PR19 final methodology queries and answers 6 July 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:

- 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 until 31 March 2018 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. We published revised data tables and our response to the ninth set of queries on 25 June 2018. We have continued to receive queries. This document therefore sets out our response to the tenth set of queries we have received.

Ref No.	Topic	Query	Response
612	Data tables	**App 33** We have noted that the embedded formulas used to calculate the NPV are not aligned with the guidance, specifically if t = the number of years to discount by , and r = discount rate then the discount factor = $1 / (1 + r)^t$, but the formula in the table is $(1 - r)^t$. Whilst this is fine as an approximation, it does not align to the guidance. We note that the table requires information on the cash flows in respect of leases that fall within the scope of IFRS16 which we understand will provide better information with respect to the amounts that requiring funding from customers, however, the payment profiles may be considerably different in certain situations whereby we might benefit from prolonged rent free periods. Additionally, it is not clear how the information in App 33 will reconcile to the information included within WS1a and WWS1a. For capitalised assets, in line with RAG 2.07, we intend to allocate the capitalised	**App33** We have looked at the formula in App33 spreadsheet and are content with it. If companies use a different approach, they should explain this in their business plans. Companies should complete App33 in accordance with the cash flows discounted to the base year. Again, companies can explain in their business plans, if this is different to what would have been included in totex if IFRS16 did not apply. Companies should explain in their business plans where App33 does not reconcile to WS1a and WWS1a.

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		lease costs against the price control with principal use. It is not clear how/where we would record the associated recharges to other price controls.	Recharges should be made on the same basis as any other capital expenditure and would be recorded as other operating expenditure.
		App 33 states that new leases expected to be entered into during 2018/19 and 2019/20 need to be factored in. We intend to also include new leases expected to be entered into during 2020-2025, e.g. where we know that current lease agreements are due to end during the AMP7 period.	App33 relates to leases to be reclassified under IFRS16 that will be (or planned to be) in existence as at 31 March. 2020 that will determine the RCV adjustment. Subsequent new lease agreements or renewals should not be included in App33, but will form part of totex at their discounted NPV.
		Should the discount rate we use in App 33 be the same as the discount rate used in all the other tables when calculating NPVs of leases?	The discount rate is the applicable real wholesale cost of capital on a blended 50:50 RPI/CPIH basis for each price control. This is because this equates to the rate of return that will be earned on lease liabilities that are capitalised to the RCV.
		WS1a and WWS1a We will include the 'addition' of the capitalised leases within lines 12-16, allocated to the price control with principal use, in line with RAG 2.07 as detailed above.	**WS1a and WWS1a** WS1a and WWS1a are to be completed as if IFRS16 had not been implemented so operating leases would still be reported on the current basis, therefore we would not expect any capitalised costs in there. There would be in WS1 and WWS1 for new leases not existing at the start of the price control. New leases in 20-25 will be included as capex.

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		App 11/11a We will include the 'depreciation' on the capitalised lease within lines 12-16. The depreciation will be in App 11a, with accumulated depreciation in App 16.	**App11/11a/16** That is correct.
613	Data tables	**WS4 L6-8 - Wholesale water other (explanatory variables),WWS4 L1-3 - Wholesale wastewater other (explanatory variables)** PR19 business plan data tables require reporting of "energy usage (electricity, gas, liquid fuels) imported and self-generated (irrespective of the power source)". We self-generate and use energy recovered from sludge in the forms of electricity and heat. We would like Ofwat to confirm that they expect us to report all energy usage irrespective of source, including usage of renewable heat. The inclusion of energy from heat is consistent in scope with historic "June Return – Table 42", and current Greenhouse Gas emissions reporting process to Ofwat.	We confirm that to the extent that it is used beneficially, energy recovered from sludge in the form of heat should be included in the figures reported in table WWS4 lines 1-3. The same principle applies to table WS4 lines 6-8, though we do not expect energy recovered for sludge to be relevant for controls in wholesale water.
614	Data tables	**Wr7 Block A Lines 1 - 7 & 8 - 14** We only have space for 7 asset types, however we need to enter 14 asset types.	The asset type lines for Wr7 will not be increased beyond the current 7. Companies should explain what each of the 7 asset type categories include (may include several asset types with the same asset lives) and map assets to these

