business plans submitted on 2 December 2013; and
- provided a signed Board assurance statement to support the (updated) business plan.

Both South West Water and Affinity Water have risen to the challenge set by our regulatory approach for the 2014 price review (PR14). They have developed business plans which can be considered by other companies as examples of good practice.

Table 1 below sets out some highlights of these two companies' plans, including their responses to our risk and reward guidance.

Table 1 Plan highlights for South West Water and Affinity Water

Company	Plan highlights
South West Water	• Strong focus on engagement and balancing the need to keep customers' bills affordable while also investing in the environment and service improvements. • Engagement programme running for two years with two phases: (1) understanding its customers' priorities; and (2) presenting customers with investment and bill options to choose from. • Responding to customer acceptability of proposed bill increases by scaling back investment in some areas and challenging itself further on efficiency. • A comprehensive range of schemes in place to support customers who would find its proposals difficult to afford, including a social tariff put in place in 2013-14.

Company	Plan highlights
	• A focus on affordability and efficiency, through the use of new technology, partnership working and innovative approaches. • Working in partnership with others to pursue low-cost sustainable solutions for improving water quality, managing flood risk and improving the resilience of its service. • Delivering proposed improvements to its retail service at no additional cost to its customers and absorbing cost increases through efficiency savings. • Building legitimacy with customers, in particular through a Board pledge to share the benefits of success fairly between customers and investors through an independently monitored and transparent performance sharing framework called 'WaterShare'. • Comprehensive package of outcome delivery incentives (ODIs) that represent a strong first step under the new methodology. • A wholesale WACC of 3.7%, with a household net margin of 1% and a non-household net margin of 2.5%, consistent with our risk and reward guidance. • Relying on existing uncertainty arrangements in the price control for areas of uncertainty except business rates. • An uncertainty mechanism for business rates, with sharing arrangements to incentivise the company to minimise costs (company retains 20% of the cost risk, with 80% passed through to customers). • The Board's view that the plan is high quality was supported by evidence and data from the rest of the plan and it provided a comprehensive update on assurance when submitting its updated business plan, which included strong evidence on how the Board had been involved in addressing the company's pre-qualification actions.
Affinity Water	• Identifying major challenges the company faces, in particular a supply/demand deficit, and using the results of its engagement with customers and the wider consumer interest to shape its proposed solutions. Consistent with the results of its customer engagement, it is focusing on demand management solutions comprising leakage, water efficiency measures and metering. • Engaging with its customers and providing convincing evidence that its plan is affordable, and clearly acknowledging the impact of the Thames Tideway Tunnel on the acceptability of combined water and wastewater bills. Working with its CCG to agree proposals to address this – that is, a comprehensive communication programme to inform customers of potential price changes and taking steps to mitigate the

Company	Plan highlights
	impact on vulnerable and low-income customers. It commits to introducing a social tariff in April 2014. • Highlighting an opportunity to increase choice of supplier for business customers. The company plans to develop a business SIM measure tailored to its business customers and to use focus groups of commercial users to create dialogue about how it can better serve their needs. The company also plans to develop and publish a Business Customer Charter. • Convincing evidence that its wholesale plan is efficient. Proposing to deliver efficiencies in retail costs to offset any increase in input price pressure. • An innovative company plan and vision – for example, reporting performance at a community level as well as at a company level. • ODIs which provide a plausible and acceptable basis to incentivise performance without rewarding the company for simply catching up with industry best practice. • Relying on existing uncertainty arrangements in the price control for areas of uncertainty except business rates. Affinity's Board has provided clear assurance that it will continue to comply with any new statutory environmental obligations and other new legal obligations. • An uncertainty mechanism for business rates, with sharing arrangements to incentivise the company to minimise costs (company retains 25% of the cost risk, with 75% passed through to customers). • A wholesale WACC of 3.7%, with a household net margin of 1% and a non-household net margin of 2.5%, consistent with our risk and reward guidance. • Convincing evidence that its Board has provided strategic direction and leadership as well as convincing evidence of how the Board assured itself that the plan was of high quality.

Both companies now gain the reputational advantages of enhanced status, as well as a fast-track through the price review process – benefiting both the companies and their customers. As we said in our pre-qualification decision document, these companies also receive financial benefits, through an initial financial award and access to enhanced cost performance menus reflecting the benefits of high-quality business plans to current and future customers.

We commend these companies on achieving enhanced status through excellent business plans and strong management.

Affinity Water must now complete one remaining action by 11 April.

In our pre-qualification decision document, we highlighted that South West Water and Affinity Water would need to carry out a limited number of actions within the timetable for draft determinations for enhanced companies. On 17 March, both companies confirmed that they would carry out all of the identified actions.

Affinity Water has one remaining action to complete by 11 April, ahead of us publishing enhanced draft determinations on 30 April. Affinity Water must comply with our guidance on retail cost allocation. Its Board has provided a firm commitment that it will discharge this action by 11 April and the company has submitted a detailed plan for doing so.

If Affinity Water fails to complete the outstanding action, then it will not be an enhanced company.

In order to complete the price review, we will need enhanced companies to provide us with additional information later this year.

To help companies understand the next steps in the price control process and the areas where we will need further information, this document summarises relevant policy decisions and updated information requirements issued since our 10 March announcement. Today, we are also publishing details of our risk-based review assessments for South West Water and Affinity Water, and all other companies. This information has already been shared with the companies.

Table 2 below summarises the areas of further information covered. For each area, this document either provides further information in the appendices, or where the information is provided outside this document, signposts to where further details can be found.

We are publishing this information to provide all stakeholders with greater transparency of our approach and decisions. We hope that a transparent approach will help all stakeholders to understand our decisions and will assist companies throughout the remainder of the price control process.

