December 2017

Trust in water

Delivering Water 2020: Our final methodology for the 2019 price review
Appendix 15: Responses to our draft methodology

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Contents

Responses to our draft methodology

In this appendix, we summarise the responses to our draft methodology proposals, published in July of this year. The full representations that respondents submitted are available on our website[1].

Each of the companies affected submitted representations. We also received representations from customer challenge groups, retailers, developers, investors, customer and environmental bodies, statutory bodies and other interested parties. These are listed in the table below.

As well as the formal, published representations submitted by the parties listed above, we have also had regard to views expressed as part of ongoing dialogue with the Welsh Government and the Department for Environment, Food and Rural Affairs (Defra).

Our views have also been informed by working groups and workshop discussions. We have held a number of workshops and events since the publication of our draft methodology proposals, including:

- our 'resilience in the round' event, in September 2017.
- an Ofwat-PwC event: 'Bad debt and residential retail efficiency', on 28 September 2017;
- two working groups on customer measure of experience (C-MeX), in September and October 2017;
- three working groups on developer measure of experience (D-MeX), in September and October 2017;
- a workshop on the bioresources forecasting accuracy incentive, held on 4 October 2017; and
- an affordability and vulnerability workshop, held on 25 October 2017.

On outcomes, we have also been working collaboratively with a number of interested parties (such as, Water UK, UKWIR, water and wastewater companies, the Environment Agency and Natural Resources Wales), to develop consistent metrics for performance commitments. These include:

[1] with the exception of one confidential response.

- leakage;
- supply interruptions;
- resilience; and
- sewer flooding.

We have also facilitated meetings of the CCG chairs each quarter during 2016 and 2017. These will be held every two months from early 2018.

This PR19 final methodology draws on work that we have conducted as part of our Water 2020 programme, including:

- Towards Water 2020 – meeting the challenges for water and wastewater services in England and Wales (July 2015);
- Water 2020: Regulatory framework for wholesale markets and the 2019 price review (December 2015);
- Water 2020: our regulatory approach for water and wastewater services in England and Wales (May 2016);
- A consultation on the approach to the cost of debt for PR19 (September 2016); and
- A consultation on the outcomes framework for PR19 (November 2016).

Table A List of respondents

Type	Respondent	Notes
Water and sewerage companies	ANH	Anglian Water
	NES	Northumbrian Water
	SRN	Southern Water
	SVT	Severn Trent Water (including Dee Valley Water)
	SWB	South West Water
	TMS	Thames Water
	UU	United Utilities
	WSH	Dŵr Cymru/Welsh Water
	WSX	Wessex Water
	YKY	Yorkshire Water
Water only companies	AFW	Affinity Water
	BRL	Bristol Water
	PRT	Portsmouth Water
	SES	Sutton and East Surrey Water
	SEW	South East Water

Type	Respondent	Notes
	SSC	South Staffordshire Water
Infrastructure provider	Thames Tideway	
Statutory bodies	CCWater	The Consumer Council for Water
	DWI	The Drinking Water Inspectorate
	EA	The Environment Agency
	Natural England	Responsible for managing England's natural environment, including freshwater and marine environments.
	Natural Resources Wales	Responsible for the former functions of the environment agency, countryside commission and forestry commission in Wales
Customer challenge groups (CCGs)	NES CCG	Northumbrian Water CCG
	SWB CCG	South West Water CCG
	Thames CCG	Thames Water CCG
	UU CCG	United Utilities CCG
	WSX CCG	Wessex Water CCG
	YKY CCG	Yorkshire Water CCG
Developers		
	Fair Water Connections	Membership group for self-lay organisations
	Home Builders Federation	Membership organisation for home builders
	Kier	Property, residential, construction and services group. Supply partners to multiple water companies
	PN Daly Ltd	Supplier of gas, water, electricity and telecoms network design, construction, connection, repair, maintenance and support services
Retailers	Anglian Water Business	Associated with Anglian Water
	Business Stream	Associated with Scottish Water and purchased Southern Water's business customers
	Clear Business Water	Independent retailer based in Scotland
	NWG Business	Associated with Northumbrian Water
	South East Water Choice	Associated with South East Water
	Three Sixty Water	Associated with Yorkshire Water
	Water Plus	Joint venture between United Utilities and Severn Trent Water
Investors	Allianz, DIF, Infrared	Allianz, DIF and Infrared respectively own 36.6%, 26.9% and 36.6% of Affinity Water.

Type	Respondent	Notes
	Anglian Water Investors	Composed of CCP Investment Board (32.9%), Colonial Fist State Global Asset Management (32.3%), IFM Investors (19.8%) and 3i (15%).
	Hastings	Hastings manages the share in South East Water for Utilities of Australia (50%), RBS pension (25%) and Desjardins cooperative (25%).
	iCON Infrastructure	iCON Infrastructure advises institutional funds which collectively own 80% of Bristol Water.
	Kelda Investor Group	Consortium of investors composed of Corsair Capital, GIC, Deutsche Alternative Asset Management and State Infrastructure which own Yorkshire Water.
	OMERS and Wren House	OMERS (Ontario's municipal employees pension fund) and Wren House (investment arm of the Kuwait Investment Authority) respectively own 23% and 9% in Thames Water.
Customer bodies	ICS	Institute of Customer Service
	StepChange Debt Charity	Consumer debt advice organisation
Environmental bodies	Blueprint for Water	Coalition of 18 environmental, water efficiency and fisheries organisations
	Canal & River Trust	Charity which owns and maintains canals and other inland waterways in England and Wales
	Committee on Climate Change	Independent, statutory body responsible for advising the government on preparing for climate change
	WaterWise	Independent not for profit water efficiency organisation
	WWF-UK	World Wide Fund for Nature, independent not for profit conservation organisation
Other	A. Lambert & D. Pearson	Specialists in leakage and pressure management
	British Water	Membership organisation for the water sector supply chain
	CH2M	Engineering consultants
	CIWEM	Chartered Institution of Water and Environmental Management
	Hertfordshire County Council	Local authority
	Heathrow Airport	Owner of Heathrow airport, price regulated by the Civil Aviation Authority
	Martin Blaiklock	Independent consultant in financing infrastructure projects
	MOSL	Retail market operator
	National Grid	Owner and operator of the electricity transmission system in England and Wales and the gas transmission network in Great Britain.
	Safe SuRe	Research team in the Centre for Water Systems at University of Exeter

In the remainder of this appendix, we summarise the issues raised by responses to our draft methodology proposals for each of the chapters of our draft methodology document. For each of these issues, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals. Views have been summarised and grouped into broad themes for clarity and brevity. For a complete understanding of the specific issues raised by each respondent, please refer to the representations themselves, which are provided in full on our website.

In the table below, we list all of the questions that we asked in our draft methodology proposals, and signpost the subsequent table in which the responses to that question are considered. We note that in these subsequent tables, we also summarise issues raised in response to our draft methodology proposals where we did not ask specific questions, but did receive comments, along with our consideration of those issues.

Table B List of consultation questions

Question		Table reference
Section 1: Engaging customers		
No questions asked, but comments received.		Table 1.1
Section 2: Addressing affordability & vulnerability		
1	Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?	Table 2.1
2	Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?	Table 2.2
3	Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?	Table 2.3
4	Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?	Table 2.4
Section 3: Delivering outcomes for customers		
1	Do you agree with our proposals for common and bespoke performance commitments?	Table 3.1
2	Do you agree with our proposals on setting performance commitment levels?	Table 3.2
3	Do you agree with our proposals for strengthening outcome delivery incentives?	Table 3.3

Question		Table reference
4	Do you agree with our proposed Customer Measure of Experience (C-MeX)?	Table 3.4
5	Do you agree with our proposed Developer Measure of Experience (D-MeX)?	Table 3.5
Section 4: Securing long-term resilience		
1	Do you agree with our resilience planning principles?	Table 4.1
2	Do you agree with our approach to assessing resilience in the initial assessment of plans?	Table 4.2
Section 5: Wholesale controls		
1	Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?	Table 5.1
2	Do you agree with our proposals for the form of control for water resources as set out in the 'Wholesale controls' chapter and appendix 5, 'Water resources control'?	Table 5.2
3	Do you agree with our proposals for access pricing for English water companies set out in the 'Wholesale controls' chapter and appendix 5, 'Water resources control'?	Table 5.3
4	Do you agree with the proposals for company bid assessment frameworks set out in appendix 9, 'Company bid assessment frameworks: the principles'?	Table 5.4
5	Do you agree with our proposals for the form of control for bioresources as set out in the 'Wholesale controls' chapter and appendix 6, 'Bioresources control'?	Table 5.5
Section 6: Direct procurement for customers		
1	Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)	Table 6.1
2	What are your views on the type of tender model (ie an early or late tender model) appointees should use? Do you have any views on whether or not we need to specify a tender model companies should use?	Table 6.2
3	What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?	Table 6.3
Section 7: Retail controls		
1	Do you agree with using a weighted average revenue control, where appropriate taking account of different costs by customer type for the residential retail price controls for English and Welsh water companies?	Table 7.1
2	Do you agree with using an average revenue control for business retail price controls for Welsh companies not subject to competition?	Table 7.2

Question		Table reference
3	Do you support price controls for business retail activities for English water companies that have not exited the business retail market?	Table 7.3
4	Do you support price controls for water service customers of Welsh companies using more than 50 megalitres a year?	Table 7.4
5	Do you support a three year price control for residential retail activities and business retail activities?	Table 7.5
Section 8: Securing cost efficiency		
1	Do you agree with our overall approach to cost assessment?	Table 8.1
2	Do you agree with our proposed cost sharing incentive? We welcome thoughts on the calibration of the incentive.	Table 8.2
3	Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?	Table 8.3
4	Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?	Table 8.4
5	Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?	Table 8.5
6	Do you agree with our preferred approach not to index the retail controls to a measure of general inflation, and, if appropriate, deal with input price pressure as part of our totex allowance?	Table 8.6
7	Do you agree with our proposals for the transition programme?	Table 8.7
Section 9: Aligning risk and return		
1	Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?	Table 9.1
	Company specific adjustments. (This was not a consultation question but a number of respondents commented on it.)	Table 9.1a
2	Do you agree with our approach to indexing the cost of new debt?	Table 9.2
3	Do you agree with our proposal to index price controls to CPIH (subject to its re-designation as a national statistic before we publish our final methodology)?	Table 9.3
4	Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? a. Should the true up mechanism be limited to changes in corporate tax rates and capital tax allowances or should we extend that true-up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?	Table 9.4

Question		Table reference
5	Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?	Table 9.5
	Balance of risk and return. (This was not a consultation question but a number of respondents commented on it.)	Table 9.5a
Section 10: Financeability		
1	Do you agree with our overall approach to assessing financeability?	Table 10.1
2	Do you agree the calculation of the metrics (as set out in Section 11.5 in the Financeability chapter) that we are proposing to use in our assessment?	Table 10.2
Section 11: Accounting for past delivery		
1	Do you agree with our proposed approach for dealing with PR14 reconciliations and the service incentive mechanism (SIM)? If not, please explain your alternative approach and why this would be in customers' interests.	Table 11.1
2	Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.	Table 11.2
Section 12: Securing confidence and assurance		
1	Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?	Table 12.1
2	Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?	Table 12.2
Section 13: The initial assessment of business plans		
1	Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (high quality, ambition and innovation) c. In terms of the business plan categories we propose to assign companies to? (significant scrutiny, slow track, fast track, exceptional) d. In terms of the financial, procedural and reputational incentives we propose to put in place?	Table 13.1
2	Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?	Table 13.2

Question		Table reference
A1	Do you agree with the key questions under each of the test areas?	Table 13.3
A2	Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?	Table 13.4
A3	Do you agree with our high-level approach for scoring business plans into the four categories (significant scrutiny, slow-track, fast-track, exceptional)?	Table 13.5
A4	Do you agree with our proposed schedule for the initial assessment of business plans?	Table 13.6

1. Engaging customers

There were no consultation questions on customer engagement in our draft methodology proposals as we were confirming our existing policy for engaging customers for PR19. Nevertheless we received a number of responses.

Table 1.1 Summary of issues raised on customer engagement

Engaging customers			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It is not just customers' views that should inform companies' business plans but also environmental and societal concerns.	EA, Natural England, WWF-UK, Blueprint, CIWEM and CH2M	Our PR19 model of customer and stakeholder engagement, including CCGs, allows for environmental and societal concerns to be fed into companies' business plans. We are clarifying how our methodology takes the environment into account in our PR19 final methodology.	Clarification
Companies and we need to take the views of business retailers into account more.	Anglian Water Business, Business Stream, NWG business, South East Water Choice, MOSL	We consider wholesalers should engage with business retailers as part of the customer engagement process to learn about their views and the views of their customers.	No change
We could provide more support to CCGs.	CCWater NES CCG, WSX CCG, TMS CCG	We have listened to feedback from the CCGs and provided them with a draft "aide memoire" of the main points they need to be aware of in the methodology. We will update the aide memoire following publication of our PR19 final methodology. We are holding meetings with all the CCG Chairs every two months in 2018 to provide additional support to the CCGs.	Clarification

Engaging customers			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The potential for conflict between customers' views and our methodology.	AFW and SEW	We are clear in our PR19 final methodology where customers' views shape companies' business plans. In many cases our approach sets challenges but requires companies to take account of customers' views when addressing our challenges e.g. when proposing performance commitments.	No change
There should not be further customer engagement on mechanisms agreed in the price review following customer engagement.	SVT	Some price control mechanisms can require further customer engagement when they are implemented. An example is that an ODI and how it operates are agreed at the price review but a company might subsequently want to smooth the effect on bills and in such cases learning about customers' views would be beneficial to the effective implementation of the ODI.	No change
It is not the CCG's role to represent a regulator	NRW	We agree that a CCG does not represent the views of a regulator. In our Customer engagement policy statement for PR19 we explain the role a regulator plays through the CCG as follows (pages 26-27): "the statutory environmental and drinking water quality regulators […] are crucial participants in the CCG process and we expect them to play a significant role informing CCG discussions at PR19." We also state that: "It is very useful to understand if the environmental and drinking water quality regulators have raised concerns through the CCG process that a company's proposals put compliance with its future statutory environmental and drinking water quality obligations at risk. It is also very useful to understand if the relevant regulators have not identified or raised material concerns, or if these concerns have been raised and subsequently addressed by the company. We recognise the ultimate responsibility to comply with legal obligations lies with the companies. And that the regulators' participation in the process does not mean they endorse the business plans, especially with respect to a company's compliance with its legal obligations."	Clarification

Engaging customers			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Water efficiency efforts help promote engagement	Waterwise, CIWEM	We agree. Our common performance commitment on per capita consumption will promote companies engaging with their customers to reduce consumption.	No change
Engagement with developers is important	HBF	Engagement with all customers is important. We have added in a reference to developer services customers in the customer engagement chapter to make it clear these are included in customer engagement. Our proposal for D-MeX, which involves surveys of developer services customers, promotes engagement with developers.	Clarification

2. Addressing affordability and vulnerability

Q1. Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?

In our draft methodology we proposed to incentivise companies to develop business plans that address:

- overall affordability, providing value for money;
- long-term affordability; and
- affordability for those struggling, or at risk of struggling, to pay.