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		Can Ofwat add extra asset types to the table to allow us to enter all these details?	categories. In the instance that companies have more than 7 discrete asset lives for its asset types, it will need to combine asset types with others with similar asset lives and make this clear in the commentary. This should have a minor impact on the data presented.
615	Data tables	**APP1** For the common measure - Internal sewer flooding incidents (including severe weather) please can you clarify whether this needs any normalisation (per10,000 connected properties? As stated in the December 2017 appendix 2 document) as this is inconsistent with the final reporting guidance march 2018 which does not mention any normalisation.	We explained our approach on pages 14 and 15 of Appendix 2 of the methodology "When comparing companies, we agree that companies should normalise sewer flooding by the number of sewer connections to make the data comparable. Companies might also want to present their performance commitments in absolute numbers to make it easier for customers and stakeholders to understand."
616	Data tables	**R1 line 134** Line 69 of change control states new line added for local authority rates (we knew about this from previous set of tables APP5). Line 134 then states that this line is removed. BUT it hasn't been removed. Should it have been removed – can Ofwat make a correction?	We restated this line for the May 2018 release of the data tables and have amended the change control sheet to confirm this. 'Local authority and Cumulo rates' remain in the latest version of table R1 issued 25 June 2018.
617	Data tables	**APP1 - Columns 144 – 154** Unit for marginal cost and marginal benefit:	1. We have adjusted the number of decimal places from 2 to 6 in the version of the table published 25 June 2018. 2. The cost and the benefit required to be reported in this table is that faced by the average household customer.

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		• In our wholesale ODI calculations, the unit for marginal cost and benefit's is '£m per unit for all customers served', consistent with our incentive rate units, and calculations. In the Ofwat APP1 table, the unit for marginal cost and marginal benefit is set as '£ per unit per household to 2 decimal places'. We just want to clarify our understanding so that we provide data that is consistent with other companies and that what we provide is appropriate for the intended use. 1) This value and format will make a number of our marginal costs and benefits appear to be zero, at two decimal places. 2) £/unit/ household could be interpreted in one of two ways, • firstly as the estimated coefficients from willingness to pay studies: In this instance we have triangulated our values, therefore this would not represent the values that are used in cost benefit analysis and ODI calculation. What we use in CBA and ODI calculations is not	Companies should not include benefits for non-household customers. Information on non-household customers and all customers should be provided separately where relevant. The table has the facility to provide up to two estimates of the benefit for the average household. A short description is required for each estimate and you may wish to expand on this in the commentary. The marginal cost provided should be on a consistent basis with how costs are recovered through customers' charges.

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		just the household value, but the appropriately combined value for all properties. We have separate household and non- household values, which we have triangulated and then aligned to the individual PC definitions. • Secondly, the aggregated benefit divided by the number of households, this could be pre or post triangulation and could include the non-household valuations. Given that different companies may apply different approaches to disaggregate marginal cost and benefit to household level, by using differing assumptions for current or projected household numbers, this could be another area of inconsistency.	
618	Data tables	**APP1 column 62** In the App1 table, column reference 62 (Financial ODI may accrue or apply). The guidance is as follows: "For the five years 2020-21 to 2024-25: 'Yes' if an outperformance payment or underperformance penalty may accrue or apply. Otherwise leave blank."	We have corrected this error in the version of the table published 25 June 2018.

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		However if we try and input yes into one of these fields we receive the following error: "The value you entered is not valid"	
619	Data tables	**WS2, WWS2 Non-SEMD enhancement** In cost assessment table 4M (enhancement spend) there is a line for 'Non-SEMD related security enhancement', whereas there is no line for this in the corresponding table in our annual return (4M). This implies that in our cost assessment table we should be treating this spend as enhancement but in the annual return we should be treating it as base. This doesn't make sense as we will have to state spend in 2017/18 for both submissions based on the same RAGs. We are reporting this spend (if there is any) as base in the AR but just wanted to flag up that this may be inconsistent with our CA submission.	We acknowledge the mismatch between tables 4L and 4M in the 2017-18 APR and tables WS2 and WWS2 in the Business Plan Data Tables. If companies have expenditure in this category that they consider is enhancement then they should include it in the freeform lines at the bottom of tables 4L / 4M as appropriate.
620	Data tables	**WS2, WWS2, WS10, WWS10** WWS2 guidance states "Where a quality enhancement scheme (or the proportionally allocated component of a quality enhancement scheme) has more than one cost driver, companies should allocate the expenditure attributable to	We acknowledge the inconsistency between the guidance for the enhancement expenditure tables (WS2 and WWS2) and the transitional expenditure tables (WS10 and WWS10). The latter should be ignored. The guidance that "any net additional cost for meeting the requirements of any further drivers should be included in the (different) relevant line"

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		the primary driver to the relevant line. Any net additional cost for meeting the requirements of any further drivers should be included in the (different) relevant line. The expenditure in this table must exclude that associated with a dummy price control (Thames Tideway) which should be entered separately in table Dmmy2." WWS10 guidance states: "Quality enhancement schemes' investment with more than one cost driver - where a quality enhancement scheme (or the proportionally allocated component of a quality enhancement scheme) in AMP7 has more than one cost driver, companies should allocate the expenditure attributable to the primary driver to the relevant line. Any net additional cost for delivering any further drivers should be included in the additional lines at the bottom of Block A." This guidance seems to be inconsistent. Can this be clarified?	should be taken as applying to tables WS10 and WWS10 as well as to WS2 and WWS2.