Table 2 Summary of information and its purpose

Area	Issue	Summary	For which companies is this relevant?	Further information
Risk-based review of company business plans	Risk-based review feedback	We are publishing the material that Ofwat's Board used to decide whether South West Water and Affinity Water are enhanced. Appendix 1 summarises the results of the assessment. We are also publishing our internal methodology, which describes the tests and our expectations for each risk-based review test.	South West Water and Affinity Water	Appendix 1, company documents and '2014 price review risk-based review – internal methodology'
'Do no harm' principle for enhanced companies	Draft determinations process	We confirm that we will use a 'do no harm' principle to address new information that becomes available after enhanced draft determinations on 30 April. We also set out our approach in our pre-qualification decision document.	South West Water and Affinity Water	Appendix 2
Process for enhanced companies	Draft determinations process	Appendix 3 summarises the process and timeline for enhanced companies for the remainder of the price control.	South West Water and Affinity Water	Appendix 3

Area	Issue	Summary	For which companies is this relevant?	Further information
Focusing on delivery	Service incentive mechanism (SIM)	We are publishing the outcome of the future SIM consultation we initiated in October 2013. We set out our conclusions on the SIM incentive properties in our pre-qualification decision document. We are also now confirming the SIM measures and the programme for testing them. This includes a trial of measures for the small company service incentive.	All companies	Appendix 4 and 'Service incentive mechanism (SIM) for 2015 – conclusions'
	Abstraction incentive mechanism (AIM), network plus incentives, network management incentives.	We set out our approach to taking forward these important areas of policy.	All companies	Appendix 4
Securing value for money	Wholesale cost assessment and models	To provide stakeholders with greater transparency of our approach to wholesale price control costs we have shared with companies, and published today, our suite of costs assessment tools used in the risk-based review. The models will also support setting of price controls. We have also published summaries of our decisions for each company for the risk-based review.	All companies	Appendix 5 and wholesale cost assessment

Area	Issue	Summary	For which companies is this relevant?	Further information
	Menus	In this document, we set out important design features of cost incentive menus.	All companies	Appendix 5
	Retail cost allocation	We have set out cost allocation rules for each company to use. This includes a standard set of cost drivers that companies must use for allocating their 2013-14 costs for the purpose of setting the wholesale and retail price controls, and also the household retail and non-household retail price controls from 2015-20.	All companies	Appendix 5 and '2014 price review cost allocation for retail and wholesale price controls'
	Default tariffs process and policy guidance	We explained in IN 14/01, 'Adapted approach for default tariffs' that our review of companies' default tariff proposals had been removed from the risk-based review and we were adapting the default tariff setting process. Today, we have published further guidance on the data all companies should provide and the approach they should take in developing their default tariffs. We are confirming that companies will have until 27 June to provide us with the information we need.	All companies	Appendix 5 and IN14/01, 'Adapted approach for default tariffs'

Area	Issue	Summary	For which companies is this relevant?	Further information
	Other revenue items	Most revenue companies receive relates to the provision of wholesale and retail water and wastewater services to end customers. But we sometimes need to take into account revenue from other sources. This document explains how companies should account for the following specific revenue items in setting price limits. • Connection charges and infrastructure charges. • Land sales and rental income. • Water trading incentives.	All companies	Appendix 5
Balancing risk and reward	Inflation assumptions	In setting price controls we need to reflect actual inflation and make assumptions about forecast inflation in the 2015-20 price control period. In this document, we confirm the assumptions we expect to use. We will keep these under review and confirm the assumptions used in our draft and final determinations when we announce the determinations.	All companies	Appendix 6

Area	Issue	Summary	For which companies is this relevant?	Further information
Reconciling 2010-15 performance	Adjustments to 2015-20 price controls	We are providing further information on how 2015-20 price controls will reflect actual performance during 2010-15. This includes how we will deal with actual performance to be reported in 2013-14 and 2014-15.	All companies	Appendix 7 and 'Setting price controls for 2015-20 – further information on reconciling 2015-20 performance'
Business plan data	Draft determinations process	We are issuing some new business plan tables covering information not originally collected in business plans submitted in December 2013. Enhanced companies will need to submit a sub-set of these tables, comprising: • seven new tables not originally collected in business plans submitted in December 2013; • tables relating to legacy performance; and • tables relating to retail proposals (ACTS and default tariffs).	All companies	Appendix 7 and 8 and business planning tables

List of appendices

Appendix 1: Our assessment of South West Water and Affinity Water business plans under the risk-based review

On 10 March, we announced that South West Water and Affinity Water had pre-qualified for enhanced status. We said that South West Water and Affinity Water must decide whether to accept our risk and reward guidance and to address a limited number of actions we had identified. We considered these actions could be addressed within the timetable for draft determinations for enhanced companies. We confirmed that a company would be confirmed as enhanced on 4 April if it:

- is pre-qualified;
- accepts our risk and reward guidance;
- takes the limited actions that we have identified (by 11 April); and
- remains affordable and financeable.

On 17 March, both companies submitted their risk and reward proposals and confirmed that they would comply with the required actions by 11 April. Both companies' proposals comply with our risk and reward guidance and remain affordable and financeable. Both companies have also made appropriate progress against the pre-qualification actions.

- South West Water has completed all of the seven actions we identified.
- Affinity Water has completed five out of the six actions. It has one action that is still outstanding – to comply with our guidance on retail cost allocation.

We now confirm our decision that South West Water and Affinity Water are enhanced companies. In Affinity Water's case, this is subject to it complying with the one outstanding action by 11 April. If the company fails to complete this action by this date, then it will not be an enhanced company.

A1.1 Risk and reward

To determine whether South West Water and Affinity Water have accepted our risk and reward guidance and remain affordable and financeable, we have assessed their business plans against the following risk-based review tests and key assessment criteria.

Table A1 Risk-based review tests and criteria relevant to assessing whether pre-qualified companies should be confirmed as enhanced

Area	Risk-based review test	Assessment criteria
Outcomes	Outcome delivery incentives	3.1 To what extent do the proposed incentives conform to the framework specified in our methodology?
		3.2 How well do the proposed incentives represent an appropriate balance of risk between companies and customers?
		3.3 How consistent are the company's proposed ODIs with consumers' interests and with customers being appropriately compensated for any under-delivery of performance commitments?
		3.4 To what extent do the company's ODIs take properly into account its assumptions on other regulatory incentives, including totex efficiency sharing and any incentives or penalties it proposes associated with the wider statutory frameworks within which it operates?
Risk and reward	Risk	8.1 How far has the company provided sufficient information – including on company-specific risks – for us to analyse the impact of risks on consumers and companies?
		8.2 To what degree are the companies' proposed risk impacts plausible and acceptable?
	Rewards and returns	10.1 How well do the returns assumed in the company's business plan provide rewards to the company (and its investors) that are appropriate to the relevant risks the company is bearing for each element of its plan?
	Retail net margins	11.1 Has the company proposed a reasonable household and non-household retail net margin?
Financeability and affordability	Financeability	12.1 Taking account of assumptions on costs, revenues, risks and capital structures, how clear is it that the company, if efficient, will be able to finance its functions?
		12.2 How clearly do the company's proposals for each control allow sufficient returns to be self-financing, if it is efficient, over the longer term?