In our draft methodology we proposed to use five principles against which to assess how companies were addressing these three areas of affordability in their business plans.

All respondents supported our proposal with some (UU, YKY and BRL) strongly supporting the use of the five principles.

Issues raised are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals. (Some of the respondents' comments on this question related to the common metrics that we will collect through the business plan tables to assess how companies are addressing affordability. These are covered in table 2.2.)

Table 2.1 Summary of issues raised in response to affordability and vulnerability, question 1

Q1. Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Additional principles			
Companies should understand relevant customers' views at a segmented level rather than in the round.	SEW	There was general support for the five principles we proposed. We consider that how well companies understand customers at a segmented level forms part of our first principle on customer engagement. We welcome companies understanding more about their different customer segments. This is in line with our principle of customer engagement, which is about companies understanding the needs and requirements of different customers.	No change
The extent to which companies are contributing to the funding of affordability assistance.	CCWater	There was general support for the five principles we proposed. This suggestion feels too specific to be a principle. We consider that how companies contribute to the funding of affordability support can be covered by our assessment of the third area of affordability - affordability for those struggling to pay. In this area we can look at all the ways companies assist those who struggle to pay, including the extent to which companies are contributing to the funding of affordability assistance.	No change
Supportive of principles - all respondents agreed with our proposal. Below we list the specific issues raised.			

Q1. Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Important to establish how the assessment of the three affordability aspects will be balanced. Too much focus on one aspect could have a detrimental impact on the broader objectives of companies' plans (e.g. long-term investment and resilience).	ANH	We consider that all three areas of affordability are important in our assessment.	Clarification
Welcome recognition of the importance of considering affordability over the longer term and the long term path of bills.	SRN	Noted.	No change
Agree affordability is a function of customers' circumstances in relation to proposed bills and important to engage with customers to understand their circumstances and to assess affordability. Companies should not deliver affordability at the expense of resilience, and affordability should take into account inter-generational fairness.	TMS	Noted. We consider that all three areas of affordability are important in our assessment.	No change
Sensible framework. Figure 3.1 in chapter 3 which links 5 principles to the 3 areas of affordability is useful. Pleased that the importance of effective segmentation, intergenerational fairness and looking beyond the plan period is stressed.	Thames CCG	Noted.	No change
Strongly agree with engaging on a wider basis with customers on affordability. Caution may be needed when engaging with customers who are struggling or	BRL	Noted. We look forward to seeing companies demonstrate innovative ways in how they engage those customers who are struggling or at risk of struggling to pay.	No change

Q1. Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
at risk of struggling to pay as this can be a sensitive area. Using third parties can help bridge that gap.			
Application of principles			
There may be challenges in how these principles are used to assess companies' plans consistently.	AFW	Noted. We will develop a more detailed methodology for the initial assessment of business plans next year to allow for a consistent assessment of companies' approaches to affordability. Our collecting of common metrics of affordability will also support our consistent assessment of companies' approaches. However, our approach needs to be sufficiently flexible to take account of different companies' and their customers' circumstances.	No change
The three initial assessment tests for affordability specifically do not reference the principles. This could act as a clear reference point for what Ofwat will consider in its assessment.	SES	We will apply the principles to assess the three areas of affordability. Figure 3.1 in chapter 3 of the draft methodology links the 5 principles to the 3 areas of affordability. We repeat this figure in chapter 3: addressing affordability and vulnerability.	Clarification
Concern that national or regulatory requirements may limit the extent customer bills can be made affordable. Regulators and Government need to take a balanced approach.	UU CCG	Our assessment of companies' approaches to affordability allows for companies to explain their approaches in the context of the constraints and circumstances they face.	Clarification

Q1. Do you agree with our proposal to use the five principles of customer engagement; customer support; effectiveness; efficiency and accessibility to assess how a company is addressing affordability in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The principles should allow an assessment of affordability approaches to customers struggling most. Adequate monitoring and reporting systems will be crucial for firms to meet Ofwat's affordability challenge. Needs more detail on this area in the final methodology.	StepChange Debt Charity	Our PR19 final methodology approach to affordability promotes three areas of affordability, which we consider are equally important in our assessment. Our principles allow us to assess the third area of affordability for those struggling, or at risk of struggling, to pay. It is up to companies to demonstrate how their business plans address affordability for those struggling to pay.	Clarification

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?

In our draft methodology we proposed that companies should provide information (qualitative) and metrics (quantitative), including common metrics, to demonstrate the affordability of their plans against five principles. We considered that there was benefit from us collecting a set of common metrics of affordability to provide comparative information and transparency for customers and other stakeholders.

The majority of respondents supported our proposal to use information and metrics. However, some respondents also expressed mixed views on the use of common metrics and the specific common metrics that we proposed.

The issues raised by respondents are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals for the final methodology.

Table 2.2 Summary of issues raised in response to affordability & vulnerability, question 2

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Using bespoke metrics / companies should decide the evidence they provide			
Common measures will not deliver as much benefit to customers as companies developing bespoke measures with their CCGs which take account of customers' views. Want to see more qualitative measures which reflect the complexity of engaging customers on a regular basis about companies' developing plans, ensuring engagement across the customer base, including those in the most vulnerable circumstances.	TMS	We have retained the common metrics because it gives us some common evidence across companies. This helps us to evaluate companies' approaches to addressing affordability alongside companies' own qualitative and quantitative information, as well as taking account of company-specific information. We have revised our list of common metrics after a workshop for companies, the UK and Welsh Governments and CCWater on 25 October 2017 where we asked for views on a list of alternative metrics suggested in consultation responses. We then received comments from CCG chairs on a revised list, which we considered before deciding on our final list.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics. See appendix 1: Addressing affordability and vulnerability and table App4 of the business plan tables. Definitions included in table App4 of the business plan tables.
Do not support the inclusion of common metrics as affordability is a complex area that each company treats differently. It is more appropriate for companies to focus on customers that are struggling to pay.	WSX		
Strongly agree with the need for transparency on how the industry approaches affordability, and support the approach of requiring companies to report against common metrics. Affordability is a complex and sensitive area and not suitable for a 'one size fits all' approach. Support using both qualitative and quantitative sources of information and think that all areas have been covered. Quantitative metrics need to be meaningful and create the right behaviours. Prefer companies to have flexibility to provide qualitative and quantitative evidence most relevant to their own	YKY		

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
customers, rather than a prescriptive, regulatory driven set of information.			
Bespoke measures are more suitable than common. They better reflect a company's specific circumstances and the preferences of its customer base. Common measures should only be used when there is a clear benefit of being able to compare performance across companies.	AFW		
Using the principles-based approach with metrics, is the right option as it allows the principles to be applied more objectively, gives greater transparency around what is expected and will ensure companies understand the benchmarks they are expected to meet. Only limited cross-company comparisons should be applied and more weight placed on the CCG challenge. If there are to be more cross-company comparisons greater clarity of the definitions is needed.	SVT		
The onus should be on companies to provide evidence (including quantitative) to support their plan. The chosen metrics will not add benefit to the assessment process and resources will be devoted to generating data without improving the service delivered to customers.	SES		
Customer Challenge Groups (CCGs) have raised concern about the common affordability metrics and it is important that they do not incentivise negative behaviour. The focus should be on measuring the impact in this area, and not just outputs.	YKY CCG		
We agree it is important to use information and measures to assess how a company performs.	StepChange Debt Charity		
Developing metrics with stakeholders			

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It would be helpful if the sector could work with Ofwat, CCWater and other stakeholders to consider this area further. It is important that the metrics chosen are robust and incentivise the right behaviours, and that comparisons take into account valid differences between companies.	NES	We have revised our list of common metrics after a workshop for companies, the UK and Welsh Governments and CCWater on 25 October 2017 where we asked for views on a list of alternative metrics suggested in consultation responses. We then received comments from CCG chairs on a revised list, which we considered before deciding on our final list.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
We support the proposal to use information and measures to assess company performance on affordability. The proposed measures are a good starting point, although there is a need to develop more robust and insightful measures before comparing performance. Using common measures has merit, particularly once a fuller understanding of such common measures has been developed across the industry. Keen to work with Ofwat and the industry to further develop this common understanding. A wider consideration of companies' operating environment and bespoke performance commitments should also form part of the assessment of business plans.	UU		
Common performance commitments			
CCWater's annual tracker on the affordability of water bills could be used as a standalone or combined common performance commitment which would reflect impact across the range of customers served.	CCWater	We are not proposing a common performance commitment on affordability because we recognise that no single measure captures the complex and dynamic nature of affordability, and because the challenges vary across companies. We consider that our strong emphasis on affordability and vulnerability in PR19 will incentivise companies to address these issues effectively in their business plans. We will build on experience in PR19 and consider	No change - see appendix 1.

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		common performance commitments for affordability and vulnerability at PR24.	
Comments on metrics that we proposed			
Metric: number of customers engaged with on affordability of the business plan			
This is a relatively crude measure and only captures quantity. It does not capture the underlying quality of the engagement, which should the primary consideration.	ANH	We no longer have this metric in our list of metrics.	Minor change - we have removed this metric from our set of common metrics. See appendix 1 and table App4 of the business plan tables.
A far wider number of customers' views will be considered as companies triangulate with feedback from customer unwanted contacts, complaints and feedback from expert affordability organisations.	PRT		
This measure could be problematic as it may lead to companies prioritising sheer numbers over reaching those most in need.	StepChange Debt Charity		
This would require numbers to be normalised in some way to reflect company size in order to compare. An alternative would be to compare the percentage of customers engaged with on affordability.	WSX		
Metric: Percentage of customers finding their bill affordable to them			
We support using the measure 'percentage of customers who think their bill is affordable to them'.	BRL	Noted	No change
It is possible to measure acceptability and affordability separately but the two can often mean the same thing to customers. Propose	WSX	We consider that the two metrics of affordability and acceptability provide distinct pieces of information that are useful for assessing the three areas of	Clarification

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
percentage of customers finding bills acceptable as the common measure.		affordability against our five principles. For example, a customer might think their bill is affordable, but not acceptable.	
Metric: percentage of customers who think their bill is acceptable			
This metric could produce a variable outcome as customers may be able to afford their bill, but still don't find the principle of paying for water acceptable.	BRL	We recognise that companies might collect acceptability information using different approaches. We consider that measuring customer acceptability provides useful information for our assessment of affordability. We will take into account the degree of comparability of the data in our assessment.	Clarification
For a number of years we have asked our customers about satisfaction with value for money and affordability but not 'acceptability' and so it is not possible to provide a robust figure. Different companies have different approaches to measuring this.	SES		
If we seek acceptability for the water bill we are likely to get a higher acceptance than if we include an estimate of a typical sewerage bill. Depending on the approach taken, acceptance rates for water-only companies may not be easily comparable to water and sewerage companies.	PRT	We have amended this metric (and the equivalent one on affordability) to clarify how it applies to water only customers.	Minor change – we have amended this metric and provided definitions in table App4 of the business plan tables.
Need further guidance on whether water only companies should take account of wastewater bills in their service areas, even though those water only companies cannot control the wastewater charges.	AFW		
Metric: benefits of applying affordability measures (for example, decrease in revenue outstanding)			
This metric does not take into account tariffs that help customers classed as the 'struggling silent' that may not be in debt but who are still in water poverty.	SWB	We have kept the "benefits of applying affordability measures" in the list of common metrics, but we no longer give the example of the decrease in revenue outstanding. This metric is meant to	Minor change - we have revised the description of this metric in our set of common metrics. See
This metric does not capture a significant number of customers struggling with affordability issues. It is important that measures of	CCWater		

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
effectiveness are not confined to debt related criteria but also reflect the benefit provided to those suffering in silence and just about managing to pay.		capture all the benefits of applying affordability measures.	table App4 of the business plan tables.
A measure on £s contributed by companies to support affordability schemes is not the correct measure. The effectiveness of schemes, for example how many people are receiving help with bills and continue successfully on to pay in future years may be better, or the average bill reduction from financial assistance measures may be another indicator.	UU CCG	As in the row above, we have clarified that this metric is meant to capture all the benefits of applying affordability measures. We also now have a metric on customers who have a payment plan and who continue to pay their bill in our revised list of common metrics.	
Metric: Average (mean) bill reduction from financial assistance measures			
This metric will be impacted by both the level of need in the community served and customers' willingness to support financial assistance schemes – both of which are outside of companies' control.	SES	We no longer have this metric on our revised list of common metrics.	Minor change - we have removed this metric from our set of common metrics. See table App4 of the business plan tables.
Quantitative measures of financial support (both the average bill reduction provided and the number of households helped) will need to take account of the extent of the customer funding contribution and what companies are contributing through benefit sharing. A measure of company funding contribution, such as the ratio of assistance provided to the costs passed on to customers, would be a useful common measure.	CCWater		
An appropriate reduction in bills is a key metric, as long as support is available to all those who require it.	WSX		

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Metric: costs and benefits of applying affordability measures **Metric: debt management costs as a percent of the average bill**			
Capturing the full range of costs and benefits associated with the range of affordability measures runs the risk of oversimplifying the complexities of assessing the range of activities companies undertake as part of managing affordability. The discrete benefits are difficult to capture given the need to control for wider factors (e.g. changes in wider macroeconomic factors affecting customers' ability to pay).	ANH	We consider that having information on the costs and benefits of affordability measures will help us to assess how efficient companies' affordability schemes are alongside other information provided by companies. See chapter 3 and appendix 1.	Clarification
This metric could be manipulated by reducing debt management activity.	NES	We no longer have a debt related metric on our list of common metrics. We consider that having information on the costs and benefits of affordability measures will help us to assess how efficient companies' affordability schemes are alongside other information provided by companies. We want to know the overall benefits to companies and customers of the company's approach to affordability. We have included definitions in the business plan tables.	Minor change - we have removed the debt management metric from our set of common metrics. See table App4 of the business plan tables.
Any metric needs a detailed definition to avoid companies including/excluding different elements. For example, whether the costs and benefits relate to customers as well as to the company.	SES		
When considering debt management costs as a percentage of the average bill, Ofwat should consider that water and sewerage companies will likely benefit from having a dual service (and therefore higher) average bill.	SEW		
We agree that companies should consider the costs and benefits of different affordability options, to ensure that the measures adopted are the most efficient.	WSX	Noted	
Metric: number of customers receiving financial assistance			

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It is important to look at valid differences between companies and at data quality. A company with a larger number of affluent customers may score poorly on this metric unless allowance is taken of this fact.	NES	We no longer have this metric on our list of common metrics.	Minor change – we have removed this metric from our set of common metrics. See table App4 of the business plan tables.
The number of customers could change or reflect the circumstances that the company is operating in. It does not provide a good indication of accessibility. It would be challenging to assess plans in a consistent way.	AFW		
This metric does not differentiate between the levels of assistance provided. A satisfaction measure on affordability support could provide a more consistent comparison, to take into account the satisfaction of customers who receive support and those who do not.	BRL		
It is important to ensure all financial assistance that customers receive is included and not just those customers receiving tariff-based support.	SWB		
This is a blunt metric that does not recognise the difference between companies' support schemes and variation in the levels of discount offered. Any comparative measure would need to capture uptake against eligibility for the schemes or monitor companies' own numbers on a year-by-year basis against their forecasts.	WSX		
General comments on metrics			
Some of the metrics seem more suited to assessing affordability for those struggling to pay. The metrics should not be applied too rigidly across all three of the elements of affordability, but interpreted sensibly for each. It is difficult to compare different affordability (reduced tariff) plans of different companies. The	WSH	Noted. We are capturing information related to overall and long-term affordability through some of other data tables (for example, bill levels), which might be why the focus looks to be a little	Clarification