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622	General	Please can you clarify the time of the deadline for submission of PR19 Business Plans on 3 September 2018?	It would be helpful if companies can submit their PR19 Business plans by 5pm on 3 September.
623	Retail	On the Household Retail Reconciliation model, are companies expected to complete the "actual customer numbers" and "actual revenue collected" sections with forecasts for 2018/19 and 2019/20, or to leave these blank?	Companies should complete these lines with forecasts.
625	Past delivery	**PR19 RCV adjustments feeder model (published June 2018)** I have a question/clarification request regarding the PR19 RCV adjustments feeder model that was published this week. Within the feeder model, it includes lines for: • IFRS16 adjustments to RCV • Water Resources and Bioresources RCV values My understanding is that the early submission (with the APR) was focused on the AMP6 reconciliation adjustments, and therefore would not include these items – i.e. that we would be making proposals for IFRS16 adjustments to	When submitting the RCV adjustments feeder model in the past delivery early submission (July) we do not expect companies to have completed the lines for: • IFRS16 adjustments to RCV; and • Water Resources and Bioresources RCV values. These lines will, however, need to be completed in the populated RCV adjustments feeder model submitted in September.

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		RCV, and for Water Resources and Bioresources RCV values along with our PR19 business plan in September, and not part of this early submission. However, it is a bit ambiguous whether you are expecting these items with the early submission, given that they are in the feeder models, or not. Would you be able to clarify whether or not you are expecting these items to be included within the early submission in July, or if (as I had assumed) that these should not be included, as they are expected as part of the September submission?	
626	Past delivery	**WRFIM PR14 reconciliation spreadsheet - June Version** The letter received from Andy Duffy dated 25th June states: "WFRIM spreadsheet – enabling companies who will apply the RCM blind year adjustment at PR19, rather than just those who will apply this over the years 2017-20."	The June update of WRFIM ensures the RCM blind year adjustment, when a company elected to apply it at PR19, is included in the output values and passed through to the revenue adjustments feeder model and onwards to the PR19 financial model. This modification is required because table App25 lines 2 and 4 'Total Adjustment Revenue carry forward to PR19' include the CIS adjustments and exclude the RCM adjustments. It will therefore be correct to include the RCM adjustment in WRFIM and report through lines 22 and 23 of the App25.

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		However the 2 calculation sheets "WRFIM - Water" & "WRFIM - Waste " show the adjustment figures in the 2019/20 columns and those figures ultimately feed into the sheet "WFRIM adjustments" implying these adjustments will be made before PR19, even though on the Inputs sheet "Data" the "Percentage of blind year adjustment by year" sections have been left blank. We don't' think this is correct if the adjustments are being made in PR19. Are you able to assist or point me in the direction of someone who may be able to assist me please?	In the WRFIM spreadsheet, when the 'Percentage of blind year adjustment by year' sections have been left blank (or zero) then 'AMP5 RCM blind year adjustment (Outturn price base)' in line 23 will be zero and the RCM adjustment does not flow into the 'Adjusted Allowed Revenue (AR)' in line 38 which remains unchanged from 'Allowed Revenue from FD' in line 37. Similarly, if the 'Percentage of blind year adjustment by year' sections total is less than 100% then the unutilised % does not flow into the 'Adjusted Allowed Revenue (AR)'. The new lines added on the calculation sheets (lines 25 to 28) process the unutilised RCM adjustment which goes directly into 'Total reward / (penalty) at the end of AMP6' in line 84.
627	Financial modelling	**WRFIM** We would expect that any WRFIM adjustments associated with the AMP6 wastewater price control should be made to the AMP7 wastewater network+ price control, and that any WRFIM adjustments associated with the AMP6 TTT price control should be made to the AMP7 TTT price control (i.e. the Dummy price control in the data tables and financial model). Is this correct?	We confirm that is correct. We have included a replica of WWS13 table in the Dummy section (as table Dmmy11) and updated the revenue adjustments feeder model. We will expect you to submit two versions of the WRFIM model, one to reflect the wholesale water and wastewater price controls, and one to just reflect the TTT price control.

