

## About this document

In '[Consultation on the final 2010-15 reconciliation](#)' we invite comments on our proposals for reconciling the incentive arrangements for companies' performance and expenditure for the 2010-15 period now that actual information is available for the complete period, including 2014-15 the last year of the price review 2009 (PR09) price control.

To the extent that the adjustments we propose are different to the assumptions we made as part of the price review 2014, the differences will mainly be taken into account at the next price review in 2019, although one, in respect of the revenue correction mechanism, could be adjusted through revenue in the period 2015-2020.

In this appendix, we set out the proposals in respect of Wessex Water. It shows how we have assessed the claims the company has made, and the basis for our proposals.

We are also publishing detailed spreadsheets containing calculations of the adjustments for each company alongside the consultation.

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## 1. Introduction

At PR09 Ofwat included a number of incentive arrangements designed to protect customers by encouraging companies to improve and deliver their services more efficiently over the period 2010-2015. The mechanisms also were intended to help companies manage uncertainty.

Many of these mechanisms required data for the last year of the price control period, 2014-15 (the blind year) to assess the final outturn for the benefit of customers, or companies, as the case may be. When PR14 was completed in December 2014, this financial year had not finished. Consequently, companies provided forecast data, which Ofwat considered and adjusted as necessary, for inclusion in the PR14 final determination.

Companies have now provided complete information and final audited spend and performance data for the whole 2010-2015 period, which we have used to update our analysis.

In reaching our proposals on the 2010-15 reconciliation, we have applied an approach that follows that previously consulted on and set out in the PR14 Reconciliation Rulebook. In 'Consultation on the final 2010-15 reconciliation', we:

- Recap on the approach we used at PR14 to reconcile companies' proposed adjustments to 2015-20 price controls given companies' performance against incentive mechanisms put in place at the last price control review (PR09); and
- Explain how and why these adjustments differ from those we made in our PR14 final determinations, and those proposed by companies.

In this appendix, we set out our proposals of the blind year reconciliation adjustments for Wessex Water resulting from the company's actual performance during the period 2010-2015, reflecting actual data for 2014-15.

We have structured this appendix to begin in section 2 with a summary of the adjustments. In section 3 we explain each of the adjustments in turn:

- Revenue correction mechanism (RCM);
- Change protocol (logging up, logging down, shortfalls);
- Service standard outputs;
- Serviceability performance;
- 2009 agreed overlap programme; and
- Capital expenditure incentive scheme (CIS).

In addition to the incentive arrangements listed above, we also cover the 2014-15 transition mechanism in section 3.7. We summarise how and when our proposed adjustments will be implemented in section 4.

For each mechanism we outline:

- Our position as set out in PR14 final determination;
- How our proposals differ from decisions taken at PR14; and
- How our proposals differ from companies' proposals.

There are a number of other PR09 incentive mechanisms not listed above, in particular the service incentive mechanism (SIM), the opex incentive allowance (OIA) and other revenue adjustments. For these mechanisms we expected all information to be available at PR14 and so did not include these in the scope of this final reconciliation. In any case we are not aware of any reason to change these adjustments. This document makes no further reference to these.

In order to calculate the blind year adjustments, we have undertaken detailed calculations within our models for the RCM, CIS and serviceability shortfalls and the PR14 reconciliation rulebook legacy blind year model. While we provide an explanation of our interventions within this appendix, each model contains the detail of the specific calculation.

Populated models for the blind year update proposals are published alongside the consultation.

All monetary values stated in this document are in 2012-13 prices unless otherwise stated.

## 2. Summary of 2010-15 final reconciliation adjustments

Table A1 below sets out for each of the incentive tools for water and wastewater services a quantification of:

- PR14 final determination (FD) position;
- the company's view of the required adjustment (if stated in its blind year update submission); and
- our view resulting from the blind year reconciliation (BYR).

There are no significant differences between the company view in its submission and our view of the adjustments required for the final 2010-15 reconciliation.