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
information gathered should be interpreted and analysed 'in the round' given the particular characteristics of the affordability plans of each company.		more on affordability for those struggling to pay. Following feedback from stakeholders we are emphasising that we will assess how companies' plans address affordability in the round, not just by reference to the common performance commitments. See chapter 3 and appendix 1.	
We support common affordability measures in principle. You need to place more emphasis on outcomes and the qualitative aspects of the assessment rather than the numbers of customers on support schemes. You should put greater focus on all customers' satisfaction with the affordability options.	SEW	Our revised list of metrics is now focused more on customer impacts rather than outputs, following feedback from our stakeholders.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The scope of an affordability measure is not clear. It is important to recognise the support provided through measures such as debt alleviation schemes and charitable trusts as well as social tariffs and WaterSure. You need to recognise differences in the type of help provided by such schemes and the impact these have e.g. on-going help with future bills or a single intervention to help with existing arrears.	CCWater	We note the difference between the range and level of affordability assistance measures offered by companies. We want to ensure that we take account of this range in our assessment of companies' business plans and not just one type of assistance such as social tariffs. We have made this clearer in our revised data tables.	Clarification
Application of the common metrics			
We would appreciate further guidance on whether water only companies should take account of wastewater bills in their service	AFW	Water companies will need to explain to customers that their wastewater bill could	Clarification – see definitions in table App4

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
areas, even though those water only companies cannot control the wastewater charges.		change so that customers are informed before providing their views. We have amended the affordability and acceptability metrics to clarify how it applies to water only customers.	of the business plan tables.
You need to clarify status of the common metrics, as compared to performance commitments. Delivery of these common metrics should not be regarded as performance commitments since they have not been developed in consultation with our customers. While they might be reasoned forecasts, they should not be subject to the same levels of accountability through regulatory incentives.	WSX	We will use the common metrics to assess companies' approaches to addressing affordability alongside other quantitative and qualitative information provided by companies. The common metrics are not performance commitments. Companies are not making commitments on them and there are no ODIs associated with them. However, a company can choose to use one or more of the common metrics as performance commitments if they want to with the usual forms of engagement that involves. We are not proposing a common performance commitment on affordability because we recognise that no single measure captures the complex and dynamic nature of affordability, and because the challenges vary across companies. We consider that our strong emphasis on affordability in PR19 will incentivise companies to address these issues effectively in their business plans. We will build on experience in PR19 and	Clarification

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		consider common performance commitments for affordability and vulnerability at PR24. See chapter 3 and appendix 1.	
There is useful and innovative thinking that can be shared within companies and across sectors. A common set of measures, assumptions and language can only help to facilitate this. This will represent a challenge though.	TMS CCG	Noted. We have sought to draw on our stakeholders' expertise in this area in our revisions to the list of common metrics for our PR19 final methodology.	No change
The consultation does not set out the detail of how company performance on affordability will be measured or compared. Measures have limitations and weight should be given to how CCG's think companies are performing.	UU CCG	The CCG report will be an important part of the evidence that we will consider when assessing business plans. We are confirming that we will take account of the views of the CCG as well as the common metrics and qualitative and quantitative information provided by the company in our assessment of affordability. We will not provide the full level of detail on how we will assess company performance as part of the Initial Assessment of Business plans (IAP) in the final methodology so that we do not unduly restrict company approaches and to enable us to learn from innovative approaches companies might adopt.	Clarification
Ofwat and water companies should be tracking uptake of support by eligible customers as a performance metric as it is a measure of an effective outcome, rather than focusing on the availability of support.	Blueprint for Water, WaterWise.	Noted. CCWater tracks how many customers are receiving help through a range of affordability assistance measures offered by companies. Our revised list of metrics now focuses more	Minor change - no change to policy of common metrics, but significant changes to our list of common

Q2. Do you agree with our proposal to use information and measures on affordability, including possible common measures, to assess how a company performs against the five principles in its business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		on customer impact metrics rather than outputs such as customer awareness of affordability assistance measures and customers who are in debt who have a repayment plan.	metrics – see appendix 1 and table App4 of the business plan tables.
We expect some challenges in how the principles are used in practice. For example, on the accessibility principle, it may be challenging for Ofwat to qualitatively assess companies' plans in a consistent way and the extent to which comparisons can be made. E.g. the assessment of the number of customers who have received financial assistance does not necessarily provide a good indication of accessibility.	AFW	Noted. We will be assessing how companies' plans address affordability in the round. We consider it is better to look at the accessibility of assistance measures than not to examine the issue at all. See chapter 3: Addressing affordability and vulnerability and appendix 1. We have revised our set of metrics. The metric the company gives as an example is no longer on our list of metrics.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The methodology (and data tables) focus on households.	NWG Business	Our emphasis on "affordability for all" and "long-term affordability" includes affordability for business customers (although only the wholesale part of their bills in England). Our policies on cost assessment, outcomes and the cost of capital will improve affordability for all customers. However, we do need to look at assistance measures for residential customers as part of our affordability assessment.	Clarification

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?

In our draft methodology proposals we explained that our approach to vulnerability would be an explicit part of the price review for the first time at PR19.

In our draft methodology we proposed that we would require companies to propose bespoke performance commitments on addressing vulnerability. Our view was that this would require all companies to engage with their customers and CCGs on their future commitments in relation to vulnerability.

Most respondents agreed with this proposal, with some (UU, YKS, BRL, StepChange debt charity) strongly agreeing with this approach. Some stakeholders, including some that agreed with our approach, raised some issues for us to consider. These are set out in the table below.

For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 2.3 Summary of issues raised in response to affordability and vulnerability, question 3

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Support for a bespoke performance commitment on vulnerability			

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
A bespoke performance commitment will allow companies to better reflect local circumstances.	SRN, UU, WSX, YKS, TMS CCG	Noted.	No change
A bespoke commitment is appropriate as vulnerability is a new test area at PR19, but could evolve to a common vulnerability measure beyond PR19.	AFW	Noted.	No change
A bespoke commitment is more appropriate as there is not robust enough data to support a common performance commitment. There are wider policy changes (universal credit) that mean a better candidate for common metrics will emerge over time.	NES	Noted.	No change
There are diverse and changing reasons for vulnerability – a bespoke performance commitment will allow companies to better reflect that diversity.	SVT	Noted.	No change
The proposal allows companies flexibility to identify bespoke performance commitments to reflect the current stage of company's vulnerability journey.	SWB	Noted.	No change
The potential scale and nature of vulnerability will vary from company to company.	ANH	Noted.	No change
Allowing bespoke performance commitments will promote innovation in the sector as companies are likely to develop different approaches in this area.	NES, SEW	Noted.	No change
Bespoke performance commitments should encourage best practice and should be shared to the benefits of all customers.	SWB, TMS CGG	Noted.	No change

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
A bespoke performance commitment allows companies to identify the most appropriate measures based on customer preferences and expectations.	AFW, BRL	Noted.	No change
A bespoke performance commitment allows companies to identify the most appropriate measures to meet customers' needs.	WSX, YKS	Noted.	No change
A bespoke performance commitment will create the opportunity to co-create the performance commitment.	BRL, SEW	Noted.	No change
We support using qualitative and quantitative evidence to assess companies' approaches to vulnerability.	TMS, WSX	Noted.	No change
Application of a bespoke performance commitment			
You should not require a financial ODI on the bespoke vulnerability performance commitment.	TMS	Companies' bespoke performance commitments on vulnerability are subject to our standard approach to financial ODIs. This is that we expect a company to propose a financial ODI for its performance commitment or to explain to us why this is not appropriate.	No change
The detailed design of such measures, including whether these have associated rewards and penalties, will need to be subject to further consideration and customer engagement and support.	ANH		
The development of bespoke performance commitments should be left as a choice for companies, based on discussion with customers and other stakeholders. Note that vulnerability would likely appear in companies' frameworks anyway.	SES	We want to ensure all companies engage with their customers on vulnerability issues which our requirement for a bespoke performance commitment on vulnerability will facilitate.	No change
Both the qualitative assessment and development of bespoke performance commitments relies heavily on CCGs. They should be well placed to undertake this work, particularly those	WSX	Agreed, CCGs' independent reports will be a key part of the evidence that companies have appropriately engaged with customers and that feedback from customers has been	No change

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
members who are themselves from organisations with expertise in this area.		appropriately reflected in companies' proposals.	
Companies need to work with CCGs and other relevant expert bodies to make their measures as meaningful as possible. This planning period should be used to test a variety of methodologies.	TMS CCG	Agreed, CCGs' independent reports will be a key part of the evidence that companies have appropriately engaged with customers and that feedback from customers has been appropriately reflected in companies' proposals. We support companies testing their methodologies with their stakeholders.	No change
Metrics may not capture the nature of vulnerability			
It is challenging to come up with a meaningful and appropriate metric of a company's support for vulnerable customers (other than affordability measures). Vulnerability comes in many different forms, and the type of support companies may offer are numerous and varied. These customers are often 'hard to reach' with surveys.	WSH	A number of companies developed a bespoke performance commitment in relation to aspects of vulnerability at PR14. We are not expecting companies to develop a bespoke performance commitment that captures all aspects of vulnerability. Our assessment of companies' approaches to vulnerability will take account of the qualitative and quantitative evidence companies provide, not just the bespoke performance commitment.	Clarification
Dealing with customers at times of vulnerability is about staff exhibiting the right behaviours as much, if not more than, having the right policies.	PRT	Agreed. Our assessment of companies' approaches to vulnerability will take account of the qualitative and quantitative evidence companies provide, not just the bespoke performance commitment.	No change

Q3. Do you agree with our proposed option for requiring companies to propose bespoke performance commitments for addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		Our requirement for companies to propose a bespoke performance commitment on vulnerability will ensure all companies engage with their customers on vulnerability issues.	
Bespoke performance commitment should be supported with a common performance commitment			
Bespoke performance commitments on vulnerability should be complemented by a common performance commitment on all companies. The common performance commitment should be reputational only so that companies do not profit financially through assisting those customers who are in vulnerable circumstances or who have affordability issues. We propose a common performance commitment based on the percentage of consumers who agree the services offered by a company meet their needs and that all customers should be asked this question given the transient nature of vulnerability.	CCWater	We will not require companies to have a common performance commitment for vulnerability because we recognise stakeholders' concerns about the complexity and dynamism of vulnerability and that the challenges vary across companies. We consider that our strong emphasis on vulnerability in PR19 will sufficiently incentivise companies to address these issues effectively in their business plans. We will reconsider common performance commitments on vulnerability for PR24.	No change

Q4. Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?

In relation to vulnerability, we proposed in our draft methodology that we would ask companies to provide the following in their business plans:

- information relating to the three test areas set out in the 'vulnerability focus report', which can be qualitative information, quantitative or both;
- bespoke performance commitments on vulnerability; and
- information on a set of common quantitative metrics to enable customers and other stakeholders to understand more fully the nature of vulnerability issues, understand variations between companies and provide the sector with better information to identify ways of improving approaches to vulnerability in the future.

We explained that we were proposing not to look at the common metrics individually when assessing companies' approaches to vulnerability, but would look at them as a set alongside other qualitative and quantitative information provided by companies.

The majority of respondents supported our proposal to use common metrics in our assessment of companies' approaches to vulnerability in business plans. However, there were some mixed views (TMS, SEW, CCWater) and some disagreed with our proposal (WSX, SES, PRT).

Many respondents suggested the common metrics we had proposed might not have been sufficiently clearly defined, targeted enough, or could incentivise companies to act against the interest of customers. Many respondents suggested alternative metrics that would be more targeted and measure the impact of assistance measures on customers. We discussed our common metrics for vulnerability with stakeholders at a workshop on 25 October 2017, and with the CCG Chairs on 8 November 2017.

We summarise the issues raised below, explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals for our PR19 final methodology.

Table 2.4 Summary of issues raised in response to affordability and vulnerability, question 4

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Support for using measures			
We support the use of qualitative measures	SVT, WSH, UU CCG	Noted.	No change
Support for using common measures			
Sharing this information publicly will encourage companies to consider the reputational impact of the data and take steps to improve performance where necessary.	NES	Noted.	No change
Quantitative measures should form a subset of the evidence needed to understand companies' effectiveness in supporting customers in vulnerable circumstances.	UU	Agreed. Our assessment of companies' approaches to vulnerability will take account of all the qualitative and quantitative evidence companies provide.	Clarification
The metrics need to be developed in collaboration with wider stakeholders.	ANH, YKS, TMS CCG	We have worked with our stakeholders since our draft methodology proposals to revise the list of common metrics for vulnerability. This has resulted in significant changes to the metrics on our list.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Companies should work together as much as possible to share learning and best practice	TMS CCG	Noted	No change
The common metrics could form a basis for common performance commitments on vulnerability in the future.	ANH, NES, TMS	Noted. We will build on experience in PR19 and reconsider common performance commitments for vulnerability at PR24.	No change
Issues raised on our approach to common metrics			
The common measures need to be clearly defined for them to be meaningful.	TMS, WSX	We consider our common metrics will provide useful information on company approaches to support customers in circumstances that make them vulnerable. When we assess companies' approaches to vulnerability, we will use the common metrics alongside other sources of information, including qualitative information. The CCGs' independent reports will be a key part of the evidence that we will consider. Following feedback from stakeholders on our proposed set of metrics, and following our stakeholder workshop on 25 October and input from CCG Chairs, we have significantly amended our set of common metrics to be more targeted and to measure the impact of assistance measures on customers.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The proposed common measures are unlikely to reveal how effective schemes are at supporting customers or how local differences in need are being addressed. The Vulnerability Focus Report set out that support for those in vulnerable circumstances needs to be tailored to local conditions to ensure it is effective, therefore substantial weight should be placed on independent bodies' assessment of companies' affordability plans, including but not limited to the views of CCGs.	UU		
The usefulness and inclusion of common measures is questionable particularly those proposed in the consultation because it is very difficult to produce them without applying some sort of common label to customers.	WSX		
The onus should be on the company to provide evidence of how vulnerability is being addressed in its	SES		