Area	Risk-based review test	Assessment criteria
		12.3 To what degree do the company's proposals represent a fair balance between the company and customers?
	Affordability	13.1 How well has the company demonstrated that its proposals are affordable over 2015-20 and that it has used appropriate means to secure the affordability of bills for customers?
		13.2 How clear is it that the company's proposals are affordable in the longer term? How far has the company demonstrated that it has explored all possible options to ensure that this is the case, for example, by the way it has set out its cost recovery proposals?
Other considerations	Board assurance of a high-quality plan	15 To what extent has the company's Board provided assurance that the business plan is of high quality?

In the same way that we assessed companies' business plans in the pre-qualification process, we used a four-point scale to score companies' risk and reward submissions against our tests and 'other considerations'. We carried out a detailed assessment process, scoring each assessment criterion individually, and then assigning an overall score for each test. In most cases, we carried out separate tests for each element of companies' business plans (household retail, non-household retail, water wholesale and wastewater wholesale), but in some cases we applied the tests at a whole company level.

We explain the four possible test scores below.

- **A** – Where a company has demonstrated that it is exceeding stakeholders' expectations and overall we consider that the evidence put forward is exceptional.

- **B** – Where a company has demonstrated that it has robustly addressed stakeholders' expectations, and we have received sufficient and convincing evidence to support companies' proposals.

- **C** – At this stage, we do not have sufficient and convincing evidence. More information is required for us to understand companies' proposals or to give us confidence that companies will deliver proposals that protect customers' interests.

- **D** – At this stage, substantially more information is required for us to understand companies' proposals and to give us confidence that companies' will deliver proposals which protect customers interests.

Further detail on the scoring framework used for the risk based review is provided in '2014 price review risk based review – internal methodology'.

Our assessment of the companies' risk and reward proposals against the relevant risk-based review tests is summarised in table A1.2 below.

Table A2 Our assessment of South West's and Affinity's risk and reward submissions

Area	Pre-qualification test	SWT	AFW
Outcomes	Outcome delivery incentives	✓	✓
Risk and reward	Retail net margins	✓	✓
	Rewards and returns	✓	✓
	Risk	✓	✓
Financeability and affordability	Financeability	✓	✓
	Affordability	✓	✓
Other considerations	Board assurance	✓	✓

We also re-confirmed the results of the pre-qualification tests. None of the test scores have changed as a result of testing risk and reward guidance.

A1.2 Pre-qualification actions

As explained above, both companies had a limited number of actions to address by 11 April in order to provide greater assurance that their business plans will deliver the benefits we seek for customers. Table A3 provides a summary of the companies' progress against the pre-qualification actions.

Table A3 Our assessment of South West Water's and Affinity Water's risk and reward submissions

Action	Detailed action	SWT	AFW
AFW 1	**Performance commitments (PCs):** Provide sufficient and convincing evidence that five PCs represent value for money	N/A	✓
AFW 2	**Performance commitments:** Confirmation on actions to record, monitor and assure delivery of PCs	N/A	✓
AFW 3	**Performance commitments:** Consider PCs around asset serviceability or provide convincing evidence why customers will be protected.	N/A	✓
AFW 4	**Retail cost allocation:** Ensure compliance with Ofwat guidance (firm commitment to comply by 11 April)	N/A	In progress
AFW 5	**Legacy adjustments:** Ensure compliance with Ofwat guidance	N/A	✓
AFW 6	Programme of customer engagement on Thames Tunnel Tideway impact on bills	N/A	✓
SWT 1	**Performance commitments:** Provide sufficient and convincing evidence that ten PCs in the wholesale water control represent value for money	✓	N/A
SWT 2	**Performance commitments:** Provide sufficient and convincing evidence that three PCs within the wholesale water control are consistent with long-term customers' interests	✓	N/A

Action	Detailed action	SWT	AFW
SWT 3	**Performance commitments:** Provide definition of 'Time taken to fix significant leaks' PC to effectively measure performance	✓	N/A
SWT 4	**Performance commitments:** Provide sufficient and convincing evidence that three PCs in the wholesale wastewater control represent value for money	✓	N/A
SWT 5	**Performance commitments:** Provide sufficient and convincing evidence that two PCs within the wholesale water control are consistent with long-term customers' interests	✓	N/A
SWT 6	**Performance commitments:** Provide sufficient evidence on performance levels relating to two PCs	✓	N/A
SWT 7	**ACTS:** Provide sufficient evidence to support its calculation of the size of its bad debt ACTS adjustment	✓	N/A

Further details on the risk-based review assessment for Affinity Water and South West Water are can be found on our website, including details of our assessment of the pre-qualification tests and our assessment of the companies' risk and reward proposals.

Appendix 2: Benefits for enhanced companies

In our final methodology statement, we confirmed there would be reputational, financial and procedural benefits for companies that produced high-quality business plans.

In this appendix, we summarise the combination of financial, reputational and procedural incentives we are offering to enhanced companies, consistent with our pre-qualification decision document.

Table A4 Summary of the financial and procedural benefits of enhanced categorisation

Benefit	Summary
Financial benefits	We are offering enhanced companies an incentive package of: i. an initial award of £11 million to South West Water and £4 million to Affinity Water, reflecting the scale of the two companies; and ii. an enhanced menu, with a cost sharing rate that is 5% higher for both under- and over-performance (a symmetric menu). Further information on enhanced menus is provided in appendix 5.
'Do no harm' principle	We are offering enhanced companies a range of commitments to ensure that they will not be any worse off for being categorised as enhanced and receiving an earlier draft determination. The 'do no harm' principle applies in relation to specific aspects of enhanced draft determinations, either in relation to their absolute position at a point in time or their relative position in relation to other, non-enhanced companies. The 'do no harm' principle applies to: • movements in capital markets; • early material changes in companies' statutory obligations; • any relevant new industry-wide uncertainty mechanisms; • the impact of Ofwat policies on form of control, default tariffs, charging, SIM, and financial reporting and monitoring; and • the impact of new data (for example, industry data, RPI data) on our final determinations.
Reputational incentives	Public recognition and acknowledgement of a high-quality and customer-focused plan.