The table shows adjustments made through revenue and those made through the RCV separately. This is because the PR09 incentive mechanisms are adjusted for in different ways. Mainly, they are adjusted through an adjustment to the RCV, however the RCM and the penalty / reward element of the CIS adjustment are both made through revenue.

**Table A1 Revenue and RCV adjustments 2015-20 (£ million)**

	Water service			Wastewater service		
	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR
<b>Revenue adjustments</b>						
RCM	5.289	n/a	1.388	-6.895	n/a	-14.442
CIS	13.428	n/a	13.019	0.681	n/a	0.798
Total revenue adjustments <sup>2</sup>	18.717	n/a	14.408	-6.214	n/a	-13.644

	Water service			Wastewater service		
	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR
<b>RCV adjustments</b>						
Elements of CIS:						
Adjustment for actual expenditure 2010-15	-170.338	n/a	-167.855	-121.628	n/a	-120.875
Adjustment for change protocol – logging up/down	0.000	0.000	0.000	20.759	19.821	19.821
Adjustment for change protocol – shortfalls	0.000	0.000	0.000	0.000	0.000	0.000
Adjustment to overlap	0.000	0.000	0.000	0.000	0.000	0.000
CIS total <sup>2 3</sup>	-170.338	n/a	-167.855	-100.869	n/a	-101.054
Serviceability shortfall	0.000	0.000	0.000	0.000	0.000	0.000
Total RCV adjustments <sup>2 3</sup>	-170.338	n/a	-167.855	-100.869	n/a	-101.054

## Notes:

1. The revenue and RCV adjustments are added for comparison against the materiality threshold in the PR14 reconciliation rulebook blind year model.
2. Totals may not add up due to rounding.
3. The FD position has been updated for the RCV indexation correction that will be applied separately at PR19.

The adjustments for the Change protocol and 2009 agreed overlap programme are considered separately, but both are implemented through the CIS.

### 3. Adjustments by 2010-15 incentive mechanism

#### 3.1 Revenue correction mechanism

Our view for the revenue correction mechanism (RCM) adjustment is detailed in table A2 below. This shows the components of the movement from the RCM adjustment included in the PR14 final determination.

Table A3 summarises our interventions in relation to the 2010-15 RCM adjustments.

For the RCM, we apply the PR14 vanilla wholesale WACC (real; pre-tax cost of debt, post-tax cost of equity) as the discount rate. As in the final determination, the PR14 discount rate is 3.6% for Wessex Water.

**Table A2 RCM total adjustments for 2015-20 (£ million)**

	Water service	Wastewater service	Total
FD position	5.289	-6.895	-1.606
Impact of RPI changes <sup>1</sup>	-1.223	-2.062	-3.285
Impact of updated data from company	-2.677	-5.485	-8.163
Impact of other adjustments	0.000	0.000	0.000
Impact of Ofwat intervention	0.000	0.000	0.000
Ofwat BYR	1.388	-14.442	-13.054
Change from FD position	-3.900	-7.548	-11.448

Note:

1. The calculated movement from the RCM adjustment included in the PR14 final determination relates to actual RPI being lower than forecast at PR14 for 2014-15.

The changes shown in table A2 above will be implemented in the PR14 reconciliation rulebook legacy blind year model as discussed in section 4.

**Table A3 Interventions on proposed 2010-15 RCM adjustments**

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
PR14 discount rate	Our assumption for the PR14 discount rate at final determination was 3.6% to calculate our view of the RCM adjustment.	The company proposed a PR14 discount rate of 3.5%. In accordance with 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance' we used the vanilla wholesale WACC as the discount rate for PR14 for the RCM. Our assumption for the PR14 discount rate at FD was 3.6%.	There has been no change from the final determination.	There has been no change from the final determination.
FD09 assumptions – Measured non-households' revenue for the measured non-household group immediately above and below the 50ML threshold	Our assumptions included our view of the FD09 assumptions. Our view of the company's revenue assumptions for the measured non-household group immediately below and above the 50 ML tariff basket threshold originated from the company's FD09 revenue forecasts that come from the tariff basket model, which we used for PR09.	There were differences between the company's and our view of the FD09 assumptions used in the company's populated RCM model. The company applied different assumptions for 'FD09 Measured non-households' revenue for the measured non-household group immediately above and below the 50ML threshold' compared with our view of its FD09 assumptions.	There has been no change from the final determination.	There has been no change from the final determination.