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
plan. Vulnerability assistance options need to be clearly defined.			
You should take care to avoid driving behaviour by companies that is not in the interest of customers.	WSH		
A common set of definitions can help with understanding the relative scale of companies' vulnerability schemes. But they are unlikely to reveal how effective those schemes are at supporting customers or how local differences in need are being addressed. Substantial weight should be placed on independent bodies' assessment of companies' affordability plans.	UU CCG		
Any quantitative assessment should be undertaken alongside a qualitative assessment of the range of help offered. This ensures both breadth and depth when assessing vulnerability in company's business plans. You need to consider the range of support / social tariffs that are in place across the industry vary and are based on customer research for what should be offered and funded within each region. A simple comparison of customer numbers may not be appropriate across the industry. It is not evident within the methodology that support for vulnerability service offerings needs support from the wider customer base due to cross subsidy issues; therefore we propose it is measured and forms part of the vulnerability assessment by Ofwat.	SEW	When we assess companies' approaches to vulnerability, we will use the common metrics alongside other sources of information, including qualitative information. The CCGs' independent reports will be a key part of the evidence that we will consider. We have significantly amended our set of common metrics to be more targeted and to measure the impact of assistance measures on customers.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Where information, such as the percentage of customers specifically registered for services is held, comparisons can be made. Things like the number of customers contacted by the company about eligibility for vulnerability assistance is much harder to capture as this will often not be the principle reason recorded for a contact, but will happen as a result of a contact having been made.	PRT	When we assess companies' approaches to vulnerability, we will use the common metrics alongside other sources of information, including qualitative information. The CCGs' independent reports will be a key part of the evidence that we will consider.	Minor change - no change to policy of common metrics, but significant changes to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
Issues raised on specific common metrics proposed – the proportion of eligible customers receiving support			
This metric could result in companies changing and narrowing their eligibility criteria.	NES, YKS	Following feedback from the consultation we have dropped this metric from our list of common metrics for vulnerability. We have significantly amended our set of common metrics to be more targeted and to measure the impact of assistance measures on customers.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The definition of 'eligibility' is important and we are not currently clear on how it would be determined.	SWB, TMS, WSH, WSX, BRL		
It is difficult to provide a robust estimate of 'eligibility'.	SES, CCWater		
This metric does not reflect the transient nature of vulnerability	SES, SWB		
This metric lends itself to a more defined scheme like the PSR.	WSH		
Issues raised on specific common metric proposed – the number of customers contacted by the company about eligibility for assistance			
The definition of a 'contact' needs consideration.	SWB, WSH		

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
This metric could result in poorly targeted, or mass communications that do not take account of the quality of the contact.	NES, SWB, YKS, SES, UU CCG	Following feedback from the consultation we have amended this metric to be the proportion of "Customers aware of the non-financial vulnerability assistance measures offered." We recognise that measure proposed may not take account of the impact of the communication, may allow companies to not acting in the interest of customers or the measure being inconsistently applied. We have amended the proposed set of metrics to be more targeted and to measure impact of support. When we assess companies' approaches to vulnerability, we will use the common metrics alongside other sources of information, including qualitative information. This will allow companies to provide evidence on the quality of the support provided.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The metric might not be a meaningful - we advertise support for customers in vulnerable circumstances on or with every bill, in magazines, in bespoke leaflets and on our websites.	WSX		
This metric does not measure whether customers have read and understood the information.	CCWater		
The metric puts the emphasis on communication about the PSR rather than the quality of support provided.	BRL		
Issues raised on specific common metric proposed – percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance			
We support the development of appropriate common measures, which might include 1. Tracking customer satisfaction (through C-MeX) for customers in vulnerable and non-vulnerable circumstances. 2. Tracking complaints from customers on our priority services register and those eligible for social tariffs. CCWater track measures and may have suggestions.	NES	Noted. We have reflected on stakeholders' comments and amended our proposed metrics. In particular, we have dropped the metric "percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance" and replaced it with "Customers satisfied that the services provided by their company are easy to access".	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
This information will be picked up through C-MeX.	WSX	Customers receiving vulnerability support will only form a subset of the information collected through C-MeX and this information will not be available in time for companies' business plans. We consider there is still a need for us to collect information on customer satisfaction with vulnerability assistance, but we have amended the metric to "Customers satisfied that the services provided by their company are easy to access" following feedback from stakeholders.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
It is not clear how to survey this customer group in a non-intrusive way.	WSH	We have reflected on stakeholders' comments and amended our proposed metrics. In particular, we have dropped the metric "percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance" and replaced it with "Customers satisfied that the services provided by their company are easy to access".	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
The sample size would be very small or require significant expenditure to achieve a robust sample size which would not drive a better service for customers.	SES		
The focus on the customers' experience and satisfaction with the support received will create the right incentive for companies to recognise the different needs of customers and the quality of services they receive. This metric has the greatest opportunity for the involvement of wider stakeholders, such as CCWater and consumer advocate groups, to provide independent administration and oversight of satisfactions surveys.	YKY	Noted. Collaborative working to support customers is something that we advocate and have encouraged companies to progress with. We have changed the metric from "percentage of customers receiving vulnerability assistance option(s) who are satisfied with the assistance" to "Customers satisfied that the services provided by their company are easy to access", but maintained the focus on satisfaction.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
There is a benefit in asking vulnerable customers in receipt of help how satisfied they are with the help they received. We propose that further customer research and work with the CCG, CCWater and the industry would establish a customer satisfaction baseline.	TMS	Noted. Collaborative working to support customers is something that we advocate and have encouraged companies to progress with. The work suggested here may not have sufficient time to deliver results to feed into companies' business plans.	No change
Alternative common metrics of vulnerability proposed by respondents			
It would be more appropriate to encourage regular reviews of PSRs to ensure customers on it are receiving the right level of help to meet their needs. We have no concerns with seeking views from customers receiving vulnerability assistance, this could be done at the time of any data cleanse calls such that it is not overburdening the customer.	SWB	We have reflected this comment in our revised set of metrics. We now have the metric "Customers on SAR/PSR contacted over the previous two years to ensure they are still receiving the right support" in our list of common metrics.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
Achievement of BSI accreditation would be a suitable qualitative measure for priority services and has the potential to be a common measure in future controls.	TMS	Noted - this could form part of a company's qualitative evidence on how it is addressing vulnerability.	No change
Companies should work with their CCGs, charity representatives, CCWater, customers and third parties on appropriate measures and commitments that protect their most vulnerable customers.	TMS	Our approach to customer engagement and vulnerability encourages companies to work with a broad set of interested stakeholders to design the most effect assistance for their customers. Companies are welcome to propose further bespoke performance commitments on vulnerability and further quantitative metrics to support their approach to addressing vulnerability in their business plans following customer engagement.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		Following feedback from stakeholders on our proposed set of metrics, and following our stakeholder workshop on 25 October and input from CCG Chairs, we have significantly amended our set of common metrics to be more targeted and to measure the impact of assistance measures on customers.	
One option for enabling more frequent qualitative reviews of companies' support for vulnerable customers is to ask companies to publish an annual report on the support they offer. United Utilities published an annual report in September 2017.	UU	We welcome companies being open and transparent with customers and stakeholders about the support that they offer. Where companies do this, it could form part of a company's qualitative evidence in their business plan.	No change
You could measure the increase on a company's Priority Services Register over time would be an alternative to number of customers eligible to receive support. Measuring the awareness of the PSR would be an alternative to the customer satisfaction with assistance received.	WSX	We have reflected this comment in our revised set of metrics. We have included metrics on number of "Customers on Special Assistance Register/ Priority Service Register (SAR/PSR)" over time and "Customers aware of the non-financial vulnerability assistance measures offered"	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
You could calculate the number of customers assisted as a proportion of the total residential customer base (either as a percentage or on a per 10,000 customer basis).	YKS	We have included "Customers on Special Assistance Register/ Priority Service Register (SAR/PSR)" as a percentage of the customer base on our revised list of common metrics.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
A measure around the PSR could best address vulnerability. Satisfaction of customers who have been	BRL	A number of the revised list of common metrics relate to the PSR.	Minor change to our list of common

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
in contact about assistance options (both those who take up the scheme and those that didn't).		We considered measuring the satisfaction of those on assistance schemes but recognise this may be difficult given the transient nature of vulnerability, and that some customers may be hard to reach. To measure satisfaction, we have included common metrics on: "Customers satisfied that the services provided by their company are easy to access" and "Customers on SAR/PSR contacted over the previous two years to ensure they are still receiving the right support".	metrics – see appendix 1 and table App4 of the business plan tables.
Companies could measure the extent to which water companies and other utilities and stakeholders share information on vulnerable customers.	UU CCG	Collaborative working to support customers is something that we advocate and have encouraged companies to progress. Companies should provide evidence on how they are sharing information to benefit customers who are in circumstances that make them vulnerable as part of their qualitative evidence in their business plans.	No change
Stepchange proposed 3 different options for common metrics: 1. The percentage of customers a supplier identifies as vulnerable against expectations from benchmarks like national datasets / other sectors 2. The percentage of vulnerable customers experiencing payment difficulties 3. The percentage of people experiencing payment difficulties who are amongst	Stepchange	We welcome proposals for metrics for addressing vulnerability. In relation to metric 1, companies could look at information from other datasets to inform their understanding of their customer base. Metrics 2 and 3 would provide useful information on the interlinkage between affordability and vulnerability of customers. However, we have revised our list of common metrics to focus on the impact of the support companies are providing	No change

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		customers to their customers, following feedback from our stakeholders.	
You should measure uptake of support by eligible customers as it is a measure of an effective outcome, rather than focusing on the availability of support	Waterwise	We have reflected this comment in our revised set of metrics. We now have common metrics on "Customers on Special Assistance Register / Priority Service Register (SAR/PSR)" and the support services provided through these.	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.
CCWater proposed a number of different options for common metrics: • The percentage of consumers aware of the additional help available would track how successful companies' have been in engaging effectively with consumers. It is more beneficial to measure the effectiveness by measuring awareness e.g. was the message received and understood by the consumer. We already track this in our annual Water Matters research. • The percentage of consumers satisfied that their company's services are easy to access would cover all consumers and track whether they believe that companies are designing and implementing inclusive services. We are also considering tracking this in our annual Water Matters research.	CCWater	We welcome proposals for metrics for addressing vulnerability. We have reflected these proposals in our revised set of metrics. We have included: "Customers aware of the non-financial vulnerability assistance measures offered"; "Customers satisfied that the services provided by their company are easy to access"; and "Customers on Special Assistance Register/ Priority Service Register (SAR/PSR)".	Minor change to our list of common metrics – see appendix 1 and table App4 of the business plan tables.

Q4 - Do you agree with our proposed option for using measures in our assessment of companies' approaches to addressing vulnerability in their business plan?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
• CCWater track annually the number of consumers per 10,000 connections receiving non-financial vulnerability assistance (priority services).			

3. Delivering outcomes for customers

Q1. Do you agree with our proposals for common and bespoke performance commitments?

In the draft methodology we proposed that companies should develop a balanced package of performance commitments so that:

- stakeholders could more easily compare and challenge the stretch in companies' proposals in key areas;
- companies were able to develop innovative performance commitments that reflected their customers' priorities; and
- stakeholders would have trust and confidence in the outcomes framework.

In order to deliver this balanced package, we proposed in the draft methodology that companies should have both common and bespoke performance commitments.

A majority of respondents agreed with our approach. However there were many comments and views on the definitions of and reporting on the common performance commitments. Some respondents considered that the balance of common and bespoke performance commitments was weighted too much towards common performance commitments.

This section outlines respondents' views and our responses on outcomes that are not covered in appendix 2 (delivering outcomes for customers). The sub-questions we refer to in the table were included in the Water 2020 draft methodology response template.

Table 3.1 Summary of issues raised in response to outcomes, question 1

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Q1a - Do you agree with the common PCs (1 - 14)?			
CRI – other responses on CRI are covered in appendix 2			
For CRI, as with MZC, we would propose a penalty only ODI. As every compliance failure (or event) represents a failure of the company to meet their statutory obligations it is not appropriate to offer rewards. As such, in terms of a target, companies should aim for CRI (and ERI) scores of zero and thus aspire to continuous improvement and results of at least at a level that is equal to or below the national average.	DWI	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.	Clarification
The definition should include a full list of parameters.	WSX	We are working with DWI to put a full definition of CRI on our PR19 metric definitions webpage.	Clarification
CRI is only available after APRs	WSX	We are working with DWI on whether CRI can be made available before companies submit their APRs.	Clarification
We wondered why a performance commitment on water quality was included when it is a DWI requirement.	UU CCG	We have retained CRI as a common performance commitment because water quality is a top customer priority. We agree that it is a DWI requirement, which is why outperformance payments are not appropriate for this performance commitment.	Clarification / No change
The company had a concern that the proposed above ground asset health metrics overlap with CRI so there could be double counting of each failure.	SEW	We acknowledge that there may be some overlap between the common performance commitments. Companies can calibrate their ODIs for any overlap between the performance commitments, if they consider they would involve undue outperformance payments or underperformance penalties,	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		should they outperform or underperform on related performance commitments.	
Whilst we are happy to provide projections for a further ten years, it needs to be appreciated that there will be considerable uncertainty over such a period. It will not be possible to project the value for CRI to 2034-35 as current we only have one data point.	WSX	We understand the DWI is working with water companies to backcast CRI data for a number of years. For CRI we would expect the long term projections of performance to be zero as it is a statutory obligations.	No change
Supply interruptions - other responses on supply interruptions are covered in appendix 2			
The choice of options for determining stop/start times for interruptions may create the situation where investment into more sophisticated monitoring may be discouraged, as this would potentially suggest poorer performance against customer contact reporting. This may also discourage the development of an approach to determine the duration and extent of interruptions.	PRT	We consider that since companies should apply the precautionary principle, using the start and finish times and the properties affected that will give the highest supply interruption value in the event of uncorroborated or conflicting data, this issue will not disincentivise companies. We expect further developments to definitions to continue over the period ready to be implemented at PR24.	No change
Interruptions of supply specifically exclude interruptions arising from the loss of strategic trunk mains which may have a significant impact on supply continuity. The level of investment to manage the risk of trunk main failure is inadequately reflected in current common performance measures.	PRT	We are not aware of any exclusions. We are in the process of commissioning a joint project with Water UK to improve the consistency of the reporting on and definitions of a number of the common performance commitments. This project will look at supply interruptions.	No change
Per Capita Consumption - other responses on PCC are covered in appendix 2			
These respondents consider that we should be more explicit about the interaction of PCC with the new definition of leakage. It should be noted that the new definition of leakage will change the reported performance for PCC, due to the water balance being re-estimated. A similar process for	ANH, PRT, NRW, Blueprint for Water, UU	We have considered the interaction that PCC has with leakage and the overall water balance. We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
setting performance commitments during the transition period of leakage might also be required for PCC.		commitments. This joint project covers PCC and will seek to understand the impact of moving to the new definition of leakage has on the calculation of PCC. We also note that the WRMP guidance also requires companies to set out what impact the new definition of leakage will have on the water balance (such as PCC and non-household use). We have set out in appendix 2 under 'Setting performance commitment levels for metrics that lack a continuous times series of historical data' how companies should set their performance commitment level in such cases. Companies should follow this guidance in setting PCC.	
The company is considering proposing a bespoke performance commitment to capture water savings achieved through water efficiency and metering programmes as we have done in PR14	WSX	We welcome companies proposing additional bespoke performance commitment measures, where these are supported by customers. When proposing their bespoke performance commitments companies need to take account of any overlap with the common performance commitments.	No change
The company questions whether it is appropriate to have the same target across the industry. It considers that targets for PCC should be set according to a company's circumstances, whilst of course being stretching.	PRT	In the draft methodology we proposed that companies set performance commitments for PCC following engagement with their customers and stakeholders while challenging themselves against a range of techniques for setting performance commitment (e.g. cost benefit analysis and comparative information). These techniques allow companies to propose company-specific commitment levels that take into account company-specific circumstances.	No change
These respondents wanted clarification over what number of decimal places PCC is being reported to. The use of decimal places for PCC reporting indicates a false level of accuracy	PRT, Blueprint for water, Water Wise	We confirm that companies should report PCC to 1 decimal place. While we understand the concern that a company has in providing information to this degree of accuracy, it will enable us	Clarification