Benefit	Summary
Early draft determinations	Enhanced companies will receive early draft determinations on 30 April. All companies will receive a final determination at the same time, in December 2014.

A2.1 Responses from pre-qualified companies

We asked South West Water and Affinity Water to consider how the initial award for being enhanced should be profiled over time, taking the likely views of their customers into account. Both companies have now proposed how the initial award will be recovered over time in a net present value neutral manner.

South West Water has proposed that it will recover its initial award of £11 million through an addition to its 2015-16 regulatory capital value (RCV) so that the impact on bills is aligned with the long-term benefits of what it delivers. It is proposing that 50% of the initial reward should be shared with customers through reinvestment to further improve services. South West Water has also accepted the enhanced cost sharing rate we set out on 10 March 2014, and proposes to seek the benefit from the adjustment to the sharing rate through an adjustment to its RCV in 2020, which reflects the long-term nature of the improvements it plans to make.

Affinity Water is proposing to recover the £4 million reward for enhanced status by adding the total amount to its opening RCV. The company considers this is the fairest way of recovering this from customers over time.

In accepting our risk and reward guidance, Affinity Water has also accepted that the ‘do no harm’ principle will apply only to movements in capital markets, as is the case with South West Water.

A2.2 Applying the ‘do no harm’ principle to variations in 2010-15 performance

We now confirm how the ‘do no harm’ principle applies to the process of reconciling 2010-15 performance.

The 2010-15 price control included ex-post incentive tools to deliver rewards and penalties associated with the performance of the companies within the 2010-15 period. These tools were part of the final determinations for all companies in 2009 and continue to apply to all companies regardless of their categorisation in the risk-based review process.

As part of our draft determinations for enhanced companies, we will apply the company assumptions on performance, rewards and penalties for the legacy incentive tools. Assuming that the enhanced companies deliver performance within the 2013-14 and 2014-15 years in alignment with their performance assumptions in their business plans, we will not amend the rewards and penalties applied in our draft determinations.

But, where we identify that the updated information for 2013-14 and 2014-15 means that there are material impacts to the incentive adjustments for enhanced draft determinations, we will discuss this with companies and reflect the revised adjustments in final determinations.

Appendix 3: Process for enhanced companies

This appendix provides further information on the process for April draft determinations for enhanced companies. It explains what enhanced companies need to provide to us and when, and the remaining steps through to the final determination.

A3.1 The process for draft and final determinations

We will publish draft determinations for enhanced companies on 30 April.

Unlike previous price reviews, we will be setting draft determinations at different times depending on whether a company:

- is enhanced and receives a draft determination in April;
- requests an earlier draft determination in June; or
- requests a draft determination in August.

In appendix 2, we have explained how we are dealing with changes to assumptions and external factors between the enhanced draft determinations, draft determinations in June and August, and final determinations.

We will continue to run consultation periods at the time of each draft determination, but at this stage we do not intend to publish our final views on these until we set final determinations for all companies in December 2014.

A3.2 Further information that enhanced companies need to submit

Enhanced companies will need to submit additional information later in the price control process. Table A5 below set out the additional information and key dates for enhanced companies.

Table A5 Further information

Information requirement	Due date
SIM performance data for 2013-14.	2 May
Updated business plan tables and commentary to reflect the new cost allocation rules (see our information on cost allocation for retail and wholesale price controls).	By 27 June
Revised default tariff tables and supporting evidence.	27 June
Information on actual performance in 2010-15, including: • actual 2013-2014 cost information; • commentary on the variance between costs based on the revised cost allocation guidance and the actual costs expected to be reported in the published, audited 2013-14 regulatory accounts; and • 2010-15 performance – 2013-14 actual performance and updated 2014-15 forecast performance with respect to RCM, OIA, change protocol, serviceability information and CIS (see appendix 7).	27 June
Published risk and compliance statements, performance reports and regulatory accounts	15 July

Appendix 4: Information for focusing on delivery

A4.1 Service incentive mechanism (SIM) for 2015-20

In our final methodology statement, we said that we would continue to use SIM as an incentive to encourage all companies to improve the service that customers received. In October 2013, we consulted on:

- applying SIM incentives to the price controls set for 2020 onwards (based on the performance during 2015-20); and
- the design of the SIM measures for 2015-20.

We said we expected to use the year 2014-15 to test the conclusions the consultation reached on the SIM measures.

We received a number of responses to this consultation and have now reached conclusions on the design of the SIM for 2015-20.

In our pre-qualification decision document, we explained the key conclusions on the SIM incentive properties. We confirmed that the SIM for 2015-20 will be similar in structure and form to the current incentive, but with more weight on the qualitative versus quantitative measures (3:1). We did this to enable pre-qualified companies to make informed decisions about the SIM incentive contribution to their risk and rewards and to provide maximum certainty for 2015-20. We confirmed that the SIM incentive would apply to households for companies in England and Wales, and to non-households for companies who operate wholly or mainly in Wales.

In 'Service incentive mechanism (SIM) for 2015 onwards – conclusions' published today, we now confirm the measures that will form the SIM and set out a plan for their testing. It includes information about the development of:

- a small company service incentive; and
- an incentive for non-household customer service.

A4.2 Abstraction incentive mechanism, network plus incentive and network management incentive

The **abstraction incentive mechanism** (AIM) will no longer be part of the PR14 programme. Instead, it will be taken forward to slightly longer timescales in 2015. This is because of difficulties with the underlying data and information on the environmentally sensitive sites that AIM is intended to cover and the apparent diversity across companies in respect of sites and data. These issues will require intense and perhaps extended efforts to resolve, if any incentive arrangements are to be soundly based.

Attempting to do this alongside the challenging timetable of the PR14 programme does not appear realistic and would risk creating inappropriate and counter-productive incentives with respect to environmentally sustainable abstractions. Given the importance of environmental and sustainable development matters this does not appear an appropriate course of action. Also bearing in mind the importance of these matters, we commit now to creating a task force with the sector with the objective of properly resolving these matters in 2015.

This should facilitate the timely and rapid development of AIM as a national reputational incentive to benchmark, on a consistent basis, levels of abstraction at low flows from designated environmentally sensitive sites. We will take forward policy development through the Choice and Trading Arrangements project, which will ensure links to Government proposals for longer-term abstraction reform and upstream trading arrangements will be maintained.