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		If this is correct, we would expect to run the WRFIM model separately for the wastewater and TTT price control (which is consistent with how we set charges in AMP6, and report them in the APR). Would it therefore make sense to add a new data table in the "Dmmy" section, equivalent to WWS13, to document the WRFIM for the TTT price control? Similarly, the latest revenue feeder model does not have the scope to include a revenue adjustment from the WRFIM in the Dummy price control. Should this feeder model be updated to include such an adjustment? This would enable the adjustment to flow into the Dummy price control of the financial model.	
628	Financial modelling	**Blind year adjustments** There is currently no scope in the RCV feeder model to include any adjustments to the TTT price control RCV relating to the blind year. One such adjustment is the item referred to in the attached letter from Keith Mason to Nick Fincham. We would also expect to include a true-up	We agree there is currently no scope in the RCV feeder model to include any adjustments to the TTT price control RCV relating to the blind year nor the potential for there to be land disposals during the 2015-20 period. For the latter we have added block C in table App9 for the TTT price control. We have added two lines in the Dmmy RCV section of table App8, one line for 'NPV effect of 100% of the proceeds from

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		associated with any difference in TTT land costs in 2014/15. Is this in line with your expectations? Should the RCV feeder model be updated to include a blind year adjustment for the Dummy price control? Similarly, should App8 include a row for such adjustments for the Dummy RCV section?	disposals of interest in land' and the other for 'Other adjustments to wholesale RCV'. We have updated the RCV adjustments feeder model to calculate the opening RCV balances correctly.
629	Data tables	**Opening RCV** The pre-populated data in App8 for the closing AMP6 Wastewater RCV (row 43) currently shows the combination of the RCV for the Wastewater TTT price controls. Our expectation is that this row should just show the closing AMP6 RCV for the Wastewater price control, and then the Dummy price control section (row 83) should show the closing AMP6 RCV for the TTT price control. Would this be an appropriate way of populating this table? (For reference, we note that App8 row 83 is in a different price base (2017-18 FYE RPI) to App8 row 43 (2012-13 FYA RPI).	We recognise that we have incorrectly pre-populated table App8. As explained in our letter to Regulatory Director's on 26 June from Andy Duff, Director Data and Modelling, companies are able to change pre-populated data, but this must be clearly highlighted and explained in the table commentaries.

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		However, the RCV feeder model looks to be dealing with the different input price bases correctly in each case).	
630	General	To incorporate these June changes, do I manually edit my own master sheet to match these new changes? Or do Ofwat not provide a method of dealing with this, it's up to the specific company? I am trying to figure out the best and most accurate manner of adding these new changes as they are extremely late edits and time is gold dust.	You must use the June release of the template as this has the F_Ouputs sheet built in, to allow us to transfer your data into our database.
631	Data tables	**App9** I am including the June changes in our master table sheet and noticed a formula in App 9 that isn't included in the change controls in this new release. In your latest release, Cell I8 has the formula $=(I7/1000 - 16) / 2$ but previous to the June update the formula was $= (I7 - I6) / 2$. This formula hasn't been mentioned and I need to know whether this new formula is correct as it changes the calculated output?	The change to formulae in lines 3 and 14 takes account of the fact that the actual and forecast sales are to be input in £000 rather than £m for consistency with table 2E of the Annual Performance Report. This change should have been included on the control sheet for the June release of the templates.
632	Data tables	**App8**	For the June release of the PR19 business plan data tables, we replaced the original App8 table with the draft version of the table we had included for information purposes in the

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		In your change control release last week you have; "App8 New line added in block B (line 86) for the dummy control: "Wastewater ~ Totex menu RCV adjustment at 2017-18 FYE CPIH deflated." 600 But you have added this change into App 8 (DRAFT) table and not the initial App 8 table. Can you confirm if this line is to be inserted into NEW App 8 or the initial released App 8 as you only have one App 8 table in your new company specific release.	May release. The latest version App8 includes additional lines for IFRS16 RCV adjustments and this new line in block B for the dummy control.
636	Outcomes	The Atkins report set out an output table of three numbers with the % of population broken into Low, Medium and High %. However, the Ofwat reporting table seeks the % of population at risk from a 1:50 flooding event. Clearly there is a risk that companies could report different outputs within Table 3s without further guidance. It is recommended by the PSG members, that companies should report the sum of	We agree that companies should include both medium and high risk properties in the calculation of Risk of sewer flooding in a storm (new risk-based resilience metric – wastewater). We will amend the definition on our website to "Percentage of population at risk of sewer flooding in a 1-in-50 year storm (medium and high risk properties)."

