PR19 final methodology queries and answers 15 January 2018

A price review is when water companies and their customers create plans for the future that will deliver customers' wants and needs. Our role is to:

- set the framework and methodology;
- check and challenge the plans; and
- set out our decisions on the five-year price, service and incentive package for each company.

We have published our final methodology for the 2019 price review (PR19), setting out:

- our expectations and requirements for companies preparing their business plans to meet the needs of their customers from 2020 to 2025 and beyond;
- how these expectations form the basis for how we assess company business plans;
- the approach that we will use if we need to intervene in those plans to ensure that companies deliver the step change required by customers; and
- how our assessment will flow through into companies' price limits, service commitments and the wider incentive framework.

In the PR19 final methodology we stated that we will run a queries process for specific questions about the methodology. We stated that if a query was raised which we think is relevant to other stakeholders then we will publish the query and our response on our website. This document sets out our response to the first set of queries we have received on the PR19 final methodology. We will publish our response to further queries in due course. Stakeholders should direct any further queries for clarification, corrections or further explanation in relation to our methodology to PR19@ofwat.gsi.gov.uk.

Ref No.	Topic	Query	Response
1	Outcomes	Can you explain why you are not allowing outperformance payments on CRI, but you are for pollution incidents?	Our general approach is that outperformance payments are not available for statutory compliance, but only for going beyond statutory obligations. However, where there is customer and stakeholder support and evidence that outperformance payments are leading to improvements that would not otherwise take place, companies can make a case for outperformance payments. We explain our approaches to CRI and pollution incidents in Appendix 15 as set out below: In relation a point from the DWI on CRI on page 49 of Appendix 15 to the final methodology we say: “We are maintaining our approach that outperformance payments are not appropriate for CRI because companies should be achieving full compliance. We agree that the performance commitment needs to be set at zero (ie full compliance). Companies can set a penalty deadband for this performance commitment.” In Appendix 15 to the final methodology, page 80, we say in response to a point from Blueprint for Water that “companies should not be rewarded for pollution incidents or for legal compliance.” the following: “We consider that companies should be able to propose outperformance payments for pollution incidents if this is supported through customer and stakeholder engagement. So far this price control period, a number of companies have made significant reductions in the number of their pollution incidents, which seems to be linked to the financial incentives available for both outperformance and underperformance (see appendix 2).”

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2	Outcomes	Why do WoCs not have to have treatment works compliance as a common performance commitment?	As explained in Appendix 2 of the final methodology, pages 20-21, "We have decided on treatment works compliance as the common performance commitment for wastewater non-infrastructure asset health." And "We are using the definition of treatment works compliance in the Environmental Performance Assessment (EPA), which includes both water and wastewater treatment works. We consider that it is better regulatory practice for companies to report the same metric to both us and the Environment Agency in this case. We note that water treatment works make up a relatively small proportion of all treatment works for most water and sewerage companies." Water-only companies (WoCs) can have treatment works compliance as a bespoke performance commitment if this is a particular issue for the company, its customers and/or its stakeholders. However, we are not making treatment works compliance a common performance commitment for water-only companies. This is because we want companies to have a balanced package of common and bespoke performance commitments (see page 4 of Appendix 2 of the final methodology). We consider requiring water-only companies to have a common performance commitment on treatment works compliance, when its purpose was to ensure water and sewerage companies had an asset health performance commitment on wastewater non-infrastructure, is not necessary and could shift the balance too far towards common performance commitments for water-only companies.
3	Initial Assessment of business Plans (IAP)	Please can you tell us how you will distinguish between 20-35 basis points for exceptional business plans?	We will decide on the final percentage based on such factors as the level of ambition and innovation to the benefit of customers.
4	Confidence and assurance	Will feeder models form part of the data capture system?	No, feeder models will not be part of the capture system. We will however require populated feeder models back from the companies, as they produce items (expressed in a CPIH deflated price base) that are on the various PR14 reconciliation tables within the business plan.