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
therefore it would be preferable to round PCC to the nearest integer for reporting purposes.		to better understand how the company is performing over the price control period.	
There is some ambiguity in the definition for PCC which should be removed to better ensure consistent reporting. References to 'customer' should be avoided and instead the definition should refer to 'population' or 'person'.	SES	We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments. This joint project covers PCC.	No change
Pollution incidents and non-infrastructure pollution incidents - other responses on these metrics are covered in appendix 2			
Performance commitment 14 'asset health: wastewater asset failure causing pollution' overlaps with PC 8 'wastewater pollution incidents'. Both have the same service impact on the customer and 14 is a subset of 8. As a result, there is a risk of too much emphasis on pollution as this is covered by the two performance commitments mentioned above in addition to Environment Agency (EA) regulation. In contrast, wastewater quality (river quality or consents) is not represented in the common performance commitments. This means that only acute wastewater issues are covered and chronic issues are not. This imbalance is emphasised when comparing wastewater asset health to water asset health where there are separate infra and non-infra focused performance commitments	SWB	As described in appendix 2 we have replaced "Non-infrastructure wastewater asset failure causing pollution incidents" with "Treatment works compliance".	Minor change
The inclusion of category 4 pollution incidents in this measure is inappropriate (Category 4 incidents are no-impact events and the EA does not collect or validate this data, or use it to report performance as they do with categories 1, 2 and 3)	EA, Natural England, TMS	As described in appendix 2 we have we have replaced "Non-infrastructure wastewater asset failure causing pollution incidents" with "Treatment works compliance".	Minor change
Wastewater resilience - other responses on this metric are covered in appendix 2			

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
This metric needs to include flooding of clean not just wastewater assets. Some respondents were disappointed that we did not have a common performance commitment dedicated to the resilience of the environment or ecosystems or that we did not include them in the wastewater resilience metric. Ideally the metric should include threats other than high-intensity rainfall.	SWB WSX, Blueprint, WWF Safe and SuRe	We agree that none of our options looked at the resilience of the wastewater system comprehensively, and are focused on an important single hazard, a severe (1-in-50 year) storm for wastewater and a severe drought (1-in-200 year) water. This reflected the difficulty of developing comprehensive metrics covering all aspects of resilience. We welcome work on more comprehensive metrics building on the work companies have carried out up to now. Companies should propose bespoke resilience metrics to cover any additional areas they consider particularly important for their customers or for their circumstances, which could include the flooding of water assets or environmental resilience.	No change
For flooding, disaggregated measures of both magnitude and duration of any negative impacts are required.	Safe and SuRe	The current wastewater resilience metric is a positive initial step in the ongoing development of resilience metrics. Safe and SuRe's proposal sounds an interesting area to consider for future development.	No change
Metric 1 essentially implies rainfall events beyond 1:50 RP are 'extreme' and therefore beyond an agreed (funded) level of service. So this type of approach could assess the magnitude of flooding (numbers affected) – a key resilience performance metric. It does not capture the duration of flooding which is a key resilience performance metric. The term risk should be avoided. Metric 2 could potentially give an indication of CSO operation frequency under extremes. It would need to be disaggregated into magnitude and duration as these are key to understanding environmental impact. Metric 3 is a properties metric (ie % disconnection) rather than a performance metric; Metric (3) in particular does not	Safe and SuRe	We have selected the further developed metric 1 as a common wastewater resilience performance commitment. We agree it does not incorporate duration of flooding although the calculation of the metric involves taking 3 time periods and modelling them to select an appropriate one. As noted above we acknowledge that this metric is not fully comprehensive but does reflect a lot of work by the industry to produce a workable metric in time for PR19. We agree that our options 2 and 3 were lagging indicators and less focused on the resilience of wastewater systems. However, companies can use them as bespoke performance commitments if they reflect particular challenges they face or their customers' preferences.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
measure negative impacts (performance) and may not be indicative of resilience.			
Drought resilience - other responses on this metric are covered in appendix 2			
Agree with the proposed measure. ANH and SEW note the benefits of its simplicity. Propose to work closely with Ofwat to support further development.	ANH, EA, PRT, SEW	Support has been noted. An industry group has further developed the definition and reporting requirements since our draft methodology proposals.	Clarification
Respondents highlighted that there is no standard definition for how a 1-in-200 year drought should be estimated for modelling purposes, which risks inconsistency and uncertainty in approaches between companies. More guidance would be useful.	BRL, NRW, SVT, SWB, WSH, WSX, A. Lambert and D Pearson	An industry group has worked on the definition of a confidence grading to reflect the sophistication and robustness of the 1-in-200 year drought estimate, and then the sensitivity of the output (how much has to change for a move from no risk to risk or vice versa) – see the metric definition. We have clarified that the assumptions used to calculate the 1-in-200 year drought supply-demand balance forecasts should also be consistent with companies' WRMPs (where applicable).	Clarification
There is a need for normalisation when comparing this measure (to address issues like population density and divergence in geography).	SWB	The risk is reported as both the absolute number of customers at risk but also as a normalised proportion of total customers at risk.	No change
The achievement of supply-demand balance under this measure should span multiple AMPs.	TMS	The metric reflects that operational resilience is important both now and in the long term. An element of the metric includes a 25-year forecast of performance over this period.	No change
The population at risk from a drought in a zone is everyone or no-one. This could overstate the metric for companies with a low number of zones as it is likely that not all customers within a zone would face the same level of restrictions. This raises concerns about improving the connectivity of our network and therefore its resilience and	SES, SSC, WSX	One of the benefits of this metric is that it is relatively easy to understand. The simplicity does mean that the metric treats everyone in a water resource zone as at risk for severe restrictions in a zone or not. However, water resource zones are	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
performance under this metric. Also small improvements in resilience will not be captured by this metric. WSX proposed the metric at a smaller geographic area, such as a drought management zone level to more reflect how they would manage a 1-in-200 year event. SSC and WSX proposed alternatives to the simple pass/ fail aspect of the drought resilience metric.		meant to reflect the areas over which water supply risks are approximately the same, so this approach is reasonable. Both the alternative proposals involve looking at the deficit in a 1-in-200 year drought and reporting it as a proportion of demand or a population equivalent. These make the metric more complex to both calculate and report on.	
We would like to see greater specificity in the common performance commitment on the risk of exposure to severe supply restrictions and the duration.	WWF, CIWEM, Safe and SuRe	We acknowledge that this metric looks at risks of severe restrictions at water resource zone level (see our response immediately above). We also acknowledge that the duration of potential supply restrictions is important. To keep the metric simple to understand and practical for the industry to calculate we have not incorporated duration into the metric at this stage. We welcome more work on comprehensive metrics in the future and are keen to support this.	No change
Respondents welcome the introduction of a risk based metric for drought, but believe that the proposed metric for a specific 1-in-200 year drought is not appropriate in the Welsh context	NRW	We acknowledge that there is not a requirement for companies to be resilient to a 1-in-200 year drought in Wales, or to even test this level of resilience. The design of this metric aims to give a comparative view of companies' drought resilience which is why the industry has agreed to using a 1-in-200 year drought for the purposes of this metric. This does not impact companies' ability to use different levels of service for their water resources planning.	Clarification
The metric will be complex to calculate, including the requirement of a full 25 year forecast for a 1-in-200 year event and whether this is necessary.	NRW	The metric has been progressed as part of an industry group. Since our draft methodology proposals, as part of these discussions, Welsh Water indicated that they consider that 25-year forecasts would be feasible for this metric.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
We are concerned at the proposal to simply apply a standard of supply threshold in terms of "severe supply restriction", without reference to the environmental impact of meeting that standard, fails to reflect customer/wider society interests in protecting the water environment. Basing the evaluation on Water Resources Management Plans (WRMPs) does offer some comfort around baseline environmental compliance. However, it will not differentiate those companies who invest to minimise the environmental impact of drought, from those who will rely heavily on drought orders/permits that exacerbate harm. We believe this loophole could be addressed by tightening the definition of the metric to exclude the population that will rely on enhanced abstraction (drought orders etc.) to meet the 1:200 standard of service.	Blueprint	We want to keep this metric as consistent with the water resource planning process as possible. The outputs should be consistent with the reference level of service testing undertaken by companies and any assumptions made in this analysis. We want to avoid two different processes reporting different results to customers in relation to their risk to drought.	No change
Is Ofwat aware of the damage that rota cuts and standpipes cause to distribution systems? Why not base the resilience metric for water resources on a measure of persistent continuous failure to meet standards of service for pressure at the delivery point, which would be more meaningful – low pressure in the mains (with standpipes, in extremis) rather than no pressure in the mains with standpipes as currently written.	A. Lambert and D Pearson	Using severe restrictions, such as standpipes or rota cuts, is consistent with the reference level of service testing companies carry out in the water resources planning process.	No change
Asset health common PC: Mains Bursts			
We agree that the Ofwat proposed 'burst rate' indicator is better than the current indicator ('total number of bursts') as it allows comparison between companies. However, we	TMS	We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments. This project includes main bursts.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
consider that other measures could be considered, for example, 'reported and detected bursts ratio' (%).			
Asset health common PC: Unplanned outage			
The common performance commitment on unplanned outage overlaps with supply interruptions and companies could be penalised twice. We would prefer it to be non-financial or replaced with an alternative of the Security of Supply Index (SOSI).	SRN	We acknowledge that there may be some overlap between the common performance commitments. Companies can calibrate their ODIs for any overlap between the performance commitments, if they consider they would involve undue outperformance payments or underperformance penalties, should they outperform or underperform on related performance commitments. The SOSI measure primarily looks at the risk to supply in a drought, while this metric on unplanned outage is to provide insight into asset health performance.	Clarification
Several responses highlighted that unplanned outage should be limited to asset failure and exclude weather events or third party failures UU suggested that unplanned outages as a result of asset failure would be a better measure of asset health. This would exclude outages due to issues which are not asset related e.g. electricity supply failure.	AFW, BRL, SRN, UU	We want to ensure that companies are incentivised to mitigate the risk of service failure during severe weather or as a result of third party failures for example. Therefore we do not think this metric should be limited to asset failure.	Clarification
This metric needs to be consistent with the UKWIR / EA definition for outage as used for WRMPs.	BRL	We are working with industry to improve the metric definition. As part of this work (and the draft methodology definition) we will consider the definition used for WRMPs.	Clarification
Outage needs to be compared against total company Deployable Output (DO) or total treatment capacity.	BRL	The metric does this, as it reports total unplanned outage (lost production capacity) as a proportion of total company production capacity.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Shutdowns due to raw water quality (e.g. turbidity) should be excluded as they occur to reduce the risk to drinking water quality and would affect planned approach to water quality management. WSX stated that the inclusion of raw water quality could incentivise treatment solutions	PRT, WSX	As part of the ongoing industry work on the definition, we consider that it is appropriate to exclude planned shutdowns of works to manage raw water quality from the metric.	Minor change
There is uncertainty about the metric as an outcome as there will not always be an impact on service. At certain times companies can legitimately choose to delay fixing some operational outages as part of least cost plan for operating our assets.	SES, WSX	Although each unplanned outage may not have a direct impact on customers, some of them will. A high level of unplanned outage can mean that customers are at a heightened risk of a direct impact. The measure is also used for insight into the overall health of the asset base.	No change
Companies are penalised when unplanned outages occur during times of low demand with no increased risk to the customer. Companies can operate with a higher managed outage allowance in winter when demand is low compared with the summer, in order to operate as efficiently as possible.	ANH, WSX	Unplanned outage is a measure of asset health and issues relating to asset health do not necessarily always directly impact on outcomes for customers. In the long term it is in the interests of customers that companies maintain their asset health.	No change
Guidance will need to be prepared to ensure companies include / exclude data as appropriate and ensures accuracy. TMS specifically wanted more guidance on the definition of the capacity of works.	SEW, TMS	We are working with industry to improve the metric definition, which will include more information on the maximum production capacity.	Clarification
Unplanned outage interacts with planned work and can cause perverse incentives, such as a reluctance to remove assets for planned refurbishment.	ANH	Planned refurbishment should not be included in the unplanned outage metric. See the definition on our PR19 metrics webpage.	Clarification
Common PCs in general			

