PR19 final methodology queries and answers 22 February 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 third 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.

<table>
<tr><th>Ref No.</th><th>Topic</th><th>Query</th><th>Response</th></tr>
<tr><td>18</td><td>SIM</td><td>Is there inconsistency in different documents regarding the application of Service Incentive Mechanism (SIM) payments and penalties?

Some documents seem to refer to an adjustment of +0.5% to -1.0% of total revenue; while others refer to +6% to -12% of household retail revenue. I appreciate that these figures are roughly equivalent for a WaSC, but they're not for a WoC. Please could you clarify?

I have read a PR14 document (http://bit.ly.2ARBLzw) which I interpret (p.4) as referring to total revenue for the real adjustment and household retail revenue for presentation purposes.

However, the PR19 methodology (http://bit.ly/2Cy91J7) seems to imply something different – the penultimate paragraph on p.208 suggests that the penalty/reward will be applied to household retail revenues (is this a retrospective change to the PR14 FD?) The methodology (p.232) implies the same.</td><td>As stated in the PR19 final methodology: "We confirm that the revenue adjustments for SIM at PR19 will be in the range of -12% (penalty) to +6% (payment) of residential retail revenues for SIM." (Page 208).

We consulted on this in PR19 methodology consultation where we said: "Revenue adjustments at PR19 will be in the range of -12% (penalty) to +6% (reward) of residential retail revenues." (Page 232). We consider this to be consistent with what we said in the Service Incentive Mechanism (SIM) for 2015 onwards – conclusions "we will retain the financial magnitude of the current SIM (that is, the range of -1.0% to +0.5% on total integrated revenues), but will express this in terms of household retail revenues (+6% reward to -12% penalty)" (page 4).

When we propose the SIM payments during PR19 companies will be able to make representations on the application of the SIM payments to them in response to the draft determinations.</td></tr>
<tr><td>19</td><td>Data tables</td><td>I've noticed the following:

1. App22 – Block D I presume this should read DB schemes rather than DC schemes?

2. App 20 – I'm not sure what columns AB through to AW refer to?</td><td>1 - We agree and have changed the line titles in block D to refer to DB schemes rather than DC schemes as per the line definitions.

2 - Columns AB to AW in App20 simply contain the item references for each cell in the table.</td></tr>
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Ref No.	Topic	Query	Response
21	Water trading incentives	Guidance for the water trading incentive indicates that WS17 should only contain information related to new trades starting during the 2020-25 period. We have existing trades and may have new trades, but these would be post 2025. Therefore, the assumption is that we will not have any incentive data to input into the table as there will be no new trades over 2020-25. Can you confirm please?	We use the business plan data tables published with our PR19 final methodology to set price controls for the upcoming period 2020-25. WS17 relates to our water trading incentives reconciliation model, which calculates incentives to be paid at PR19 for new water trades that started in 2015-20 and comply with a company's approved trading and procurement code (see appendix 3 of our PR14 final methodology). If you do not intend to claim incentives for new trades that started in 2015-20 then you do not need to complete WS17 at this time.

Ref No.	Topic	Query	Response
22	Pay As You Go rates	I have a query in relation to Ofwat's guidance on the calculation of the pay-as-you-go (PAYG) ratio and the treatment of infrastructure renewals expenditure (IRE). In Ofwat's view, would it be reasonable to include 100 per cent of IRE in PAYG, even where an element may be capitalised under IFRS rules? As background, Ofwat's guidance on PAYG states that you will assess PAYG/run-off proposals with reference to, "the economic substance of proposed totex". You also state, "For example, the total amount of revenue recovered through PAYG and RCV run-off could reflect the proportion of totex expensed in the year" (see p. 195 of final methodology). On the face of it, these statements would appear to suggest that companies should treat IRE in line with the IFRS treatment, e.g. potentially part-include in PAYG, and part-capitalise. However, at PR14, most companies included 100 per cent of IRE within PAYG, irrespective of whether it was entirely expensed in statutory accounts. The inclusion of 100 per cent of IRE within PAYG mirrors the infrastructure renewals accounting approach, which allowed for the recovery of an IRC within the year.	As set out in the methodology, companies should determine appropriate PAYG and RCV run off rates. Companies should explain and evidence why they consider their selected rates are appropriate and demonstrate that they have customer support. As highlighted in the methodology, the total amount of revenue recovered through PAYG and RCV run-off could reflect the proportion of totex expensed in the year, plus an amount reflecting the economic value of capitalized expenditure that is expensed through the profit and loss account. We expect companies to clearly explain why they consider their proposed rates are appropriate, how the rates have been assessed against the nature of forecast levels of expenditure and investment, including expenditure relating to infrastructure renewals, and why the chosen rates are appropriate given the resulting impact of PAYG and RCV run-off on revenue and customer bills.