One of the drivers for AIM was concerns that new water trading arrangements and incentives could create unbalanced incentives and encourage water companies to increase abstractions from unsustainable sources. Our final methodology statement provided a framework that would allow these concerns to be addressed independently of AIM – by the operation of Trading and Procurement Codes. These codes would make it clear that in order to qualify for a water trading incentive then the company concerned would need to demonstrate that any associated water abstractions were environmentally sustainable. We reconfirm these commitments and to the active enforcement of these conditions in the future.

Taken together, we are confident that these measures will lead to the development of robust and effective incentives with respect to sustainable abstraction.

The **network plus incentive** is designed to reveal information about costs and revenues related to companies' network and treatment activities on a consistent national basis, and the **network management incentive** is designed to reveal information about how companies manage their networks. We plan to take forward policy development in these areas through the Choice and Trading Arrangements project with further consultation with the sector taken forward in co-ordination with consultations on regulatory financial reporting.

Appendix 5: Information for securing value for money

A5.1 Overview of our approach to cost assessment

In order to set both wholesale controls, we need to estimate the efficient level of wholesale costs.

Wholesales costs are a very material proportion of water and wastewater company expenditure. Forming a view about the efficient level of these costs requires a detailed knowledge of the sector and of advanced cost modelling techniques.

In our final methodology statement, we explained that we would move to a totex-based approach to assessing efficient expenditure for the next review. We made this change because assessing operating and capital expenditure separately can lead to different incentives for companies to deliver operating and capital efficiency savings, and might contribute to a bias towards capital intensive business solutions and expenditures.

We considered the move to totex could deliver substantial benefits for customers. However, implementing a totex approach is novel for the water sector. It has required us to revise our approach to modelling efficient wholesale costs. We have devoted considerable effort to the development and quality assurance of our wholesale cost models and have developed a range of technical, econometric models to facilitate the comparative assessment of efficiency.

It is difficult for CCGs or for customers to engage effectively with the companies on such matters. For this reason, and because of the inherent complexities of cost modelling, we have sought independent advice and quality assurance of our approach. Our costs models have been developed following industry consultation by our consultants, CEPA and in conjunction with Dr Andrew Smith of the University of Leeds.

We are providing detailed information on the way we have modelled wholesale costs at this time: to provide transparency of our approach and decisions, to facilitate the preparation by non-enhanced companies for the 2 May and 27 June submissions, and to support constructive engagement on our approach to estimating the efficient level of costs. We want to encourage companies to engage with how the wholesale cost thresholds have been calculated. It is in the interests of both consumers and the companies that our assessment of efficient costs is robust.

Companies will inevitably have more information about their costs and the uncertainties associated with future cost forecasts than we do. This is one of the reasons (as explained in our final methodology statement) that we will set menus as part of water and wastewater price controls. Menus provide some additional flexibility in setting efficiency sharing factors and allow companies to better manage risk and rewards.

This appendix:

- explains the information we have released in relation to assessing the costs submitted in wholesale water and wastewater elements of business plans and how companies should respond;
- sets out our approach to baselines and menus for companies that are not enhanced;
- summarises our information on cost allocation for retail and wholesale price controls, published on 24 March 2014; and
- summarises our 'Setting price controls for 2015-20 – guidance for companies on producing default tariffs' published today.

A5.2 Wholesale cost assessment and models

We are in the process of calculating wholesale cost baselines, which feed into the price controls.

When we published our pre-qualification decisions on 10 March 2014, we said that we would provide further information on wholesale cost thresholds and publish our wholesale cost models. To calculate the cost thresholds we have used a series of wholesale cost models. We explain the suite of models we are using on in three overview documents (with appendices) as explained below. There are three broad steps underlying our approach to cost assessment for PR14.

- We produced a **basic cost threshold** for each companies' water and (where relevant) wastewater activities. The basic cost threshold represents our initial view of the costs for a typical company of a certain size and certain characteristics. We calculated the basic cost threshold without reference to the company business plan. Costs for water and wastewater are derived from separate models which in turn draw on a series of supporting models and information. Today, we have published today 28 company models populated with the basic cost thresholds.

- We have then carried out a **risk-based review of business plans and produced initial cost thresholds**. In their business plans, each company had the opportunity to explain why the costs it faces may be different from the expected level of costs calculated by cost benchmarking models. We invited companies to explain why their costs were different to the rest of the sector or why these costs were different from the company's own historical costs. As we explained in appendix 1 of our pre-qualification decision document, gaps between our thresholds and company cost projections highlight areas where there are opportunities for the companies to provide further information and evidence on 2 May or 27 June. Today, we have today published populated versions of the cost template models for those companies that scored D in the wholesale cost test (populated versions for other companies should be published shortly).

- Once companies have submitted any further information, we will review this evidence and decide whether any further adjustments are required to the cost thresholds and menu and price control baselines for each company.

In formulating draft determinations, it will be important to modify the cost thresholds so that they can form the basis of menu and price control baselines. In general this will involve three broad stages.

- Making any adjustments to take account of representations from companies and other stakeholders, and as a result of our further quality assurance process where these are consistent with protecting customers' interests.

- Considering whether it is appropriate to further protect customers in setting menu and price control baselines, in particular, for those companies with forecasts of costs below the cost threshold – this includes South West Water and Affinity Water.

- There are also a number of important but largely technical issues associated with translating cost thresholds into baselines and making sure that the final price control includes appropriate cost sharing incentives. These include the treatment of issues such as pension deficit recovery costs, business rates and transition spending.

A5.3 Setting menus

In 'Setting price controls for 2015-20 – final methodology and expectations for companies' business plans' (our 'final methodology statement'), we explained we will set menus as part of water and wastewater controls. A menu provides a framework which allows companies a degree of flexibility to determine its price control baseline and cost sharing incentive rate. At the same time, it provides incentives for companies to be efficient and to reveal accurate information about their expectations of future costs.

Below, we present our proposed enhanced menus for the water and wastewater wholesale price controls and discuss our calibration of their parameters. We provide more technical background to menus in section A5.7, while A5.8 sets out the underlying parameters for the two menus.

Table A6 below sets out our enhanced menu. The menu shows the rewards or penalties a company would earn for each menu choice for a given level of outturn expenditure. All values are expressed as a percentage of our baseline level of efficient expenditure.