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Some ways companies operate exposes customers to more risk than others. For example some may invest in service reservoirs to provide security against loss of water treatment works and booster stations. Some may invest in interconnections. The common performance commitments as they are do not reflect this historic investment to manage risk.	PRT	The 14 common performance commitments cover a large element of companies' service provision. We would expect a company that has invested well to manage risks to benefit from its investment through relatively good performance across the set of common performance commitments as a whole over time. Companies are able to propose bespoke performance commitments to reflect their customers' preferences and the particular challenges companies face.	No change
Q1b) - Do you agree with our approach to asset health outcomes?			
Our reading of the methodology documents leads us to believe that you have an expectation that common performance commitments on asset health will result in improvements, something that we do not think is necessarily appropriate since it focuses on outputs rather than outcomes. The consultation could be interpreted as requiring performance commitment levels for asset health measures to assume improvement from current levels and we would welcome greater clarity on this.	WSX	We are not differentiating asset health common performance commitments from the others, in terms of the approach to setting performance levels. We consider that there is scope for companies to challenge themselves to improve their asset health performance, given the improvements we have seen in the sector's performance since privatisation and that at PR14 many of the asset health performance commitments involved stable performance rather than improvements. Our approach to setting performance commitment levels allows companies to explain the approaches they have taken based on customer research and other evidence if they feel they cannot address the challenges we have set companies in relation to setting performance commitments. The asset health common performance commitments and improvements to them are important for services to customers and the environment over the long term.	No change
We do feel this is an area where additional metrics need to be used to enhance the understanding of the health of our assets.	AFW	Companies should supplement the common performance commitments on asset health with bespoke performance commitments where they consider this is appropriate. We are	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		requiring companies to cover resilience with bespoke performance commitments - see appendix 2.	
We remain unconvinced that asset health metrics represent outcomes and our preference is to exclude them from the outcomes framework (so no rewards or penalties would be on offer) but keep them in the annual reporting requirements. This would provide Ofwat and other stakeholders with information to allow monitoring of our commitment to maintain serviceable assets but prevent double counting the end impact to customers or, at worst, lead to an incentive to focus on the wrong areas.	SES	Asset health performance commitments are needed because asset health is a key area of network and service resilience that is important for delivering good quality services to customers in the long term. We acknowledge that there may be some overlap between the common performance commitments. Companies can calibrate their ODIs for any overlap between the performance commitments, if they consider they would involve undue outperformance payments or underperformance penalties, should they outperform or underperform on related performance commitments. Underperformance penalties on asset health metrics protect customers and align customer, management and shareholder interests by increasing their focus on maintaining and improving asset health.	No change
The asset health performance commitments move the focus away from outcomes. While asset health is clearly important, the measures seem to indicate a return to inputs / outputs which the ODI framework was intended to move the industry away from.	SWB	Asset health performance commitments are needed because good asset health is a key area of network and service resilience that is important for delivering good quality services to customers in the long term. They also provide customers and stakeholders with reassurance that companies are maintaining the health of their assets.	No change
Introducing a long list of bespoke measures is a positive step but the list is very focused on existing built assets. We would	EA	We welcome further development of natural asset and natural capital metrics and note that some are proposed as options in	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
like to see some examples of natural asset and natural capital type metrics included in the asset health long list. We would like to see Ofwat develop proposals for helping customers to better understand this area of performance.		the examples of bespoke environment performance commitments in appendix 2.	
'Performance' across the industry on these measures will vary and so it should be recognised that the levels are not comparable across the industry; an upper quartile or any form of relative 'performance' target therefore would not be appropriate. Companies have maintained their assets in at least a stable condition as required within their licences. Stable for each company is different and is defined with reference to specific historic performance commitments – this is appropriate and reflects a multitude of different historic and regional factors as well as flexible (but legitimate) asset maintenance strategies.	SEW	We are not differentiating asset health common performance commitments from the others, in terms of the approach to setting performance levels. We consider that there is scope for companies to challenge themselves to improve their asset health performance, given the improvements we have seen in the sector's performance since privatisation and that at PR14 many of the asset health performance commitments involved stable performance rather than improvements. Our approach to setting performance commitment levels allows companies to explain the approaches they have taken based on customer research and other evidence if they feel they cannot address the challenges we have set companies in relation to setting performance commitments. The asset health common performance commitments and improvements to them are important for services to customers and the environment over the long term.	No change
When looking at asset failure, surely a set of commitments should be judged over 10 years not 5? Asset renewal and maintenance is not a 5 year process. Why can't this element of the determination be broken out so that capital and asset maintenance can be managed over a 10 year cycle, or longer, this could potentially allow companies to work with the supply chain to develop work programmes that avoid the 5 year boom and bust cycle? This would help the industry maintain and recruit skills and skilled people, allow a	British Water	We expect companies to set performance commitment levels for all performance commitments for five years, and projections for at least a further ten years. Companies should expect us to continue to incentivise the outcomes that are reflected in the 14 common performance commitments in the long term. This will incentivise companies to plan to improve their performance on these outcomes to ensure	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
sustainable supply chain which will generate programme efficiencies associated with steady state operation and innovation in delivery methodology.		they can deliver good-quality services to customers over the long term.	
We think that the 'low pressure' measure on the long list would be improved if it took account of the length of time a property remains on the low pressure register, which we consider is a better representation of customer service than a metric that takes a snapshot in time.	TMS	We agree that this proposal could be an improved measure on properties on the low pressure register. It will require further work to develop this metric for PR19 and our focus is working with the industry to improve the consistency of the definitions of the common performance commitments. If companies have the data for this metric they can use it to monitor their performance.	No change
At the consultation stage we made the case turbidity was not, for Portsmouth Water, a measure of asset health. This has not been acknowledged.	PRT	We have addressed this issue in appendix 2. As part of our ongoing work on the definition of unplanned outage we consider that it is appropriate to exclude planned shutdowns of works to manage raw water quality from the metric. We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments. This project will look at unplanned outage.	Minor change/clarification
There is a need to establish mature data and common methodology on indicators especially new ones.	SRN	We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments. We recognise that some of the new metrics will have limited time series data available. In appendix 2 we provide guidance on setting performance commitment levels for metrics that lack a continuous times series of historical data.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Companies may have interpreted the standard guidance in different ways such on collapses, mains bursts.	SVT	We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments. This will look at the definitions of sewer collapses and mains bursts.	No change
Expressing the asset health penalties as a percentage of RoRE will not be easy for customers to understand. A view on comparative performance with associated rewards across the industry could be used as an alternative.	SVT	We want companies to provide information on asset health underperformance penalties as a percentage of RoRE so that we can understand companies' approaches more easily at PR19. We agree that the concept of RoRE is not easy for customers to understand. Companies can use a more customer-friendly approach when engaging with their customers. We have changed our asset health outcomes expectations for PR19 in appendix 2 to reflect this comment.	Minor change
For common performance commitments, there is no flexibility to adjust these where customers' or stakeholders' views drive this or company-specific circumstance makes this appropriate. Our view is that such company-specific circumstances should be accounted for when identifying an upper quartile benchmark, as has been proposed within the cost assessment framework.	SWB	The company has misunderstood our approach. Our approach to setting performance commitments provides a range of challenges for companies, but companies can justify why they have not followed a particular approach based on evidence, including customer and stakeholder views and company-specific circumstances.	No change
While these are not measuring a specific outcome for customers and the environment, we agree that it is legitimate to include some 'output' measures that act as leading indicators for outcomes that customers care about, such as interruptions or sewer flooding. We think that a better explanation of asset health measures is needed to ensure customers can make that link between the measure and the outcome that ultimately affects them.	CCWater	We agree with CCWater. In appendix 2 we set out our asset health outcomes expectations for PR19 which include: companies should clearly present in their business plans, their approach to asset health; companies should engage with their customers and CCGs on how their asset health metrics protect current and future customers and the environment; and companies should ensure their asset health performance commitments are easy to understand.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
1c) - Do you agree with our approach to bespoke performance commitments including areas that bespoke performance commitments should cover?			
On bespoke vulnerability performance commitments: It is our view that dealing with customers at times of vulnerability is about staff exhibiting the right behaviours as much, if not more than, having the right policies. In our view, it is important that the measure used does not drive companies to label customers. Accordingly any measure needs to be carefully chosen.	PRT	Our assessment of companies' approaches to vulnerability will take account of qualitative and quantitative evidence provided by companies, not just the bespoke performance commitment. Our requirement for a bespoke performance commitment will ensure all companies engage with their customers on issues around vulnerability.	No change
Yes we agree with your approach, while recognising the challenge of identifying an appropriate performance commitment for vulnerability.	WSH		No change
We agree in principle with regards to bespoke performance commitments covering the environment. However, with regards to catchment management it must be recognised that such metrics may have to be 'output based' as opposed to 'outcome based'.	PRT	Companies can propose bespoke performance commitments that reflect their customers' and stakeholders' preferences and their own particular challenges and circumstances. If a company considers a more 'output' based metric is needed for a bespoke performance commitment it can propose one with supporting evidence.	No change
It should be noted that the examples suggested by Natural England in appendix 2 are not SMART (specific, measurable, achievable, relevant, time-framed). In addition to this, they do not measure the water company reason for implementation of the environmental action, rather the 'secondary benefit' such a measure could bring.	PRT	Companies can select their preferred bespoke performance commitments from the examples proposed and can also propose their own metrics for bespoke performance commitments.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It would be helpful to place further emphasis on promoting long-term and sustainable outcomes, collaborative and integrated working, and building ecosystem resilience, in line with Welsh legislation.	Natural Resources Wales	We are requiring companies to cover the environment and resilience with their bespoke performance commitments. One of the reasons we are taking this approach, rather than having more common performance commitments on the environment and resilience is so that companies can propose their own metrics for bespoke performance commitments reflecting the legislation that applies to them, their customers' preferences and their particular environmental challenges.	No change
We would like to see the outcomes framework develop so that it actively promotes best practice and innovation, for example rewarding companies where they address the root cause of issues through behaviour change, or where they contribute to wider outcomes.	Natural Resources Wales	One of the main reasons for having bespoke performance commitments is so that companies have scope to be innovative. Our emphasis on companies having stretching performance commitments should promote companies adopting best practice and pushing the frontier forwards too. We expect it will be hard for a company to achieve stretching performance levels without addressing the root causes of the existing service failures issues. We consider that outperformance payments could be a way of leading to step changes in the sector's performance on the environment, rather than coming at the cost of the environment.[2]	No change
Companies should use bespoke performance commitments as a way of improving their operations and the culture of their organisations. For example, working across company	EA	The Environment Agency's comments fit with our approach that companies can propose bespoke performance commitments	No change

[2] This approach only relates to ODI policy. Also, material performance failings could be licence or statutory duty breaches with attendant enforcement consequences including, where appropriate, fines.

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
boundaries on issues such as security of supply, collaborating with other risk management authorities on flooding improvements and applying sustainable catchment approaches. The examples of bespoke environmental commitments set out in chapter 2 are a good starting point. When developing bespoke commitments companies should take account of local environmental pressures, customer priorities and the regulatory expectations set out in WISER.		that reflect their customers' and stakeholders' preferences and their own particular challenges and circumstances.	
The abstraction incentive mechanism – part of question 1c			
We do not agree with the AIM. We believe the NEP is the appropriate regulatory approach to the issue AIM is seeking to address.	PRT	The AIM supports the formal abstraction licence process where reductions in licence quantities may be necessary for a range of environmental drivers. For example, the AIM can help identify temporary and voluntary solutions that benefit the environment while more permanent solutions (including licence change) are investigated and implemented.	No change
There are already other programmes that address the problems AIM covers, specifically Restoring Sustainable Abstractions, the Water Framework Directive and improvement solutions will be endorsed in the WINEP. To ensure that the regulatory framework is proportionate and targeted, companies need flexibility as in some cases the scope of what we could propose under AIM will be limited.	SVT	AIM supports voluntary environmental improvements that can be progressed before any permanent solutions are implemented (see above). The PR19 approach to AIM site selection uses the sites identified in the latest WINEP lists with flexibility to select the sites that best achieve the AIM objectives.	No change
It should be noted that our WINEP investigations are not in all scheduled to be completed before the end of AMP7 and therefore there may be no robust baseline against which performance can be measured for this commitment unless it	BRL	We published our guidance on setting baselines for the AIM in: Guidelines on the abstraction incentive mechanism in February 2016.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
is through a simplified measure of compliance with EA WINEP requirements.			
The creation of AIM sites solely to generate a performance commitment measure could lead to perverse outcomes such as an immediate 100% compliance with the commitment, leading to a skew in the dataset against which quartile or frontier performance would be measured.	BRL	Companies have discretion to choose AIM sites, baselines, trigger points and incentive rates in line with the guidelines. When designing their AIM performance commitments companies should take account of the objective of the AIM which is to encourage water companies to reduce the environmental impact of abstracting water at environmentally-sensitive sites during defined periods of low surface water flows.	No change
Support the objective of the AIM but have been unable, based on its current form, to apply it. We consider that a better outcome will be achieved for the environment and our customers if there is more flexibility for us to design a mechanism that works in our area. Ofwat could assess the mechanism based on how well it meets the objective of the AIM (to reduce the environmental impact of abstracting water at environmentally-sensitive sites during defined periods of low surface water flows).	SES	The PR19 AIM site selection uses the sites identified in the latest WINEP lists with flexibility to select the sites that best achieve the AIM objectives. As explained in our PR19 final methodology and appendix 2 we require all companies to have a bespoke performance commitment related to the AIM for PR19.	No change
We continue to support the use of the AIM to improve the resilience of water supply and ensure that it is provided in a more sustainable way. AIM should be used to enable companies to deliver solutions quicker, or achieve outcomes that go beyond current regulatory requirements. To ensure that the regulatory framework is proportionate and targeted, companies need flexibility as in some cases the scope of what we could propose under AIM will be limited.	EA	Companies have the flexibility to choose AIM sites, baselines, trigger points and incentive rates in line with the guidelines. This enables companies to propose a bespoke performance commitment on the AIM that is proportionate to their abstraction challenges.	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
We welcome the requirement on companies "to propose a bespoke performance commitment in line with the AIM guidelines", and to "propose financial incentives to accompany AIM performance commitments".	CIWEM, WWF-UK	Noted.	No change
Note that actions under an AIM performance commitment should include the progression of demand side solutions, such as local incentive schemes, as well as the improved management of water resources themselves; this is recognised in section 2.4 of appendix 2, and should be more widely promoted	Blueprint, WWF-UK	Companies should find the best value solutions to achieving their AIM performance commitments. We agree that companies can achieve this through a range of tools, which include water resource optimisation and demand management solutions.	No change
We understand the reasons behind the removal of the AIM from the common performance commitments, so welcome the strong steer from Ofwat that all companies should retain/adopt the AIM (or similar) as a bespoke performance commitment. This will help to protect some of our more vulnerable waters from unsustainable abstraction during dry periods, and ensure that the achievement of WFD targets are not jeopardised. This option allows companies the flexibility to adapt the AIM to their own specific circumstances, whilst ensuring that all companies are taking action on damaging abstractions. We also support Ofwat's preferences on setting financial rewards / penalties on the AIM, with natural capital value followed by willingness to pay being preferred to difference in operating costs.	Blueprint	Noted.	No change
For protected sites at least, we do not currently see AIM as providing an alternative to an effective abstraction licencing regime that ensures that the quantity of water permitted for	Natural England	The AIM supports the formal abstraction licence process where reductions in licence quantities may be necessary for a range of environmental drivers (identified through the EA's Water Industry	No change

Q1. Do you agree with our proposals for common and bespoke performance commitments?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
abstraction is kept within environmentally sustainable limits that meet the sites' objectives. We are concerned that a financial reward for a positive performance in relation to the AIM baseline may not truly reflect polluter pays principle. We welcome the highly transparent and consultative process set out in the original 2016 Guidelines on the AIM, from filtering of AIM sites through to determining the AIM baseline and AIM trigger point envisaged.		National Environment Programme (WINEP) and Natural Resources Wales' National Environment Programme (NEP) processes). For example, AIM can help identify temporary and voluntary solutions that benefit the environment while more permanent solutions, including licence changes, are investigated and implemented. The AIM will have financial incentives at PR19 to give companies a greater incentive to reduce their abstraction at environmentally-sensitive sites at low flows. We propose three options that companies could use to set their AIM outperformance and underperformance payments. However, it is for companies to propose their AIM incentives following engagement with their local stakeholders. We note the support for the transparent process and will endeavour to continue this for PR19.	

Q2. Do you agree with our proposals on setting performance commitment levels?

In the draft methodology we consulted on proposals to encourage companies to set stretching service levels for bespoke performance commitments, common performance commitments and leakage.

There were mixed views on our approach in relation to stretching performance commitment levels, with some strong disagreement with our proposal in relation to challenging companies to apply 2024-25 forecast upper quartile performance as their performance commitment levels from 2020-21 onwards.

This section outlines respondents' views and our responses on outcomes that are not covered in appendix 2. The sub-questions we refer to in the table were included in the Water 2020 draft methodology response template.