Ref No.	Topic	Query	Response
23	Data tables	We have a query relating to the timing of the submission in relation to table WS13: Some of the lines are populated from the tariff models. The 2019/20 tariff model will not be completed until December 2018, which is too late for the PR19 submission. We do issue indicative tariffs (in September) but again these would be too late for the submission. Lines 19-22 and Line 30– these lines are populated from the regulatory accounts. Therefore we will not have any data for 2018/19 or 2019/20 in time for the submission. Can you let us know your expectations for completion of this table?	We expect companies to provide their best forecasts for these two years and to clearly disclose any qualifications around their forecasts in their commentaries to tables WS13 and WWS13 and / or their populated WRFIM model.
24	Data tables	We have noted that in the table WS18 (Line G10 - number of proposed performance commitments for the water service) the first date for entry is 2020-21. However, in table WWS18 (line G10 - number of proposed performance commitments for the waste water service) the first date is 2015-16. As the lines are for ‘proposed’ performance commitments can you confirm that the information for both tables is required from 2020-21 onwards, not 2015-16?	We can confirm that information is only required from 2020-21 onwards for both WS18 (Line G10) and WWS18 (Line G10).

Ref No.	Topic	Query	Response
34	Outcomes and cost adjustment claims	Post publication of the Final Methodology for PR19 we wanted to clarify our understanding regarding the early submission of our Performance Commitments (App1) and Special Cost Factors (Cost Adjustment Claims - WS9 and R2) on 3 May 2018. At present we are assuming that the versions to be submitted on 3 May do not need to be audited given that the final assured versions will be submitted together with our final business plan on 3 September 2019. Please can you confirm your agreement with this?	Your understanding is correct for both performance commitments and cost adjustment claims.
36	Outcomes	The outcome delivery incentive model published on the 25 March 2015 as part of the PR14 reconciliation rulebook allows for the modelling of two ODIs. The reconciliation rulebook notes that this will need to be updated and increased in the final workbook to reflect the number of ODIs. Would it be possible to confirm when this will be updated please?	We will not be re-issuing the outcome delivery incentive model published on the 25 March 2015 as part of the PR14 reconciliation rulebook. We explain in PR19 Final guidance on business plan tables that we have replaced the model with two tables in the business plan. In section 3.4 (page 34) and section 7.3 (page 72) we state: “We do not require companies to complete the ODI spreadsheet from the PR14 reconciliation rulebook or the K factor model, which companies used for the in-period ODI submissions in 2016 and 2017. This is because the financial model will calculate companies’ new revenue control limits, making the K factor model unnecessary, and because we have received feedback and have found ourselves that the ODI spreadsheets are not user friendly and we have replaced them with Tables App5 and App6.”
40	Data tables	We think there may be some coding errors in the guidance wording for WWS4 lines 7and 8. We have marked the changes we believe necessary in order to align the driver codes in AMP6 with the ones in AMP7. If this is not corrected it is going to mix different types of obligations in the figures between amps. Please can you confirm you agree with us?	The driver codes referred to in the definitions for WWS4 lines 7 and 8 (and all other lines) are defined in the second release of WINEP Excel workbook provided to companies in late September 2017. The originator of the query now understands what is being requested.