Table A6 Draft menu for enhanced companies

Company menu choice	80	85	90	95	100	105	110	115
Cost sharing rate	59%	58%	57%	56%	55%	54%	53%	52%
Allowed expenditure	95.00	96.25	97.50	98.75	100.00	101.25	102.50	103.75
Additional income	2.55	1.95	1.33	0.68	0.00	-0.70	-1.43	-2.18
Actual expenditure	Reward/penalty							
70	17.3	17.2	17.0	16.8	16.5	16.2	15.8	15.4
80	11.4	11.4	11.3	11.2	11.0	10.8	10.5	10.2
85	8.5	8.5	8.5	8.4	8.3	8.1	7.9	7.6
90	5.5	5.6	5.6	5.6	5.5	5.4	5.2	5.0
95	2.6	2.7	2.8	2.8	2.8	2.7	2.6	2.4
100	-0.4	-0.2	-0.1	0.0	0.0	0.0	-0.1	-0.2
105	-3.4	-3.1	-3.0	-2.8	-2.8	-2.7	-2.8	-2.8
110	-6.3	-6.0	-5.8	-5.6	-5.5	-5.4	-5.4	-5.4
115	-9.3	-8.9	-8.7	-8.4	-8.3	-8.1	-8.1	-8.0
120	-12.2	-11.8	-11.5	-11.2	-11.0	-10.8	-10.7	-10.6
125	-15.2	-14.7	-14.4	-14.0	-13.8	-13.5	-13.4	-13.2
130	-18.1	-17.6	-17.2	-16.8	-16.5	-16.2	-16.0	-15.8
140	-24.0	-23.4	-22.9	-22.4	-22.0	-21.6	-21.3	-21.0

The precise calibration of menu parameters is provided in A5.8. The main considerations that led to the selection of these parameters are as follows.

A5.3.1 The cost sharing rate

This provides companies with an incentive to reduce costs throughout the PR14 period and limits their exposure to cost overruns. The rate determines the share of any cost outperformance that the company's shareholders retain, and likewise, the share of any cost overrun that shareholders have to fund. Our draft menu for companies that are not enhanced has a cost sharing rate of 50% at the menu choice of 100. We consider that this rate provides a strong incentive on companies to seek further efficiencies through the price control period, which will benefit current and future customers. This represents a strengthening of the averaged cost sharing rate used in PR09, but remains broadly consistent with regulatory precedent. A number of companies indicated their support for this rate in their business plan submission and no company rejected this rate or proposed a different one.

As set out in our pre-qualification decision document, we have decided to set the cost sharing rate in the enhanced cost menu at 5% above the menu for companies that are not enhanced, across the full range of the menu. A significantly larger amount would result in relatively little benefit to the customer from any outperformance by the company, and a smaller amount would provide little additional incentive for outperformance by enhanced companies.

We propose to limit the variation in cost sharing rate such that the rate does not significantly depart from our central value of 50%. The variation in our menus is 2% for very 10% departure from our baselines.

A5.3.2 The break-even point

The menu framework requires us to set a break-even point. This is the point on the menu where revenues from cost outperformance (or underperformance) and the additional income are equal to expected outturn costs and the company would earn its allowed rate of return. We have calibrated the point defined by a choice of 100 and outturn cost of 100 as a break-even point. Given that our menu baselines reflect an historical upper-quartile efficiency level, a company that forecast to operate at that level of efficiency should expect to recover its normal rate of return.

This calibration was informed by our analysis of companies' expenditure forecasts. Analysis through the risk-based review suggests that around half the water and wastewater business elements are within a few per cent above or below the upper quartile thresholds. A higher break-even point would reduce the efficiency challenge of our totex framework and increase the likelihood of outperformance. For example, adopting of a 105 break-even point would increase companies' revenue allowance by about 2.5% for a cost sharing incentive of 50%. This is equivalent to nearly £1 billion for the sector over the price control period.

We note that we used the same break-even point in the capital expenditure incentive scheme (CIS).

A5.3.3 Interpolation of Ofwat's cost baselines and companies' cost forecast to calculate allowed expenditure

In designing the menu, it is necessary to decide how much weight to put on our view of efficient cost and how much weight to put on the company's view of likely cost performance. In PR09 for the CIS, we attached a 75% weight to our cost baselines and 25% to companies' cost projections to calculate a capital expenditure allowance. Ofgem has used the same weighting scheme throughout all the price reviews that have used menu regulation. We propose to adopt a 75/25 weighting scheme above across our water and wastewater menus. The same weighting scheme will apply to enhanced and non-enhanced companies.

A5.3.4 The range of the enhanced menus

We set a lower limit for the menu at a choice of 80 (in other words, when the company's expenditure choice is 20% lower than our baseline view of cost). Based on the December business plans, we do not think that the lower limit will be a binding restriction for any of the companies. We propose to set the upper limit of the enhanced menu at 115 given that the two enhanced companies submitted plans that put them around or below the 100 point of the menu. We have accepted enhanced companies' plans with minimal changes and we do not expect enhanced companies to change their initial expenditure forecast significantly.

Table A7 below summarises the key parameters of our draft menus.

Table A7 Key characteristics of our proposed menus

	Non-enhanced menu	Enhanced menu
Cost sharing rate		
Value at 100	50.0%	55.0%
Slope (rate of change)	-0.2%	-0.2%
Break-even point at the 100 menu choice		
Outturn expenditure	100	100
Allowed expenditure weights		
Ofwat baseline	0.75	0.75
Company forecast	0.25	0.25
Range of choice		
Lower bound	80	80
Upper bound	130	115

Alongside this document, we are also publishing an overview of the menu feeder model and the spreadsheets that capture the use of menus in our suite of feeder and financial models.

A5.4 Retail cost allocation

In March, we set out rules for each company to use to allocate costs between price controls in our information on cost allocation for retail and wholesale price controls. The rules include a standard set of cost drivers that companies must use for allocating their 2013-14 costs for the purpose of setting the wholesale and retail price controls and the household retail and non-household retail price controls from 2015-2020. We also explained that companies should directly attribute costs between price controls wherever possible.

Ensuring that companies allocate their costs in a consistent manner across these boundaries is particularly important for the following reasons.