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
		Our assumptions for the final determination included the FD09 revenue forecasts as contained in the PR09 tariff basket model in accordance with our published methodology 'Setting price controls for 2015-20 – further information on reconciling 2010-15 performance'.		
FD09 assumptions – number of non-household properties for the sewerage service	Our assumptions included our view of the FD09 assumptions. Our view of the company's number of non-household properties was consistent with the company's FD09 revenue forecasts, which come from the tariff basket model that we used for PR09.	The company applied different assumptions for the number of non-household properties for the sewerage service compared with our view of its FD09 assumptions. Our assumptions for the final determination corrected the company's data inconsistencies between its FD09 and its populated RCM model.	There has been no change from the final determination.	There has been no change from the final determination.
Number of households billed	Our assumptions for the final determination used the data the company submitted in business plan table R3 to calculate our view of the RCM adjustment.	There were inconsistencies with the number of households billed between business plan table R3 and the company's populated RCM model. Our assumptions for the final determination applied the data from table R3.	The company has submitted updated numbers for table R3 for 2014-15.	We have accepted the company's submission, and have not intervened.
Outturn financial year average RPI	Our assumptions for the outturn financial year average	There were inconsistencies with the outturn financial year	RPI for 2014-15 has been published.	We have updated the company's forecasted RPI for

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
	RPI at final determination used the data that the company submitted in business plan table A9 to calculate our view of the RCM adjustment.	average RPI between table A9 and the company's populated RCM model. Our assumptions for the final determination applied the data from business plan table A9.		2014-15 with actual RPI for 2014-15.

### 3.2 Change protocol (logging up, logging down and shortfalls)

Table A4 below summarises the company's view and our baseline view of total adjustments to capex included in the CIS reconciliation.

Table A5 summarises our interventions in relation to the company's proposed change protocol adjustments.

The only change from our PR14 final determination is that the company has slightly reduced its logging up claim in respect of the adoption of private sewers. As in our final determination we have not intervened in this area.

**Table A4 Summary of post-efficiency capex for logging up, logging down and shortfalls included in the CIS reconciliation (£ million)**

2009-10 to 2014-15 – post-efficiency capex	Water service			Wastewater service			Total service		
	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR
Logging up (two-sided) <sup>1, 2</sup>	0.000	0.000	0.000	20.759	19.821	19.821	20.759	19.821	19.821

2009-10 to 2014-15 – post-efficiency capex	Water service			Wastewater service			Total service		
	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR
Logging down (two-sided) <sup>1, 2</sup>	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Shortfalls (one-sided) <sup>1, 2</sup>	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Notes:

1. We exclude serviceability shortfalls from the numbers above as they are not part of the CIS reconciliation. Instead we make direct adjustments to the RCV.
2. Changes relating to 2009-10 were implemented in full in the opening RCV at PR14 final determination.

The changes for the five years 2010-15 included in table A4 are implemented through the CIS.

**Table A5 Interventions on proposed 2010-15 change protocol adjustments**

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
There are no interventions in this area.				

### **3.3 Service standard outputs**

Service standards are regulatory outputs that we set out in FD09 supplementary reports<sup>1</sup>. Where relevant companies reported their performance for 2014-15 on these service standards as part of their submissions for the blind year reconciliations.

In our PR14 final determination we were satisfied that all Wessex Water's service standard outputs, which primarily related to resilience, had been achieved and therefore we did not intervene in this area. This remains our view for this final reconciliation.