Ref No.	Topic	Query	Response
41	Data tables	Please could you provide some clarification on table App 31 line 3? The definition for this line is “total number of complaints referred to CC Water for mediation or investigation.” The definition should use the CC Water guidance on complaint handling. There is no mention of mediation in the CC Water guidance on complaint handling. There are three ways we see the above definition could be interpreted. Our preference would be that we report the number of CC Water investigations in this line. This information is provided to water companies by CC Water and is also published in the appendices of the Annual Complaints to Water Companies report. A copy of the relevant information from the 2016/17 report is shown in Appendix 1 below. This line could also be interpreted as the number of complaints CC Water has received from customers regarding water companies. These complaints are not all accepted for full investigations. This information is published (in September) in the appendices of the Annual Complaints to Water Companies report. A copy of the relevant information from the 2016/17 report is shown in Appendix 1 below. This line could be interpreted as the number of complaint responses where we inform the customer that we have exhausted our complaints process and notify the customer they can escalate their complaint to CC Water, if they wish.	We have changed the definition to reference CC Water’s ‘End of Year Complaints and Enquiries Report’ and inserted an additional line in table App31 to distinguish between complaints referred to CC Water (in line 3) and investigations opened by CC Water (new line 4). We plan to release an updated version of the Business Plan data tables Excel spreadsheet when we publish a revised Financial Model in early March. This version will take account of (and summarise) the changes made as a result of the queries and clarifications received and actioned up to that date.

42	Data tables	Please could you confirm the following line definitions should be changed: Table R1 line 25 - income from wholesale assets acquired after 1 April 2015 principally used by retail; definition is as follows, “Where an AMP6 or later asset (acquired after 1 April 2015) is principally used by retail, the capex and depreciation should be recorded in wholesale with a recharge made to wholesale to reflect the proportion of the asset used by wholesale. The corresponding income to residential retail should be recorded in this line. Companies should state in their table commentary how much of this income is from water (water network and water resources) and how much is from waste water (waste water network and bio resources). This line should be entered as positive values. Recharges should cover depreciation, repair and maintenance costs only and should not include a return on the asset.” Our query: Should ‘retail’ above be ‘wholesale’? Table R4 line 25 - income from wholesale assets acquired after 1 April 2015 principally used by retail; definition is as follows, “Where an AMP6 or later asset (acquired after 1 April 2015) is principally used by retail, the capex and depreciation should be recorded in wholesale with a recharge made to wholesale to reflect the proportion of the asset used by wholesale. The corresponding income to business retail should be recorded in this line. Companies should state in their table commentary how much of this income is from water (water network and water resources) and how much is from wastewater (waste water network and bio resources). This line should be entered as positive values. Recharges should cover depreciation, repair and maintenance costs only and should not	R1 line 25 We agree. We have renumbered the definition lines to match the table and have amended the line definition. R4 line 25 We agree. We have amended the line definition. We plan to release an updated version of the Business Plan data tables Excel spreadsheet when we publish a revised Financial Model in early March. This version will take account of (and summarise) the changes made as a result of the queries and clarifications received and actioned up to that date.

Ref No.	Topic	Query	Response
		include a return on the asset. Our query: Should ‘retail’ above be ‘wholesale’?	
43	Data tables	Please could you confirm our interpretation of your definition requirements for table Bio 1 line 18 is correct? The definition currently states, “The total quantity of sludge which is produced from a phosphorus removal process using a chemical coagulant, expressed as a percentage of total sewage sludge produced (by ttds).” Our interpretation at the recently submitted Cost Assessment Tables (CAT) was, “The additional quantity of sludge which is produced from a phosphorus removal process using a chemical coagulant, expressed as a percentage of total sewage sludge produced (by ttds).”	The line definition for this data item was discussed at the Cost assessment working group held on 25 October 2017. As a result of this discussion the line definition was revised to clarify that “quantity of sludge…” was intended to mean “total quantity of sludge…”, not the net increase in the quantity of sludge resulting from the use of chemical P removal processes. Therefore, the second interpretation set out in the query (“The additional quantity of sludge which is produced…) is incorrect. So, as an example: If in ‘year x’ a company’s total sludge production from all its sewage treatment works is 60 ttds and the quantity of sludge produced from the subset of sewage treatment works where a chemical phosphorus removal process is employed is 3 ttds, the value to be returned for ‘year x’ in Table Bio 1 Line 18 is 5%.