Table 3.2 Summary of issues raised in response to outcomes, question 2

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
2a) Do you agree with our proposals to setting bespoke performance commitment levels? and 2b) Do you agree with our proposals to setting common performance commitment levels?			
If each company is required to adopt its own forecasting approach, the inevitable outcome will be a wide range of forecasts which will each need to be assessed and reviewed as part of the determination process. The assessment of performance commitments and ODIs is a complex and sensitive part of the process, and we are concerned that the proposed approach will result in significant difficulties and delays in the assessment process	YKY	We acknowledge that companies might propose different levels for the forecast upper quartile for the same metric. However, we would not expect these to differ significantly and we reserve the right to intervene if they do once we have seen all companies' forecasts in their business plans. By having consistent definitions for the common performance commitments and providing more guidance on setting performance commitments than at PR14 we consider our assessment process should be easier. We are confident our assessment process for performance commitments and ODIs will be timely.	No change
The forecast upper quartile is not feasible for the new drinking water quality measure (CRI). For this metric we propose that the target level in determined in 2020 by which time there will be four data points whereas at the point of finalising our business plan proposals, there will only be one data point. Therefore we suggest that for this measure the target should be set on an annual basis at the level of the upper quartile from the	WSX	Section 2 of appendix 2 provides guidance on setting performance commitment levels for new metric and metrics with amended definitions. We have removed the expectation that the performance commitment level for CRI should be the forecast upper quartile because the performance commitment level should be zero as it is a statutory obligation.	Minor change

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
previous year (as long as this is not worse than the previous target).			
Setting the levels of target is something that only Ofwat can do, as it needs to be a sensible dataset which all companies can agree to and which overall represents progress for all customers.	Thames CCG	We set out in appendix 2 the different approaches companies should use to challenge their performance commitment levels against. We want companies to challenge themselves against the approaches so that when engaging with customers they are not using their current performance as the starting point, but starting from what excellent performance looks like. CCGs will challenge companies on their approaches to setting performance commitment including how well they reflect customers' views and how stretching they are.	No change
2c) Do you agree with our proposals to setting leakage performance commitment levels?			
Further consideration should be given to the practical application the three-year averages. The current proposal would result in only one adjustment in year 5 relating to the 2020-25 period.	SEW	Companies will report their leakage performance in each year of the price control period based on the average of the last three years of data. We set out more detail on applying the three-year average for leakage in the context of the new consistent definition in appendix 2.	No change
Concern that our approach to setting leakage is too prescriptive and does not take into account local circumstances, priorities and demands.	WSX, SWB, PRT, WSH	We have considered company concerns in relation to our approach to setting leakage performance commitments in section 2 of appendix 2. Our approach involves setting challenges to companies and it us up to companies to meet those challenges of justify why they cannot. Our approach is flexible. It allows companies to provide robust evidence on why a less demanding performance commitment level should be set if that is appropriate. We shall consider evidence provided by companies on their performance	No change
Our approach does not take into account the existing frontier performance of a company and sets easier challenges for less efficient companies.	WWF, CIWEM, ANH, SEW, Anglian Water Investors		

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Consider that a 15% leakage reduction is too challenging	ANH, NES, BRL, SRN, AFW	commitment levels, including feedback from customer engagement, on past performance and local circumstances.	
Concern about setting performance commitments in relation to comparative performance on leakage.	YKY, ANH, UU		
Questioned whether Ofwat has engaged with customers to define the 15% leakage target.	AFW		
Suggest the performance commitments should be based on how far company current performance is from the industry average level, with those further behind the average being set a more challenging target.	BRL	We do not consider it is appropriate for us to have a rigid approach to companies setting their performance commitment levels for leakage because it would not take into account evidence from e.g. customer engagement and company-specific circumstances. Our approach encourages companies to propose ambitious performance commitment levels while retaining flexibility for companies to reflect their customer engagement, company-specific circumstances etc.	No change
Support our proposals to set more stretching leakage targets but consider that requiring a minimum of 15% reduction for all companies will be more challenging for better performing companies who will face a higher marginal cost. It would also be difficult for better performing companies to obtain customer willingness to pay for this level of improvement. Therefore it recommends that we use an approach based on achieving an absolute level of leakage that is equal for all companies.	SRN		
Concerned that there is no glide-path for achieving forecast upper quartile performance in the first year.	PRT, SES, SEW	As explained in appendix 2, we have changed our policy on this point since our draft methodology proposals following respondents' comments.	Major change

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
If the benchmark is 2024-25 upper quartile then we consider that a short glide path is essential. This is important because what matters to customers is the improvement to their service, and not necessarily the industry upper quartile. By applying a glide path of three years the same outcome can be delivered but in a more realistic manner.	SVT	Our decision is that companies should challenge themselves using comparative information to forecast the upper quartile level of performance for each year of the price control period for their proposed performance commitment levels. Our revised approach involves an efficient path of improvement. Companies can still propose a different performance commitment level to those implied by our challenges if they can provide good evidence why the forecast upper quartile level would not appropriate.	
We are concerned about the proposal to remove glide-paths. The benefits of any investment take time to manifest. This could de-incentivise companies from making truly stretching commitments backed by long-term investments. This would also have implications for ODIs.	WSH		
We think glidepaths could be effectively used to ensure that performance improvements to upper quartile and beyond are delivered in a sustainable way. We would want to make sure that the way we invest to deliver upper quartile performance is done so in the most affordable and long term sustainable way.	SRN	As explained immediately above we have amended our approach to the forecast upper quartile. However, we expect all companies to propose efficient service levels from the start of the 2020-2025 period, with no transition to their stretching performance commitment levels. This is so that customers do not have to wait for the levels of service they have funded companies to deliver.	No change
Agree with upper quartile challenges but consider that this should be achieved over more than one AMP period and should include enhanced payments.	SVT	We consider that companies should set stretching performance commitment levels for leakage. As part of our approach to leakage companies should consider upper quartile challenges over the 2020-25 period as well as their projected performance over the longer term (at least 10 years after 2025 and for leakage we are expecting 20 years as used in Water Resources Management Plans). Companies can propose different performance commitment levels to those implied by our challenges if they can provide	No change

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		good evidence why they are not appropriate. For example, companies could suggest a longer time period for reaching upper quartile performance levels for leakage if they can provide good reasons and evidence for this. In our PR19 final methodology we say that companies could include an enhanced outperformance payment in their ODI to incentivise a major improvement in leakage performance.	
Consider that SELL can drive leakage down. SEW considered that the SELL should be strengthened to include a greater weighting to customers' preferences on the matter.	SEW, NES	We remain concerned over whether SELL drives efficiency and delivers beneficial leakage reductions. Our consultants found that SELL tends to maintain the status quo and does not incentivise efficiency or innovation. The EA and NRW are looking to move away from using the SELL in the Water Resources Management Plans in the future. We set out the key issues that have been identified in the application of SELL in section 2 of appendix 2.	No change
Asked for clarification on customer views. Considered that leakage targets should be driven by customer views along with affordability and bill impacts.	NES, SWB, BRL, AFW, UU, WSX	Customer engagement on leakage performance commitment levels is very important. Our approach to leakage involves setting challenges to companies and it us up to them to meet our challenges or justify why they cannot. This helps change the starting point for the conversations with customers from the status quo towards more stretching performance commitment levels. Our approach allows companies to provide robust evidence on why a less demanding performance commitment level should be set if that is appropriate. An important part of this evidence will be feedback from customer engagement.	No change
Wants to see clear evidence that leakage targets are supported by customer views.	CCWater		
Suggest that 'the value of water left in the environment' should feature in any considerations, particularly where abstraction is from	WWF, Blueprint	In our PR19 final methodology, chapter 4, we say that we expect companies to explain how their five-year performance	No change

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
environmentally-sensitive sources, such as chalk streams.		commitment levels and long-term projections for leakage take into account the future value of water.	
Consider that leakage should be reported on a water company level rather than water resource zone level.	SVT	Our approach allows companies to set performance commitment levels for either the whole company or at a regional level. Respondents to our November 2016 outcomes consultation suggested that companies might want to target leakage reductions on certain zones that were particularly water stressed or to trial innovation in certain zones.	No change
Agreed with taking potential water trades into account, but considered to be able to do so would require an established 'price' for traded water.	WSH	Companies can take into account the potential for future water trades qualitatively where companies have not established a 'price' for traded water. Considering the scope for future water trading might support a lower leakage level than would otherwise have been the case.	No change
In terms of reputational impact, consider that companies should report customer-side and company-side leakage separately. Customers are not aware that most leakage come from them.	SEW	The new consistent definition of leakage we will be using for PR19 includes customer-side leakage. It is up to companies how they engage with their customers on leakage. Making customers more aware of their contribution to leakage and encouraging reductions fits with our approach to customer engagement at PR19 of encouraging the involvement of customers in service delivery.	No change
Consider that 25-year predictions for leakage would be problematic.	PRT	Our requirement for companies to provide 25-year projections for leakage is in line with the forecasts that companies are required to provide as part of the WRMP process.	No change
Welcome further clarification on the expectations for the alignment of WRMP19 and PR19 business plans in relation to leakage targets.	YKY	We co-ordinated our policy on leakage with the EA and NRW. The EA updated its WRMP guidance to reflect our draft PR19 methodology. The WRMP guidance and our approach to leakage performance commitments at PR19 are aligned.	No change

Q2. Do you agree with our proposals on setting performance commitment levels?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It is critical that leakage targets are set with supply-demand balances in mind and overall efficiency of water usage. We believe that best value for money over the long term is based on a mix of solutions, including a gradual increase in infrastructure renewals expenditure (IRE) which is not allowed for in the Ofwat economic model, innovation and future efficiencies which for companies with a surplus of supply over demand will result in a gradual reduction of leakage over the longer term.	WSX	Our approach to leakage involves setting challenges to companies and it us up to companies to meet those challenges or justify why they cannot. Our approach does not prescribe what technologies companies can use to reduce leakage. Companies are incentivised to use the most efficient mix of solutions whether it is infrastructure renewal expenditure, demand side management or other.	No change
Suggest that we should use a version of Unavoidable Annual Real Losses (UARL) that was developed for the UK (UARL (m^3/year) = (6.57 x Lm + 0.292 x NC + 9.13 x Lsp) x Pc), rather than the EU version. This equation is equivalent to the EU reference	A. Lambert and D. Pearson	Following responses to our consultation we are making a change to our approach. We are allowing companies to report the minimum level of leakage using a UK-specific version of Unavoidable Annual Real Losses (UARL). We understand that a number of companies are already using this for measuring their minimum level of leakage, therefore we have included it as an alternative to using the EU definition of UARL.	Minor change
Considered that we should use the Infrastructure Leakage Index (ILI) in the EU reference document to set the upper quartile challenge instead of leakage/property of leakage/km for setting targets.	A. Lambert and D. Pearson	While we understand the rationale for proposing ILI for our upper quartile challenge, the ILI data has not been collected to date. We therefore prefer to use leakage per property per day and leakage per km of main per day for our upper quartile challenge. These metrics are also easier for customers to understand and for companies to engage with their customers on.	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?

In the draft methodology we explained that we want to better align the interests of company management and investors with those of customers and to focus companies on delivering improved service for their customers. We proposed this could be done by:

- enhancing the reputational impact of ODIs to strengthen the focus on service delivery;
- strengthening financial incentives for efficient companies, where there is customer support for them;
- companies (and customers) experiencing the incentive closer in time to when the service was delivered;
- allowing for enhanced outperformance payments (and underperformance penalties) for companies that deliver a step-change in performance; and
- challenging companies to justify why incentives cannot be strengthened to increase incentives to improve service performance.

There was general support for strengthening ODIs with mixed views on the details of in-period ODIs, enhanced rewards and the increased use of financial ODIs.

This section outlines respondents' views and our responses on outcomes that are not covered in appendix 2. The sub-questions we refer to in the table were included in the Water 2020 draft methodology response template.

Table 3.3 Summary of issues raised in response to outcomes, question 3

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
3a) Do you agree with our proposals to increase the strength of ODIs by increasing the impact ODIs have on reputation, the greater use of in-period ODIs, linking ODIs to revenue rather than RCV and having a greater onus on financial ODIs?			
The impact of revenue penalties on financial ratios for better than average performing companies (with absolute targets) is not something shareholders can mitigate. For example, to mitigate the FFO/Debt impact of a revenue penalty would result in a revenue reduction of c.5% - this is likely to exceed any headroom on credit ratios before taking into account financial shocks that may occur in the year the penalty is imposed. This would result in a higher bill level being required (particularly in the last 3 years when the penalties will impact) to provide assurance on financeability, which would increase bill volatility.	BRL	To maintain the incentives on management, we will make reconciliation adjustments relating to incentive mechanisms from previous control periods after carrying out our financeability assessment. This ensures that customers do not pay more to address financeability constraints arising either from poor performance, or as a result of an adjustment being made to allowed revenue as a result of the company's performance against its totex allowances in the previous period. Similarly, it ensures that the value of financial rewards for performance against regulatory incentive mechanisms is not eroded as a result of adjustments made, following the financeability assessment.	No change
The draft methodology appears to take a different approach from the options consulted on in the November outcomes consultation. The methodology proposes that industry leading performance is expected from all and that this should be the new norm and be funded through base revenue rather than rewards. This means that 'an average company with average performance would expect to incur penalties on its ODI package'. It cannot be right that a methodology deliberately aims for this outcome, when only by avoiding such penalties would companies be	SES	We have clarified our position since the draft methodology proposals. A company with average current performance that maintains the same absolute level of performance into the next price control period would incur underperformance penalties on its ODIs. This is because we are expecting companies to improve and are setting challenges for performance commitments, including a forward-looking, upper-quartile challenge. Average performance now will not equate to efficient performance in the future. It is possible, if unlikely, for all companies to outperform their	Clarification