### **3.4 Serviceability performance**

Table A6 quantifies the value and impact of any serviceability shortfall on the RCV. Table A7 summarises our interventions in relation to the company's proposed adjustments for serviceability.

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

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<sup>1</sup>In the 2009 final determination supplementary reports we said: "Both the project activity (as proposed in your final business plan) and the service standard are the defined output. You must demonstrate delivery of the stated service standard output through the June return. We recognise that companies may decide to prioritise activity differently in order to achieve the service output in a more efficient manner. All material changes to the project activity must be reported and explained through your June return."

**Table A6 post-efficiency serviceability shortfall value (£ million)**

Post-efficiency shortfall		2010-15
Water service	FD position	0.000
	Company view	0.000
	Ofwat BYR	0.000
Wastewater service	FD position	0.000
	Company view	0.000
	Ofwat BYR	0.000

Any changes between our PR14 final determination and our proposals shown in table A6 above will be implemented in the PR14 reconciliation rulebook legacy blind year model at PR19, discussed in section 4.

**Table A7 Impact of serviceability shortfalls on the RCV**

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
Water non-infrastructure – coliforms at water treatment works	For the purposes of the final determination, there was no intervention for this indicator. This was conditional upon the performance in 2014-15 being improved to a position such that it could be considered as stable. We noted we would consider a shortfall adjustment if this was not achieved. Any shortfalls arising would be applied at the next price control.	Performance in 2013-14 was close to the upper control limit and performance in 2014-15 (based on eight months of actuals) was expected to outturn on the upper control limit. We required the company to demonstrate stable serviceability in 2014-15. We noted if this was not achieved, we would consider a shortfall adjustment.	The actual performance for 2014-15 is worse than forecast (0.08% vs 0.04%) but within the upper control limit.	Performance for 2014-15 is below the upper control limit. We agree with the company's assessment of stable serviceability and do not propose a shortfall adjustment for this indicator.

### 3.5 The 2009 agreed overlap programme

Table A8 below confirms the 2009 agreed overlap programme assumptions. There are no changes from our final determination and there are no interventions in this area.

**Table A8 PR09 agreed overlap programme adjustments and assumptions (£ million)**

		2010-15
		Two-sided adjustments for inclusion in the CIS
Water service	FD position	0.000
	Company BYR view	0.000
	Ofwat BYR	0.000
Wastewater service	FD position	0.000
	Company BYR view	0.000
	Ofwat BYR	0.000

### 3.6 CIS

Table A9 provides details of the CIS ratios and performance incentive. It also gives the monetary amounts of the CIS performance reward or penalty and true-up adjustments to allowed revenues.

Table A10 provides details of the RCV adjustments and quantifies the impact of this final 2010-15 reconciliation compared to the PR14 final determination position (updated for the indexation correction we decided to implement in February 2016).

In table A11 we summarise our interventions in relation to the company's CIS adjustments.

**Table A9 CIS true-up adjustments**

		Water service	Wastewater service	Total service
Restated FD09 CIS bid ratio <sup>1</sup>	FD position	104.118	97.326	n/a
	Ofwat BYR	104.118	97.322	n/a
Out-turn CIS ratio	FD position	78.710	89.781	n/a
	Ofwat BYR	79.062	89.725	n/a
Incentive reward/penalty (%) <sup>2</sup>	FD position	5.906	3.284	n/a
	Ofwat BYR	5.808	3.302	n/a
Reward/penalty (£m)	FD position	29.167	18.651	47.818
	Ofwat BYR	28.737	18.759	47.496
Adjustments to 2015-20 revenue (£m) <sup>3</sup>	FD position	13.428	0.681	14.109
	Ofwat BYR	13.019	0.798	13.818

Notes:

1. The restated FD09 CIS bid ratio takes account of the adjustments for the change protocol (table A4) and the 2009 agreed overlap programme (Table A8).
2. The reward/(penalty) is adjusted for the additional income included in the 2010-15 determination and the financing cost on the difference between actual spend and capital expenditure assumed in the 2010-15 determination to derive the value of the adjustment to 2015-20 revenue.
3. The adjustment to 2015-20 revenue values shown in this table assumes a single year adjustment in the first year, and does not include the NPV profiling used for the final determination.