44	Data tables	Query 1: Table WS4, Lines 11 and 12 The unit stated against these lines is a percentage. The current methodology for these lines gives a score. There is no guidance on how this could be reported as a percentage. Please can we confirm that this should be reported as a score/number/ index and not as a percentage? Query 2: Table WS18, Line A2 There are 15 sub-categories that make up the customer acceptability rate for DWI. It is not clear in the definition which of these should be included in the measure for table WS18 line A2. Please confirm which of these sub-categories should be used? Query 3: Table WS18, Line A2 The units stated against this line is a number. Discover Water report contacts as a number per 10, 000 people. We have traditionally reported water quality customer contacts as a rate per 1000 population (as also reported to DWI and by DWI in CIR). Please can you confirm if this should be a direct number of contacts or a rate per 1000 or a rate per 10,000 population? Query 4 Wr7 Table Wr7 requires for each water resources option starting in 2020-25 a breakdown of data for capex and opex by year. There is space for up to 12 WRZ's to be	Query 1 WS4 - This was an oversight. The Compliance Risk Index and the Event Risk index lines should be reported as numbers not percentages. Query 2 WS18 - Figures to be reported in this line should be consistent with those reported for Discover Water. We have amended the line definition to emphasise this. Query 3 WS18 - Since the data in this table will be presented at an industry level, we require the direct number of contacts. Query 4 Wr7 - The 12 WRZs for table Wr7 was our estimate at the maximum number of WRZs that were likely to have water resources control options (that provide additional water resources capacity) starting in 2020-25. We have extended the table to accommodate the reporting for 15 WRZs. We plan to release an updated version of the Business Plan data tables Excel spreadsheet when we publish a revised Financial Model in early March. This version will take account of (and summarise) the changes made as a result of the queries and clarifications received and actioned up to that date."

Ref No.	Topic	Query	Response
		entered. We currently have 15 for which we would need to enter. Please confirm how we should do this.	
48	Data tables	Table App1 allows companies to enter their performance commitment targets for each of their performance commitments. The units vary, and the table allows for this by providing a 'units' column. This will sometimes be a number and sometimes it will be a percentage. The difficulty arises when what we need to enter is a percentage improvement from a base number, as per the example data you present in Appendix 2 on Page 59 at footnote 11. In this case it is unclear how we will present this in the App1 table, and in particular what we should enter as the unit (the number entered will be a percentage, but the performance commitment itself will be measured as a unit such as incidents per 1,000 customers, or Ml).	When setting a performance commitment as a percentage change from a baseline the company should set the 2019-20 baseline value to "0%". The company should state any percentage changes for 2020-25 performance commitment levels, longer-term projections and past performance relative to the 2019-20 value. Companies can include their baseline absolute values and measurement units for 2019-20 in their business plan commentaries.
49	Data tables	**WELSH ONLY TABLE** For Table R4 please could you provide guidance on the methodology companies should use for completing the data lines numbered 34 "Forecast allocated wholesale charge (nominal price base) ~ Tariff Band x" for tariff bands in 2012/13, 2013/14 and 2014/15, as the retail/wholesale split occurred from 2015/16 and these years were not required at the PR14 submission. If you do require these years to be completed, one way we could calculate the notional split would be to pro-rate backwards from 2015/16 if that is acceptable?	We agree that to provide data for years 2012 - 2013 to 2014- 2015 a notional split based on pro-rating backwards from 2015-16 is acceptable.

Ref No.	Topic	Query	Response
50	Data tables	App 8 and App 9 contain the following reference: “This is an output from new feeder model”. Please could you clarify which model is being referenced?	App 8 and App 9 refer to the RCV adjustments feeder model. We have replaced the references in the tables from 'new feeder model' to RCV adjustment feeder model. We plan to release an updated version of the Business Plan data tables Excel spreadsheet when we publish a revised Financial Model in early March. This version will take account of (and summarise) the changes made as a result of the queries and clarifications received and actioned up to that date.
54	Outcomes	What happens if a company cannot get to a 1% upside RoRE range for its ODIs based on its customer engagement?	We set out our policy on the overall ODI range in the PR19 methodology statement on page 60 of the main document. This explains that the ±1% to ±3% of RoRE ODI range is indicative and that companies need customer support for their ODIs. In particular we state: “We are removing the aggregate RoRE cap and collar to give companies an opportunity to propose higher outperformance and underperformance payments in their business plans, where customers support this.” “We are suggesting an indicative range for the size of companies’ ODI outperformance and underperformance payments of ±1% to ±3% of RoRE at PR19.” “We expect companies to develop their ODIs in consultation with their customers, and obtain customer support for the overall RoRE range proposed in their business plan.”