- The UK Government's Water Bill includes plans to allow all non-household customers in England to choose their supplier water and wastewater services by April 2017. This requires a robust and consistent allocation of costs, otherwise the relevant retail markets may be affected differently in different regions (for example, because companies use materially different cost drivers or allocation approaches). This could lead to an inconsistent operation of those markets or some non-household customers not being able to participate effectively in them. Also, in future, companies will need to ensure that they are compliant with their obligations under competition law. They will need to ensure that their non-household retail activities are able to operate as a viable and sustainable stand-alone business unit and there will be obligations to ensure that wholesalers treat their own and other retailers without preference.

- Some of our regulatory tools, such as the average cost to serve, are comparative. These tools must be applied fairly, and must use similarly defined costs.

All companies will be expected to have allocated their 2013-14 costs in line with the rules set out in our information on cost allocation for retail and wholesale price controls for the purposes of us making our final determinations in December for the period 2015-20.

A5.5 Default tariffs process and policy guidance

In IN 14/01, we explained that we were removing default tariffs from the risk-based review and would adopt an adapted process for setting default tariffs. Since then we have worked with companies to further understand the key issues in setting default tariffs.

Today, we have published guidance for companies on producing default tariffs. This provides clarification of the information that companies should submit to us on default tariffs and what companies should submit within the relevant business plan data tables as well as the approach that they should take in constructing their default tariffs. We have updated the business plan tables to ensure greater cross checking of data to reduce the scope for calculation errors.

All companies are required to submit the required information by 27 June. We will set out our draft determinations for non-household retail price controls for all companies on 29 August. We will also describe the approach companies are taking to default tariffs. Final determinations for all companies will be set by 12 December, with all non-household customers beginning the new control period (starting 1 April 2015) on the 'default tariffs'.

A5.6 Approach to revenue items

Most of the revenue that companies receive relates to the provision of wholesale and retail water and wastewater services to end customers. But we sometimes need to take account of other revenue companies receive so we can be sure that price controls properly reflect all the revenue that companies are likely to receive during the price control period.

In this price review, as outlined in our methodology statement, we are continuing to use a **single till approach** for the treatment of revenues from regulated services regardless of the different forms of regulation we will be applying to particular regulated activities and services. This means that we assess all relevant costs and revenues associated with regulated activities and services in appointees' integrated businesses when assessing business plans and setting targeted controls for specific services.

For PR14, water and wastewater wholesale controls now cover all revenues from wholesale activities services, including revenues from **connection charges** and **infrastructure charges.** As we explained in our final methodology statement, this approach means we deduct the expected capital contributions when assessing companies' allowed wholesale costs (as we have done at previous price reviews).

In setting specific connection charges for services contributing to the total revenues covered by wholesale controls, such as connection charges, we would expect companies to continue to comply with their licence obligations to ensure that pricing is cost-reflective and non-discriminatory and also to comply with all their obligations under competition law. For example, if a company increased revenue in one area by unduly reducing connection charges in another area we may take corrective action through new wholesale and connection charging rules to ensure that companies returned these monies (with financing costs) to customers, as provided for under the Water Bill.

In our final methodology statement, we explained that we would consult further at the time of draft determinations on the details of the form of the wholesale revenue controls, to allow companies more flexibility to adjust charges to deal with unexpected demand variations within the revenue caps, while protecting customers from undue bill changes from year to another. We also noted that we would consider the need to adjust the revenue caps themselves on a case by case basis in the event of exceptional unanticipated demand variations (for example, for new connections).

We will set out proposals for consultation alongside our draft determinations for enhanced companies later this month. Similarly, if demand for connections is unexpectedly high then we would nevertheless consider allowing extra revenue to compensate for the loss of price control revenue on a case-by-case basis.

We will continue to take appropriate account of any other cash or revenue accruing to the regulated wholesale businesses, in setting the calibrating price controls (through allowed revenues) for those services covered by the K factor in companies' licences. This includes **income from land sales** and **rental income** whereby all water companies are required to share the proceeds of disposals of protected land (as defined in the Water industry Act 1991 – or 'WIA91') with customers. Consistent with our approach at the PR09, we will make an adjustment at the 2019 price review (PR19) to ensure these proceeds are shared.

We will make adjustments to price control revenue at PR19 to take appropriate account of **water trading incentives**. As stated in our final methodology statement, if a water company wants to claim an export and (or) import incentive it must be operating consistently with and be able to demonstrate compliance with an approved trading and procurement code.

We will also claw back at PR19 any inefficient export profit from revenues which are not subject to the revenue cap which are not made pursuant to approved codes, and will set price limits on this basis at PR19.

A5.7 Technical background

A menu is a set of three equations of a single variable – the company's menu choice (see table A8). Each equation determines a different component of the menu: the cost sharing rate for each menu choice (also known as the efficiency incentive rate), the allowed expenditure for each menu choice and the additional income for each menu choice.

Table A8 presents the three menu equations using standard notation where **f** represents the menu choice – the ratio of a company's expenditure forecast to our menu baselines.

Table A8 The functional form of the three menu equations

Menu component	Type of function	Functional form
Cost sharing rate (R)	Linear	$\sigma_1 + \sigma_2 \mathrm{f}$
Allowed expenditure (AE)	Linear	$\gamma_1 + \gamma_2 \mathrm{f}$
Additional income (I)	Quadratic	$\alpha_1 + \alpha_2 \mathrm{f} + \alpha_3 \mathrm{f}^2$

The three components of the menu, in turn, determine the company's reward or penalty for every outturn of expenditure as follows.

Reward/penalty = (AE – outturn)*R + I

The additional income component of the menu is calibrated to ensure that the menu is incentive compatible, namely that it provides an incentive for companies to submit to us their unbiased forecast of expenditure over the price control period. In order for the incentive to work, however, a number of conditions have to be satisfied, most notably companies have to be risk neutral and our baselines must be obtained independently of companies expenditure forecast.

The calibration of the parameters in table A8 can be guided by some tangible policy decisions.

1. The rate of the cost sharing incentive at the central point of the menu (100) and the lower and upper value of the cost sharing rate across the menu. These determine σ_1 and σ_2.
2. The weights on the company view of cost and of the regulator's view of costs to be used in the calculation of allowed expenditure. These determine γ_1 and γ_2.
3. The break-even point at the central point of the menu (100). This determines α_1.