Ref No.	Topic	Query	Response
5	Outcomes	How does the approach to leakage performance commitments take account of companies that might want to start their improvements now ahead of the 2020-25 price control period?	Our approach to leakage performance commitments is set out on pages 55-56 of the final methodology and pages 61-67 of Appendix 2 of the final methodology. In addressing the challenges we have set companies on reducing their levels of leakage companies can provide the context around their proposed performance commitment levels. This could include starting to reduce leakage ahead of the price control period.
6	Outcomes	Is the approach to the threshold for enhanced outperformance payments different for leakage to the other common performance commitments?	Our approach is set out in the final methodology as follows: On page 66 of Appendix 2 of the final methodology we say: "Companies could include an enhanced outperformance payment in their ODI to incentivise a major improvement in leakage performance, for example." On page 85 of Appendix 2 of the final methodology we say: "The threshold for the enhanced outperformance payments should be set at the performance level of the current leading company, or preferably higher (for example, including a forecast improvement in addition to that performance level)." This shows that there is a different approach to the threshold for enhanced outperformance payments for leakage than for the other common performance commitments. However, if a company proposed a threshold for enhanced outperformance payments for leakage that was not at least at the performance level of the current leading company it would need to provide a convincing case for its approach.

Ref No.	Topic	Query	Response
7		Please could you clarify whether opportunities to innovate identified within the bioresources price control could now utilise the direct procurement for customers (DPC) approach? The diagram of the price controls matched to key themes and building blocks (Figure 1.1 Structure of our PR19 final methodology – pg. 18 in the main document), shows that direct procurement for customers (DPC) is applicable to water resources, water network plus and wastewater network plus controls; but does not appear to extend to the bioresources control. However, there is no mention that bioresources continues to be excluded from the DPC model in either Appendix 8: DPC, or Appendix 6: bioresources control. Please can you clarify if bioresources remains excluded from the DPC approach, and the rationale for continuation of this position from the draft methodology in April.	Direct procurement for customers does not cover bioresources. This is made clear in the summary table (Table 7.1) on page 117, which states “DPC projects could come from any part of the water and wastewater value chain and services appointees provide, except bioresources we have separate proposals to develop markets in bioresources including procurement of bioresource treatment, transport and disposal from third parties.”
8-11	**Query responses to follow**		

Ref No.	Topic	Query	Response
12	Cost assessment	Please could you clarify how we should deal with the following issue please: • Tables WS1 and WWS1 do not contain values for depreciation. Therefore, if a cross charge were to be made for the use of assets, although row 7, other operating expenditure, might be the correct line to report the charge, there is nowhere for the corresponding credit to go in the business unit of principle use • If rows were added to WS1 and WWS1for depreciation charges and credits from other units, the sum of the tables would not reflect the correct botex/totex totals as they would become a mix of totex costs and depreciation • Rows 22-24 on table R1 do reflect recharges for the use of assets from wholesale. However, as stated above, there is nowhere in tables WS1 or WWS1 to report the corresponding credit. • Capital expenditure on assets principally used by retail is included on R1, but again, by including capex in the business unit of principle use only, table R1 will not reflect retail totex needs in AMP7 • There are two key issues with the way the PR19 tables and guidance in RAG2 currently work: • Reporting capital expenditure costs in the business unit of principle use will result in cross-subsidy between price controls • • The reported totals will not accurately reflect the burden of botex/totex by price control.	WS1 and WWS1 follow Tables 2B, 4D and 4E of the APR – albeit with atypical costs being separate identified in the business plan data tables. Table 2B, 4D and 4E reports Wholesale opex – which excludes depreciation charges but will include the recharges between PCUs (the recharges received would be netted off other operating costs). Similarly table WS1 and WWS1 should follow the same logic. Tables 2A separately identifies the recharges between price control units (PCUs). It also shows the depreciation charge so that the operating profit can be derived. Therefore the questions about where these are reported do not apply. In terms of charges between business units (eg water resources to network plus) RAG2 clearly states (in Section 4.1) the methods that companies should follow. This should ensure there is no cross subsidy between price controls. The revenues that we derive when we set prices will use, as a basis, cost information that is reported on the same principal use basis.