Ref No.	Topic	Query	Response
55	Outcomes	What happens if the ODI underperformance penalty rate formula does not work for a company given its willingness to pay and costs information?	We explain our policy on companies setting ODI rates on pages 90-93 of Appendix 2. In particular we state: “Companies can base their ODI outperformance and underperformance payment rates on the existing formulas” (page 90); and “Companies can use other customer evidence to propose changes to the ODI outperformance and underperformance payment rates calculated according to the existing formulas, provided the changes are well justified.” (page 90) If the underperformance penalty formula does not work it could be for several reasons including that the estimate of incremental cost is too high. When considering alternatives the company should take account of the purpose of the underperformance penalty rate which is to “to compensate customers for the economic loss associated with the company’s failure to deliver its relevant performance commitment” (page 92).
56	Outcomes	Will performance commitment levels change during the 2020-25 period to reflect the upper quartile changing (and being different from the forecast upper quartile)?	On page 46 of Appendix 2 to the methodology statement we discuss the consultation responses as follows: “Some respondents proposed that performance levels should change dynamically through the period. Other respondents did not support dynamic changes because they can create uncertainty about performance commitment levels and undermine incentives to improve.” We did not explicitly conclude on this point in the methodology statement. We can confirm that performance commitments will be set out in advance for five years at PR19 (with projections for at least a further ten years after that). We do not expect performance commitment levels to change dynamically during 2020-25.

Ref No.	Topic	Query	Response
57	Outcomes	What will Ofwat do when companies submit different forecast upper quartile estimates for the same common performance commitments in their business plans?	This is not a clarification of our methodology, but asking for further information on what we will do in the IAP, which we are not providing now. Our policy on companies setting stretching performance commitment levels does not just relate to the forecast upper quartile. Setting stretching performance commitment levels involves companies engaging with their customers on their performance commitment levels and challenging the degree of stretch in their levels through a number of approaches, one of which is the forecast upper quartile for each year of the price control period. This is set out on page 53 of the methodology statement and pages 50-55 of Appendix 2.

59	Data tables	APP28 Line 26 and 28 Current Definitions: APP28 Line 26: “Total other contributions received from organisations towards the construction of specific capital projects which were included in the price control.” APP28 Line 28: “Total other contributions received from organisations towards the construction of specific capital projects which were not included in the price control. Also should include Inspection and supervision fees (2.5% of construction cost based on WRC ‘Sewers for adoption’).” Question: There is a line for water connection charges (s45) under Grants and contributions received – wholesale water service (Line 7) but no corresponding line for wastewater connection charges in Grants and contributions received – wholesale wastewater service. We receive income from developers for supervision, technical vetting and completion of legal agreements for new connections, sewer adoptions and adoptions of lateral drains. Can you confirm whether income received from supervision and technical vetting of wastewater new connections, sewer adoptions and adoption of lateral drains should be included in the price control (i.e. entered in line 26) or excluded from the price control (i.e. entered in line 28)?	Income received from charges associated with new connections to sewers (if levied) should be reported in line 26 of App28 'Other contributions (price control)'. Income received from charges for supervision, technical vetting and completion of legal agreements associated with the adoption of sewers and lateral drains, should be reported in line 28 of App28 'Other contributions (non-price control)'. We consider that the income received from charges set at "2.5% of estimated cost" and applying to the technical vetting and supervision of diversions, should be included in line 27 'Diversions (s185)' rather than line 28 of App 28 unless associated with schemes under the New Roads and Streetworks Act 1991.