**Table A10 CIS RCV adjustments (£ million)**

	Water service	Wastewater service
FD position	-137.002	-65.276

	Water service	Wastewater service
Impact of indexation correction	-33.337	-35.593
Corrected FD position	-170.338	-100.869
Impact of updated actuals	2.483	-0.185
Ofwat BYR	-167.855	-101.054

The changes to revenue shown in table A9 and the impact of updated actuals for the RCV shown in table A10 above will be implemented through the PR14 reconciliation rulebook legacy blind year model at PR19, discussed in section 4. The indexation correction will be applied separately at PR19.

**Table A11 Interventions on proposed CIS adjustments**

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
Methodology	We used the post-tax basis of the PR09 cost of capital for the discount rate when calculating the future value of the revenue adjustment in the 2010-15 period.	As explained in policy chapter A4 (PR14 FD), we changed the methodology in the CIS model.	Updated to reflect 2014-15 actual expenditure, RPI and COPI.	We have used the company's updated data and therefore have not intervened.
Change protocol adjustments	In carrying out our assessment, we included our view of the applicable change protocol amounts for wastewater.	We applied Ofwat's published methodology.	See section 3.2 and section 3.5 above.	See section 3.2 and section 3.5 above.

Area of intervention	What we did at FD	Why we did it at FD	What has changed in BYR	What we have done for BYR and why
Data inconsistencies	In carrying out our assessment, we used the values from tables A9, W15 and S15 of the revised business plan.	We identified inconsistencies between the revised business tables and the company's populated CIS model on: <ul style="list-style-type: none"> <li>• RPI financial year values for 2013-14 and 2014-15 ; and</li> <li>• outturn capital expenditure.</li> </ul>	Updated to reflect 2014-15 actual expenditure, RPI and COPI.	Updated to reflect 2014-15 actual expenditure, RPI and COPI.

### 3.7 The 2014-15 transition programme

Table A12 confirms the company's proposed transition programme. There are no interventions in this area.

**Table A12 Transition programme in 2014-15 (£ million)**

Net capital expenditure	FD position	Company BYR view	Ofwat BYR
Water service	0.523	0.511	0.511
Wastewater service	5.779	4.478	4.478

## 4. Implementing the changes

Our PR14 reconciliation rulebook describes how we will implement the changes between our PR14 final determination and our proposals. This includes the application of the £10,000 materiality threshold to the aggregate of the revenue and RCM adjustments.

The PR14 reconciliation rulebook legacy blind year model draws together the RCM, CIS and serviceability shortfall adjustments applied in the final determination and from the blind year update, calculates the differences, performs the materiality test and preserves the present value of the blind year adjustments for those that will be implemented at PR19. Table A13 shows the output values from the legacy blind year adjustment model.

**Table A13 adjustments to be implemented (£ million)**

	Water service	Wastewater service
RCM revenue adjustment <sup>1</sup>	-3.900	-7.548
Total adjustment revenue carry forward to PR19	-0.488	0.140
Total adjustment RCV carry forward to PR19	2.963	-0.221

Note:

1. To allow companies to manage potential volatility in customer bills, we have given them the option of implementing the RCM revenue adjustment through WRFIM in either 2017-18, 2018-19, 2019-20 or in PR19. We expect companies' responses to this consultation to propose how they want RCM adjustments to apply taking account of customer interests.

The CIS RCV indexation correction is not included in the RCV carry forward in table A13 above because it will be applied separately at PR19 in accordance with the PR14 reconciliation rulebook (section 7.2 process for adjusting CIS for both indexation and the blind year).