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## Revenue correction mechanism 2010-15 final reconciliation

### Introduction

This document sets out our decisions on the final reconciliation for the revenue correction mechanism (RCM).

The RCM is a financial mechanism that we introduced at our 2009 [price review](#) (PR09) to correct for differences between appointed monopoly companies' expected and actual price controlled revenue for the 2010-15 period.

The RCM is part of a suite of incentive mechanisms introduced at PR09 where we are considering adjustments. This is because full information for the complete 2010-15 period was not available to us when we made our 2014 price review (PR14) final determinations in December 2014. Consequently, companies provided forecast data, which we 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. We have used this to update our analysis.

We are setting out our decisions for the RCM reconciliation now as this has the potential to impact revenue limits for 2017-18 to allow companies sufficient time to consider the appropriate charges for 2017-18.

We will set out our decisions on the final reconciliation for all other relevant PR09 incentive mechanisms in early 2017.

### Background

We published [Consultation on 2010-15 final reconciliation](#) on 5 October 2016 setting out our draft reconciliation for the RCM and a number of other incentive mechanisms. Further details on the approach to the RCM reconciliation that we used at PR14 and how and why our proposed adjustments differed from those made in

PR14 and those proposed by companies, is set out in chapter 2 of our consultation document.

We received a response from each of the 17 water companies that were the subject of our consultation.

On 23 November 2016 we made changes ('modifications') to 16 water companies' licences to facilitate the operation of the wholesale revenue forecasting incentive mechanism (WRFIM) which was set in PR14 final determinations.

We consider that WRFIM and the licence change will maximise the opportunities for water companies to take ownership and accountability for managing cash flows between years for the benefit of customers. Customers in turn are likely to receive smoother movements in their bills between years.

Dee Valley Water elected not to have the modification due to its particular circumstances as a small company.

## **Consultation responses and discussion**

All water companies, apart from Portsmouth Water either agreed with our RCM calculations or made no particular comment.

- Portsmouth Water agreed with the difference we had calculated in our consultation between the revenue expected at PR14 and actual revenue which was £0.171 million higher in 2012-13 prices. In our consultation we had proposed that this should be returned to customers.
- In its response Portsmouth Water highlighted that as part of its PR14 business plan, it had chosen to forgo £5.2 million of allowed revenue for the 2010-15 period, which included the RCM corrections for 2013-14 and 2014-15.
- In our 2014 final determination, the company expected to receive £1.573 million less revenue in 2014-15 than we assumed at PR09. It could have recovered this revenue from customers in the 2015-20 period, but chose not to. It actually received £1.402 million less revenue in 2014-15. The company considers that it would be counterintuitive to give up £0.171 million, which it had not received or sought to recover. The company's customer challenge group has agreed with this proposed change.
- Our proposal effectively asked Portsmouth to return money to customers that had never been recovered in the first place.
- We agree that no adjustment is required.

In our consultation we allowed companies to propose when the RCM adjustments should be made to their allowed revenue. In their responses eight companies proposed that they make this adjustment in the 2015-20 period. The remaining companies proposed that we make the adjustment at our 2019 price review for the 2020-25 period.

## Final decisions

Apart from Portsmouth Water, the RCM related revenue adjustments are the same as we set out in our consultation document. This is apart from an adjustment to reflect time value of money allowance in WRFIM<sup>1</sup>. The adjustments that we will make are set out in table 1.

Table 1 also sets out when the adjustments will apply. We gave flexibility to companies to manage the impact that adjustments may have on customer bills. We have not intervened in the proposals that companies have made as to when to make the final reconciliation adjustments for the RCM. How the adjustments are made will take into account the time value of money so that customers are not worse off if, for example revenues due to customers are deferred.

**Table 1 RCM Adjustments and when they will apply**

Company	Service	Adjustment (£m)	Proportion of adjustment that will impact bills in each period (%)			
			2017-18	2018-19	2019-20	PR19
Anglian	Water	-0.772	100%			
	Wastewater	-3.315	100%			
Welsh	Water	-5.252				100%
	Wastewater	-4.415				100%
Northumbrian	Water	-5.384				100%
	Wastewater	-2.198				100%
Severn Trent	Water	-12.319				100%
	Wastewater	-12.501				100%
South West	Water	-6.698				100%
	Wastewater	-6.140				100%

<sup>1</sup> Email from Peter Jordan to regulatory directors 21 October 2016.

Company	Service	Adjustment (£m)	Proportion of adjustment that will impact bills in each period (%)			
			2017-18	2018-19	2019-20	PR19
Southern	Water	3.922		50%	50%	
	Wastewater	-4.816	50%	25%	25%	
Thames	Water	-4.009	33.3%	33.3%	33.3%	
	Wastewater	-8.404	33.3%	33.3%	33.3%	
United Utilities	Water	-7.853	33.3%	33.3%	33.3%	
	Wastewater	-1.690	33.3%	33.3%	33.3%	
Wessex	Water	-3.512				100%
	Wastewater	-6.796				100%
Yorkshire	Water	-5.690				100%
	Wastewater	-9.680				100%
Affinity	Water	-1.158	100%			
Bristol	Water	-0.638	33.3%	33.3%	33.3%	
Dee Valley	Water	-0.410				100%
Portsmouth	Water	0.000				
Bournemouth (South West)	Water	-0.626				100%
South East	Water	4.465			100%	
South Staff/Cambridge	Water	-1.490				100%
Sutton & E Surrey	Water	0.194	100%			

## Next steps

We expect that adjustments will apply in the way set out unless there are clear reasons that a different timing of adjustments would be in customers' interests. If this were the case, companies should consult with customers before proposing a different adjustment taking into account their views. If a company after consultation considers a change is necessary, it should write to David Black, Senior Director for Water 2020 setting out:

- the proposal;
- what consultation it has carried out; including how it determined its approach to this consultation was appropriate; and
- why the proposal is in its customers' interests.

We expect companies to consider the impact of bill movements on customers and we are open to discussing the need to abate revenue to manage the impact of bills. We intend to set out further details on the approach to abating revenue with the WRFIM in a further version of the reconciliation rulebook.