Ref No.	Topic	Query	Response
		We also have contributions received from charges set at "2.5% of estimated cost" but this only applies to technical vetting and supervision of diversions which is clearly outside of the price control and will be entered in line 28.	
61	Programme	Please can you confirm the following: • When will the dates be confirmed for companies to present their Final Business Plan during the 24 September to 5 October window? • Page 251 of the Final Methodology refers to: "…submit clarification queries to companies. After this short period, we will limit the interaction between Ofwat and water companies…" Are you able to confirm the dates for this short period and how quickly companies will be required to respond to queries submitted by Ofwat?	We have now sent invitations to all companies to present their final business plans. We will provide further details on the company query process following submission of business plans in due course. However we consider it likely that we will follow a similar process to PR14 with companies provided a limited number of days to respond.
63	Data tables	We have a query related to the submission of data tables using the fountain system. As a general rule SWW and BW data will be combined and submitted on the standard PR19 tables. However, some tables have to be duplicated to enable SWW and BW numbers to be reported separately. Please can you confirm how the additional tables will need to be submitted – as part of the main fountain submission or via a different route such as e-mail?	You will need to complete and submit 3 separate excel templates; one for SWB, one for SWT and one for BWH. In each case you will only need to complete the relevant tables / cells and leave the remainder blank. You should not delete any unused tables but just leave them blank.

Ref No.	Topic	Query	Response
69	Data tables	My query relates to table R3 - line items 17 - 21. Please could you clarify the methodology to be used for the calculation? For example, the cost of call - is this for inbound or outbound? We presume no fixed costs should be included in order to be useful for analysis of Debt Management costs?	Please see definitions for line items 17-21 below the table. For detail of the costs to be included, please see the definition of line item 28 below the table. Note: Table R3 collects disaggregated information on 2 separate areas of retail: (i) debt management (lines 1-16) to reflect activity reported in line 2 in table R1 and (ii) customer service (lines 17-28) to reflect activity reported in line 1 of table R1.
71	Data tables	Regarding table R1 - total operating expenditure (excluding third party services). Please could Ofwat clarify what is meant by this?	Please see the definition for row 7 below the table: "Total retail operating expenditure (excluding third party services) related to serving residential customers in receipt of water only, sewerage only and combined water and sewerage services respectively. The sum of R1 lines 1 to 6. This includes all costs reported in line 22 (demand side initiative / customer-side leak repairs) but should not include any expenditure funded in wholesale (lines 17 and 20). It represents total operating expenditure forecasts, including items relating costs which companies think should be excluded from benchmarking. All claims for special cost factors should be reported in table R2. It excludes capex and depreciation. The cost services purchased should be included but the costs of services provided for third parties excluded."
72	Data tables	Please could you clarify a point regarding tables R3/R1 - debt management? The two lines in the different tables appear to be asking for the same information. Please could you confirm that this is correct?	Yes they are the same. You do not have to enter data in line 1 of table R3 as this will be automatically populated, pulling through data from line 2 table R1.

Ref No.	Topic	Query	Response
77	Outcomes	Please clarify whether the residential retail revenues used as the basis for C-MeX payments refer to annual residential retail revenues or price control period residential retail revenues (i.e. 5 years of residential retail revenues)?	The basis on which C-MeX payments will be calculated is as follows: On page 65 of the methodology statement we say: "The financial incentives for C-MeX will be up to 6% of residential retail revenues for high performing companies, with higher performance payments of up to 12% of residential retail revenues (over the five years of the control period) available to the best performing companies." On page 66 of the methodology statement we say: "We will apply the C-MeX financial incentives in-period (reconciled for each year individually) to strengthen the incentive for companies to improve their customers' overall experience more quickly. The annual financial incentives are capped at 2.4% of residential retail revenues for high and low performance payments (12% of residential revenues divided by five years)." On page 164 of the methodology statement we say: "The range of possible financial incentives for C-MeX is symmetrical at ±12% of residential retail revenue over five years." To be clear, our approach is that the range of possible financial incentives for C-MeX is symmetrical at ±12% of residential retail revenues over five years. We will be applying C-MeX each year in the next price control period. Therefore the range of possible financial incentives for C-MeX in each year is symmetrical at ±12% of one year's residential retail revenues.

Ref No.	Topic	Query	Response
78	Outcomes	Please clarify whether the residential retail revenues used as the basis for SIM (2015-16 to 2018-19) payments refer to annual residential retail revenues or price control period residential retail revenues (i.e. 5 years of residential retail revenues)?	The basis on which SIM (2015-16 to 2018-19) payments will be calculated is as follows. On page 208 of the methodology statement we say: "We confirm that the revenue adjustments for SIM at PR19 will be in the range of -12% (penalty) to +6% (payment) of residential retail revenues for SIM." To be clear, our approach is that the range of possible financial incentives for SIM is a range of -12% (penalty) to +6% (payment) of five years' worth of residential retail revenues. This is the same approach we took for SIM at PR14 where we calculated the penalties and incentive payments for SIM in relation to five years of revenue (in that case we used -1% to +0.5% of 2014-15 forecast total revenues multiplied by 5).