The parameters α_2 and α_3 will calibrate 'automatically' to retain the incentive compatibility of the menu.

A5.8 Calibrating our standard and enhanced menus

Table A9 Calibrating the parameters defining the standard and enhanced menus

Menu parameter	Notation	Standard menu	Enhanced menu
Efficiency incentive – constant	σ_1	0.70	0.75
Efficiency incentive – slope	σ_2	-0.0020	-0.0020
Allowed expenditure – constant	γ_1	75	75
Allowed expenditure – slope	γ_2	0.25	0.25
Additional income – constant	α_1	7.50	8.75
Additional income – first order parameter	α_2	-0.0250	-0.0375
Additional income – second order parameter	α_3	-0.0005	-0.0005

Table corrected on 11 April 2014.

Appendix 6: Information for balancing risk and reward

A6.1 RPI assumptions

When setting price controls we need to reflect actual inflation and make assumptions about forecast inflation in the 2015-20 price control period. Similarly, companies must make assumptions when they submit data to us.

We provided details of the published monthly retail price index (RPI) values for the financial years up to and including 2012-13, plus the first two months of 2013-14 in business plan table A9. There are now published RPI values to February 2014, these are included in the updated table A9 for the business plan resubmissions.

In July 2013, we published guidance on the common assumptions for the 2015-20 price control period we wanted companies to use for their business plan scenario analysis in 'Economic assumptions for PR14 risk analysis'. These include projections for RPI inflation and other economic variables.

We have not seen any evidence to suggest that these RPI inflation assumptions need to be updated at the present time.

Table A10 summarises the historic RPI data and the forecast inflation rates for 2015-20 price control period. The figure included for 2014-15 represents the average of companies' assumptions and is taken from the business plan data submitted in December 2013.

We will continue to keep these assumptions under review and will confirm the assumptions used when we publish our draft and final determinations.

Table A10 Historic RPI and forecast inflation assumptions [2018-19 column added and 2019-20 value corrected on 11 April 2014]

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
RPI: April – index (published)	242.5	249.5								
RPI: May – index (published)	242.4	250.0								
RPI: June – index (published)	241.8	249.7								
RPI: July – index (published)	242.1	249.7								
RPI: August – index (published)	243.0	251.0								
RPI: September– index (published)	244.2	251.9								
RPI: October – index (published)	245.6	251.9								
RPI: November – index (published)	245.6	252.1								
RPI: December – index (published)	246.8	253.4								
RPI: January – index (published)	245.8	252.6								
RPI: February – index (published)	247.6	254.2								
RPI: March – index (published)	248.7									
RPI: Financial year average – index (published)	**244.68**									
RPI: Financial year average – year-on-year % movement (actual)	**3.09%**									
RPI: Financial year average – year-on-year % movement (Ofwat assumptions)			**3.00%**	**3.40%**	**3.40%**	**3.50%**	**3.30%**	**3.10%**	**3.10%**	**3.10%**

Appendix 7: Information for reconciling 2010-15 performance

In our final methodology statement, we said that, we would adjust 2015-20 price controls to reflect companies' actual performance during the 2010-15 price control period.

The adjustments we make to price controls to reflect 2010-15 performance are dependent upon data for company performance in 2013-14 and 2014-15. The timing of the enhanced draft determinations means that enhanced companies will need to submit information to us in relation to performance in these two years.

We have published updated business plan data tables to collect the revised information we need, including some new tables, to allow us to collect information on company performance in 2010-15. This will inform the final determinations for enhanced companies. We provide a general description of the revised business plan tables and guidance in appendix 8.

A7.1 How we expect to reconcile 2014-15 performance as part of the price review in 2020

At each price review, we have to deal with the fact that actual performance in the final year of the price control is not known until after we make our final determinations. For this price review, while companies must make a robust assumption of expected performance for 2014-15, we take actual performance into account in price controls from April 2020 where it is materially different from the assumed performance. This process applies for all companies (including enhanced companies). This mainly affects:

- the revenue correction mechanism (RCM) – we will carry out a reconciliation in the summer of 2015;
- the change protocol and serviceability – we will review these in the summer of 2015; and
- the CIS – this will be reconciled in the summer of 2016.

The RCM reconciliation will require companies to submit actual revenue information in the summer of 2015, which will be reconciled using the same legacy tools and mechanisms used within the price review.

The change protocol and serviceability review will require companies to submit information identical to that sought through PR14 about the delivery of the FD09 outputs and serviceability measures for 2014-15. Any material differences between FD09 outputs and actual deliverables will then be reconciled through the CIS reconciliation in the summer of 2016. This reconciliation will not affect PR14 price controls and any changes (where material) will be applied through the following price review in 2019-20.

Finally, the CIS reconciliation will examine differences between outputs and costs against FD09 assumptions, taking into account final COPI indexation and will determine final rewards and penalties for the CIS, with final revenue and RCV adjustments being determined. Where these are materially different to those assumed at the PR14 final determination then the differences will be reconciled at the following price review in 2019-20.

More detailed information on our approach to reconciling 2010-15 performance, including updated information requirements, is provided in our document on reconciling 2015-20 performance, which will be published shortly.

We will also be consulting shortly on the appropriate mechanism for managing differences between actual and forecast wholesale revenue in the next regulatory period consistent with the basic form of wholesale control set out in our final methodology statement.

Appendix 8: Updating business plan data tables

Companies submit specific **business plan data tables**, which we use to set price controls.

We have added **seven new tables** not originally collected in business plans submitted in December 2013. These relate to new SIM and asset performance data which we need in order to make adjustments for company performance in 2010-15. All companies are expected to submit data for these new tables (see appendix 7 and document on reconciling 2015-20 performance).

We are also re-issuing the business plan tables and guidance to companies receiving a draft determination in June or August. We carried out a similar exercise ahead of pre-qualified companies providing updated submissions on 17 March.

The revised tables resolve some identified errors and provide for greater validation of the data submitted by companies. Also, there are some tables where we do not need any new information from any companies because we either no longer need data, or know that data won't change.

Further information on the business plan tables and associated guidance are available on our website.

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

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7699
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

Photograph © Stockvault
Printed on 75% minimum de-inked post-consumer waste paper
April 2014

ISBN 978-1-908116-68-0

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

This document is also available from our website at www.ofwat.gov.uk.

OGL

www.ofwat.gov.uk