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		the High and Medium risks within Table 3s Line 13. It is also recommended that Companies should report the full table from p51 within company commentary to provide additional granularity of information.	
637	Past delivery	We have another question about what we need to submit as part of the July submission. Query response 603 gives a very helpful list of all the data tables and underlying feeder models required. The list of data tables required does not include the IFRS16 operating lease table, App33. However, the output of this table is required in order to fully populate the RCV feeder model. Could you confirm if you're expecting the RCV feeder model to be populated to include the inputs that reflect the IFRS16 RCV adjustments, and if so, do you also require App33 to be submitted?	We do not require table App33 to be submitted as part of the July submission and expect the inputs related to the IFRS16 RCV adjustments to be blank in the RCV adjustments feeder model submitted in July. The IFRS16 related inputs will be completed in the feeder model submitted in September.
638	Past delivery	Do you have any guidance around the submission of the PR14 reconciliation tables? We acknowledge that the submission needs to be uploaded to Ofwat SharePoint site and we have asked for	Please submit your company specific template with only those tables relevant to the PR14 reconciliation submission completed.

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		the relevant access to allow this to happen. We have also considered how best to submit the relevant tables and intend to extract ONLY the PR14 reconciliation tables into a new excel workbook to complete the submission. Is this an acceptable approach or is there a preferred method?	
639	Past delivery	For the 15th July submission of the PR14 reconciliation data tables, would you prefer to receive a pack of all the data tables with just those relevant to this submission populated, or just a pack of the relevant tables?	Please submit your company specific template with only those tables relevant to the PR14 reconciliation submission completed.
640	General	Could you let me know a date we should expect feedback on our performance commitments?	We will provide our feedback by 13 July. Our review of the draft definitions has included checking: • the clarity of the definition and whether there is any ambiguity or internal inconsistency; • the completeness of the definition; • for any inappropriate exemptions; and • for any use of aggregation of several sub-measures, which we have ruled out for PR19. We will send a letter to each Regulatory Director and feedback on each performance commitment will be constrained to these areas.
641	General	Could you please let me know when we can expect to receive feedback on our	We will provide our feedback by 13 July. Our review of the draft definitions has included checking:

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		draft Performance Commitments, submitted in May?	• the clarity of the definition and whether there is any ambiguity or internal inconsistency; • the completeness of the definition; • for any inappropriate exemptions; and • for any use of aggregation of several sub-measures, which we have ruled out for PR19. We will send a letter to each Regulatory Director and feedback on each performance commitment will be constrained to these areas.
642	Cost Assessment	We (and all WASCs I think) have some UWWTD WINEP drivers for investigations, monitors and the need for new or extra storm tanks or increased flows to treatment necessary to meet the UWWTR as required by Defra. U_IMP5 The WwTW FFT must be increased to 3PG + IMAX + 3E U_IMP6 The WwTW storm tank capacity must be increased to 68 litres/head or to 2 hours at max flow through the tanks. EA and Defra have confirmed this as part of the WINEP to ensure UK UWWTD compliance and it will be implemented through permit changes, but because it relates to an existing Directive I have	We regard both U_IMP5 and U_IMP6 as Quality driver codes for which the associated investment should be reported in Business Plan Tables WWS2, WWS2a and, if applicable, WWS10. You will note that in Table WWS2: - the definition for lines 9/56 is: "Capital / operating expenditure on quality enhancement schemes listed in the WINEP / NEP to increase the flow to full treatment to 3PG+I+3E. Relevant Environment Agency driver code for AMP7 schemes is U_IMP5." - the definition for lines 10/57 is: "Capital / operating expenditure on quality enhancement schemes listed in the WINEP / NEP to increase the storm tank capacity to 68 l/hd or to 2 hours retention at max flow into the tanks."

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		been asked to check that Ofwat also accept that this is treated as Quality.	
643	Data tables	Can you confirm where you have got your information for the R10 pre-populated data?	The qualitative performance survey scores come from the McCallum Layton reports 'Ofwat Customer Experience Surveys Q1, Q2, Q3 and Q4' for 2015-16. The quantitative composite score comes from the information companies report to CCWater on their numbers of complaints, who compile the numbers into an industry report. The overall score of 83 which is the sum of 63.33 and 19.27, is consistent with our 2015-16 web publication: http://webarchive.nationalarchives.gov.uk/20161005151913/ http://www.ofwat.gov.uk/regulated-companies/comparing-companies/customer-service/