Ref No.	Topic	Query	Response
79	Data tables	Could Ofwat clarify how to interpret the purpose of data tables WWS2a and WS2? In particular, we would like to seek clarification on whether and how to include enhancement expenditure that relates to improvements in service quality which may be associated with ODIs. For example: • Should the additional optional lines be used to provide enhancement expenditure related to PC? Should this be for common and/or bespoke measures? It is important to establish a common interpretation of the table if this is to be captured expenditure associated with ODIs. • Should this table only capture enhancement expenditure that goes beyond upper quartile performance up to the target? • How should enhancement expenditure for line items such as “improving taste/odour/colour” be recorded where some companies may and others may not have an associated outcomes measure? Should this include total enhancement expenditure to achieve the PC?	The data table WS2 (and the corresponding table WWS2 for wastewater) is intended to capture forecast expenditure (capex and opex) by companies in delivering enhancements i.e. quality enhancements (driven by statutory obligations relating to drinking water or environmental requirements), enhanced levels of service or work to maintain and improve the supply/demand balance. It is not the intention of these tables (or any other table) to identify the forecast costs associated with delivering any particular performance commitment proposed by a company. Expenditure incurred in the delivery of a performance commitment may be recorded in Table WS1 or WS2 (or the wastewater equivalents) according to whether it is characterised as 'base' or ‘enhancement’ respectively. The ‘optional’ lines at the bottom of blocks A and B in the tables are for a company to report any enhancement expenditure that it considers is not eligible for inclusion in any of the ‘standard’ lines in the tables because it does not meet the criteria in the line definitions.

Ref No.	Topic	Query	Response
81	Retail	Our question relates to retail price control. Based on the methodology, we assume that evidence of input price pressure on retail costs should be included in our business plan submission; and is not, therefore, part of the requirement to submit cost adjustment claims on 3 May 2018. Can you please confirm if this understanding is correct or not?	Companies can still choose to raise input price pressure as a cost adjustment claim if they think it affects them in a unique way. Otherwise, evidence on input price pressure on retail costs should be included in your business plan submission. Companies should report their assumed retail input prices pressure separately in the business plan tables. Companies should explain any assumptions they have made in relation to forecast input price pressure and explain why these costs are beyond management control during the price control period. See appendix 11, section 5.4 of the December final methodology for further information.
85	Data tables	In the Final Methodology data table guidance there is a draft Word template for submitting performance commitments in May 2018. Would you be able to tell us when the template will be finalised and issued to companies for completion please?	We intend to issue an Information Notice about the 3 May 2018 outcomes and cost submissions in the next month. This will contain the Word and Excel templates for submitting the performance commitment definitions.

87	Data tables	Please can you clarify our interpretation of the guidance related to table WR1, river abstraction assets: We have some abstractions where we abstract from the river and then pump the raw water to a WTW which is at a different location (sometimes several km away). When this situation arises for boreholes, the Ofwat definition requires us to split the pumping between the Resources and Raw Water Transport price controls, based on the proportion of total head of each stage of the pumping and there are examples in the RAG on how to do this. However, it is not clear what to do for pumped river abstractions, other than that the RAG 4.07 guidance (pages 94-95) states that pumps at the intake should be classified as "resources". River abstraction assets include pumping equipment, buildings, weirs, screens, inlets, fish passes, stilling well, other sundry equipment and other assets that support abstraction (regardless of their location in relation to the source). It is not clear from any of the examples in the Ofwat definitions and guidance whether or not a pumped river abstraction to a WTW at a different site should all be classified as Resources or should be split between Resources and Raw Water Transport. Please can Ofwat confirm, when abstracting from a river and pumping to a WTW at a different site, should this pumping: a) all be allocated to Resources, or	We can confirm that when abstracting from a river and pumping to a WTW at a different site, this pumping should be split between Resources and Raw Water Transport as the assets (abstraction and treatment) are not co-located: "Where a water abstraction site and water treatment works are co-located on the same site, then the raw water effectively 'by-passes' the raw water transport stage", p.96 and the water is not "transported between Water Resources assets", p.94. Therefore, the pumping head should be proportionally allocated between Raw water abstraction (Resources) and Raw water transport.

Ref No.	Topic	Query	Response
		b) be split between Resources and Raw Water Transport, e.g. by splitting total head for this “pumping route” between the pumping required to abstract the water from the river (Resources) and the pumping required to get the water from the abstraction site to the WTW site (Raw Water Transport)?	
101	Programme	Please can you consider publication queries as they are submitted instead of waiting for a response? This is to enable other companies to check if a query has already been submitted on a point and thus hopefully remove some duplication.	We have now received a number of queries on the methodology. We intend to publish our responses to queries on a more regular basis going forward.
102	Outcomes	Please can you confirm when you are publishing the updated version of the aide memoire provided to the chairs of the CCG as indicated in the Final Methodology on page 23?	We circulated the final draft of the aide memoire to CCG chairs for comment on 13 February. We will discuss it with CCG chairs at the next scheduled meeting on 14 March and expect to publish the final version on our website by the end of March.

Ref No.	Topic	Query	Response
109	Outcomes	Should companies be carrying out customer engagement on all of their performance commitments? What about C-MeX, D-MeX and performance commitments relating to statutory requirements?	Our policy on companies setting performance commitment levels is on pages 52 to 56 of the main methodology document and pages 49 to 58 of Appendix 2 to the methodology statement. In particular: “Our approach to setting stretching performance commitment levels for PR19 is that companies should: • engage with their customers on their performance commitment levels; and • challenge the level of stretch in their performance commitments with their customers, CCGs and other stakeholders against a range of approaches including, but not limited to, the following: […]” (page 53, main methodology document) An exception to this approach is: “For performance commitments that have statutory obligations, companies should set service levels in line with those statutory obligations unless they have evidence to show that customers would prefer a more stretching commitment level.” Page 50 of Appendix 2 to the methodology statement. In relation to C-MeX and D-MeX we are currently developing them with our stakeholders, including water companies. We recognise that it is difficult for a company to engage with its customers on a precise reputational performance commitment on C-MeX or D-MeX at present. However, we do want companies to engage with their customers on their preferences, expectations and ambitions in relation to customer service and customer experience.

Ref No.	Topic	Query	Response
111	Risk and return	For embedded debt at the end of AMP6, Ofwat has calculated the cost of existing debt and additional borrowing that is expected be taken out between now and 1 April 2020. The cost of that additional debt has been estimated based on the 10 year trailing average of the iBoxx index (the average rate between 2008 and 2018). This has been adjusted for 15bps of observed outperformance and 16bps to reflect the forward start to March 2020. While we think that the adjustments for outperformance and the forward start are reasonable, it's not clear why the trailing average is used? For example, any debt raised between 2018 and 2020 will start from the interest rate prevailing now; not the rate that the company might have got in 2008 or 2009. As this will be new debt, has Ofwat considered using the spot value of the index at March 2017 (3.01%) as the starting point? This would seem to be more consistent with the period over which the additional debt will be raised.	In Appendix 12 to our final methodology for PR19, we describe the calculation of a forward-looking estimate of embedded debt costs which involves replacing the reported interest cost of debt instruments due for refinancing before April 2020 with an assumed 'post-refinancing' interest cost. The assumption as described in the Appendix is that these instruments will be refinanced at the 10 year trailing average value for the iBoXX non-financials A/BBB 10yrs+ index as it stood at 31 March 2017, with an uplift to reflect outperformance and forecast movements in gilt yield curves. You correctly point out that it does not make sense to use the trailing average figure as a starting point for this assumption. We have investigated this issue, and can confirm that the 3.02% is in fact based on the simple average of the spot yields of the A and BBB 10yrs+ iBoXX non-financials index at 31 March 2017 (2.88% and 3.14% respectively - average 3.01%), adjusted for -15bp outperformance and +16bp from the rate rise embedded in gilt yield curves. The 3.02% figure is correct and is calculated based on the iBoXX index as at 31 March 2017. Thank you for bringing this to our attention.