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
expected to earn a return equivalent to the allowed cost of capital.		performance commitments and earn net ODI outperformance payments in the next price control period. We note that early evidence from PR14 shows that companies that expected ODI underperformance penalties have been able to offset this by outperforming on their performance commitments. While our approach means that companies that do not deliver stretching levels of service for customers will incur net ODI underperformance penalties, this risk is within companies control as those companies that deliver for their customers will avoid penalties.	
We would also like to highlight the importance of continuing to take into account the potential for 'double jeopardy'. Any other (non-ODI) penalties should be taken into account when calculating applicable ODI penalties to avoid companies 'paying twice'.	WSH	As with PR14, companies should calibrate their financial ODIs with totex efficiency sharing. They can also calibrate their financial ODIs with other incentives that might apply to their performance, if they can provide evidence of why this is appropriate.	No change
Pollution penalties also overlap with the fines. The penalty was adjusted in PR14 to avoid duplication but given the multiple pollution performance commitments the ODI incentive could be low for each ODI individually.	SWB		
Customer engagement has highlighted the importance our customers place on us being a local, trusted business that cares about its social responsibilities. These are important features that we may want to include in the outcomes framework but, in many cases, it would be unsuitable to ask our customers to pay more for exceptional performance. We would expect	SES	For PR19 we are putting an onus on companies having financial ODIs. However, companies can have performance commitments not supported by a financial ODI if they provide convincing evidence that this is appropriate, including evidence from customer engagement.	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat to consider the merits of non-financial ODIs as well as financial ones in the initial assessment of plans.			
Although we welcome the emphasis on reducing pollution incidents, as highlighted earlier, companies should not be rewarded for pollution incidents or for legal compliance. Instead, we would like to see reducing penalties as companies reduce the number of pollution incidents.	Blueprint for Water	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).	No change
There seems to be too little focus on the supply chain and no real ambition to address the damaging boom and bust cycle and the resultant skills shortage, job losses and obstacles to investment it creates. There is almost a sense that Ofwat feel it's 'inevitable' and there is little they can do to prevent it. If Ofwat believe that it comes down to water companies behaviours then perhaps an ODI is needed which recognises and rewards companies which demonstrate consistent spend across the 5 year AMP period?	British Water Member 1	Our approach to totex and outcomes in PR19 gives companies the flexibility to spend their allowances in what they consider to be the most efficient way. We are allowing companies to raise well justified claims for transitional expenditure in the water network plus controls and the wastewater network plus controls. An ODI which incentivises companies to spend consistently across a five year period does not sound particularly customer-facing and might reduce the flexibility for companies to spend their cost allowances in the most efficient way.	No change
The use of stronger ODIs is likely to result in additional risk being passed to the supply chain. Collaboration will be driven by a clear linkage between supply chain performance and achievement of PCs. Commercial arrangements in AMP7 should therefore be designed such that the supply chain, whether singly or within	Kier	We want companies to have a greater incentive to deliver on their performance commitments to their customers. It is up to companies how they reflect their ODIs with their supply chain. However, the greater scope for outperformance and underperformance payments at PR19	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
collaborative arrangements, has proportionate monetary reward or pain that derives directly from ODI performance on an annual basis.		provides greater scope for similar payments related to performance for the supply chain.	
We agree that the use of in-AMP rewards and penalties drives a more focused approach to continuous improvement to deliver performance commitments, but it creates the risk that step changes will not be possible due to the relatively short-term focus on returns. The ODIs should allow annual targets that may not show net improvements in the early years of AMP7, to allow time for investment and deployment of innovations.	Kier	We want companies to have a greater incentive to deliver on their performance commitments to their customers. Companies can propose annual performance commitment levels to fit an appropriate trajectory of expected improvements. There might be instances where the use of in-period ODIs is not appropriate. In such cases companies can propose end-of-period ODIs where they provide evidence that this is appropriate, for example, why it is in customers' interests.	No change
We consider stepped incentive rates (within the standard range) could be beneficial at PR19 because they allow companies to better articulate any changes in cost-benefit, especially where upper quartile targets are set but not supported by customers. It would be helpful if the data table format was adjusted to allow this.	TMS	We have amended table App1 (performance commitments and outcome delivery incentives) to include three standard outperformance payment rates and three standard underperformance penalty rates. We have not included additional caps and collars for these additional ODI rates to avoid making table App1 too cumbersome for the majority of performance commitments which use only one outperformance payment rate and one underperformance penalty rate. Therefore, if companies are proposing to use any of the additional rates, the 'Standard ODI calculation' indicator should be set to 'No' and the business plan commentary should include a clear explanation of how the proposed ODI would work.	Minor change
We think the framework for ODIs needs to be: · Understandable and acceptable to customers, with rewards achieved only for substantially improved	CCWater	We have set companies a number of challenges in relation to their performance commitments levels to ensure that when they engage with their customers and stakeholders	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
performance reflecting shifting frontier or upper quartile targets. This should take into account the companies' starting point and, therefore, the 'stretch' in performance they have made to reach upper quartile or frontier level. If a company is not upper quartile, then the incentive should be there for them to improve.		they do so in relation to stretching commitments. Companies also need to engage with their customers and stakeholders on their ODI outperformance payments. ODI outperformance payment will only be available for performance levels beyond companies' stretching performance commitment levels.	
We think the framework for ODIs needs to be: · Set on the basis of the size of the reward correlated to the level of performance the company has reached.	CCWater	As explained in appendix 2 we are discouraging trigger ODIs at PR19, where "Trigger ODIs" are designed so that when a company's performance goes over a certain threshold, a lump sum outperformance or underperformance payment becomes applicable. As a result outperformance payments will instead be linked to the level of performance a company has reached.	No change
If a company is already at the frontier (or upper quartile level) then they should only be rewarded for shifting that forward.		One of our challenges to companies in relation to setting performance commitments is that we expect companies to use information on their best past performance to inform their proposed performance commitment levels throughout 2020-25. This should ensure current good performers also consider stretching performance commitments in their engagement with customers and stakeholders.	No change
Deadbands can ensure companies aren't penalised for missing targets they aren't funded for, or rewarded for performance which isn't genuinely industry leading. Deadbands and glidepaths could also be used to encourage companies to set more stretching performance commitments. Given some of the related performance datasets are still quite volatile, if deadbands are removed, we would suggest that a rolling average metric be used.	SRN	We are discouraging companies from proposing deadbands because they remove the incentive for companies to improve performance. If a company proposes to use a deadband it will need to produce clear evidence as to why its proposal is appropriate and in the interests of their customers. We have set companies a number of challenges in relation to their performance commitments levels to ensure that when they engage with their customers and stakeholders	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		they do so in relation to stretching commitments. We do not think glidepaths and deadbands are needed to encourage companies to set stretching performance commitment levels. In appendix 2 we provide guidance on setting performance commitment levels for metrics that lack a continuous times series of historical data.	
The removal of the deadbands and averaging could also affect the asset health PCs. This means that companies cannot oscillate around an average value without being penalised. If measures such as stable are not used due to the disaggregation of the asset health PCs then the use of deadbands could be useful.	SWB	We are discouraging companies from proposing deadbands because they remove the incentive for companies to improve performance. If a company proposes to use a deadband it will need to produce clear evidence as to why its proposal is appropriate and in the interests of their customers.	Clarification
We have seen little evidence that customers support principle of companies receiving rewards for outperformance. Whilst such rewards may incentivise companies to improve service, from experience marginal improvements do not mean much to customers.	PRT	Outperformance and underperformance payments are important elements of the outcomes framework. They align customer, management and shareholder interests by increasing companies' focus on improving the services that customers care about. At PR14 a number of companies found that customers supported outperformance payments as a form of "payment by results". At PR19 our approach to outperformance payments should ensure they are only available for stretching levels of performance. We are also requiring companies to engage with their customers and stakeholders on their performance commitment levels and ODI rates.	No change
Previous water quality metrics did not include a reward option which was the preference from DWI - if this is to be reconsidered Ofwat and the industry will need to consider how setting bands for penalties and rewards	AFW	We have retained CRI as a common performance commitment as water quality is a top customer priority. We consider that outperformance payments are not appropriate for this metric as companies should be	Clarification

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
will be delivered when there is still little data to establish a baseline.		achieving full compliance and setting their performance commitment level at zero. In appendix 2 we provide guidance on setting performance commitment levels for metrics that lack a continuous times series of historical data. For CRI companies can take this guidance into account when setting their penalty deadbands.	
It is important that any bill impacts for ODI rewards are acceptable to customers, and companies would need to explain to customers what they are receiving in return for the increase and that they are not simply being rewarded for doing the 'day job' or what they are already meant to be doing. The level of reward/penalty for ODIs must also be acceptable to customers. Companies must provide evidence of customer acceptability of paying a reward in return for a service improvement. We would like to see evidence that customers are satisfied with a tangible service improvement before a reward is added to allowed revenue.	CCWater, Thames CCG	Outperformance and underperformance payments are important elements of the outcomes framework. They align customer, management and shareholder interests by increasing companies' focus on improving the services that customers care about. At PR19 our approach to outperformance payments should ensure they are only available for stretching levels of performance. We are also requiring companies to engage with their customers and stakeholders on their performance commitment levels and ODI rates.	No change
Companies would also need to be challenged to spread or pace the collection of any rewards to help reduce the potential bill impact, especially if higher inflation on wholesale charges also drives annual bill increases. Our suggested 'C-MeX satisfaction' ODI may help encourage companies to do this as bill increases could have a negative reaction on customer satisfaction. Furthermore, applying greater value of the ODI 'package' to the two C-MeX ODIs we suggest would encourage companies to spread the collection	CCWater	In relation to bill volatility, companies must strike a balance between linking incentives more closely in time to performance and a smoother path of bill change year on year. In some cases, it may be appropriate to apply the in-period ODIs over several years to smooth bills while still capturing some of the benefits of bringing forward incentive payments closer to the performance that generated them. We expect company business plans to include how they propose to manage bill volatility over the period.	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
for any rewards achieved, and ensure that rewards are only applied if there are tangible improvements in customer service and customers' 'view of the value for money of the services they receive.		We are not proposing to link companies' ODI outperformance payments with good performance on C-MeX. The problem with this approach is that if a company is performing poorly on C-MeX it would have little incentive to improve its performance on metrics such as leakage, supply interruptions and sewer flooding, which is likely not to be in customers' best interests.	
Because customers are likely to have differing views on the value they place on performance commitments, the level of ODI reward/penalty should not be common but is best set individually by each company based on its engagement with its own customers and CCG.	CCWater	In appendix 2 we explain that companies should use a bottom-up approach based on customer evidence to set their ODI outperformance payment and underperformance penalty rates. We will compare companies' outperformance and underperformance payment rates, for the same performance commitments at PR19. We will challenge companies on their proposed outperformance and underperformance payment rates, where appropriate.	No change
3b) Do you agree with our proposals on enhanced outperformance payments and underperformance penalties?			
We agree with the proposals outlined on enhanced rewards and penalties within the consultation document and welcome the approach identified in figure 4.4 (on page 76 of the main consultation document) but we would welcome further clarity and detail to be provided in the final methodology in regards to: the slope of gradients; the points at which gradients change; consistency between companies; and, size of the penalty.	BRL	We have provided guidance on how to set enhanced out- and under-performance payments in appendix 2. We are not providing more precise guidance to allow companies scope to innovate and reflect their specific circumstances in the design of their enhanced out- and under-performance payments.	No change
Although we strongly support the concept of enhanced incentives, we strongly disagree (as indicated in appendix 2, section 3.3) that companies already at the	NES	In appendix 2 we have given some guidance on how to set enhanced incentives. This includes that the threshold for the enhanced outperformance payments should be set at	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
frontier should need to achieve a level of improvement greater than that achieved historically to qualify for enhanced rewards, for the following reasons: • This approach does not mimic the way that companies would be incentivised in a competitive market – leading companies achieve enhanced rewards without reference to their rate of improvement to past performance, which is irrelevant. • By requiring companies to aim for an improvement greater than historical improvements for that metric, Ofwat is requiring leading companies not only to stretch the frontier, but to do so at a faster rate than previously. • We are concerned that this constraint could nullify the incentive properties of the enhanced rewards. We are surprised Ofwat have adopted this cautious approach.		the performance level of the current leading company, or preferably higher (for example, including a forecast improvement in addition to that performance level). Within this guidance companies have scope to propose the threshold at which their enhanced outperformance payments would apply.	
This proposal is inconsistent with the general message adopted in the methodology that, rightly, significant weight will be placed on assessing that customer acceptability was sought for all aspects of our business plan. There is a risk that this approach will result in significant differences across the country between what customers pay for a given level of service - partly because the level of service that would be deemed 'exceptional' will be forecast separately by each company. Ofwat should set out in the final methodology whether they will step in to ensure consistency.	SES, SEW	We acknowledge respondents' concerns that customers might not want to pay for wider industry benefits through enhanced outperformance payments. Companies need to engage with their customers on their overall ODI packages. If a company did obtain support for enhanced outperformance payments, and achieved them, then its customers would be benefitting from a higher level of performance than other companies' customers. There are benefits to water customers as a whole, from companies being incentivised to shift the industry's service performance. If a number of companies achieved enhanced outperformance payments for different aspects	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
If the likelihood of enhanced penalties is far greater than any potential enhanced rewards a perverse incentive occurs, which is the complete opposite of Ofwat's desire, as outlined in its current mechanism, because it would likely have the impact of discouraging companies to put forward ambitious and stretching plans.		of service, the costs and benefits will be shared across customers. We are requiring companies to accompany the enhanced outperformance payment rate with an enhanced underperformance penalty rate to provide balanced incentives and to protect customers, in case companies take unreasonable risks to achieve high performance and end up with very poor performance.	
Ofwat's justification for enhanced rewards, in terms of incentivising frontier-shifting performance, does not appear to work for enhanced penalties. We cannot think of a justification for enhanced penalties that go beyond the penalty rate agreed on the basis of customer engagement and other relevant factors.	WSH	We consider the enhanced underperformance penalty rate is needed to provide balanced incentives and to protect customers in case companies take unreasonable risks to achieve high performance and end up with very poor performance.	No change
We feel greater clarity is needed on how enhanced rewards or penalties will be set, whether they will be applied consistently and if such enhanced rewards would be in line with customer priorities and affordability considerations. Further consideration is needed of the impact on the wider industry where innovative and frontier performing companies deliver benefits for customers in other regions.	SWB	Appendix 2 outlines some guidance for companies on how to set their enhanced outperformance payments and underperformance penalties. Appendix 2 also explains that companies need to engage with their customers on their overall ODI packages. Companies proposing enhanced outperformance and underperformance payments should explain in their business plans how they will share any success with the industry during the price review period. Receiving the enhanced outperformance payments will depend on whether the company has a credible plan for sharing its approach with the sector.	No change
We agree with Ofwat's rationale but service standards are not uniformly achievable in all areas of the country,	UU	Enhanced outperformance and underperformance payments are only appropriate for the common	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
and in all specific company operating environments. Setting enhanced rewards and penalties for comparative performance can only be justified when performance is truly comparable. The challenge for Ofwat is to be confident that performance targets are set in a way that is comparable and provides all companies with a level playing field from which to perform and outperform targets.		performance commitments, which are based on comparable data so that customers, CCGs and Ofwat can be more certain that the enhanced outperformance threshold truly represents frontier-shifting performance.	
The consultation and subsequent conversations confirm Ofwat's preference for most of the weight of potential rewards and penalties to be borne through the common performance measures, including enhanced rewards and penalties for companies proposing to shift the frontier of performance for the sector. This reinforces the position we set out in our previous consultation response and repeated above, that practical considerations in terms of standardisation of definitions must be resolved prior to Final Determinations to ensure that stakeholders have confidence that rewards and penalties are driven by genuine performance rather than reporting differences.	ANH	We are in the process of commissioning a joint project with Water UK to improve the consistency of reporting on and the definitions of a number of the common performance commitments.	Clarification
Ofwat is proposing to encourage frontier shifting performance in the common performance commitments by introducing a scheme of enhanced reward/penalty for exceptional performance. To be effective we consider that the measure of exceptional performance must:	CCWater	Appendix 2 outlines some guidance on how enhanced outperformance payments and underperformance penalties will be set .The threshold for the enhanced outperformance payments should be set at the performance level of the current leading company or preferably higher. We consider that the enhanced outperformance payment threshold should be set out in advance at PR19, rather than changing dynamically. The threshold could be set in	No change

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
· Be at a level which is higher than the current performance level of the best performing company, and represent a stretching target for that company; · Increase over time through the use of adjustable dynamic targets, if industry-wide performance improves and justifies a shift in the 'frontier' threshold; and · Companies will need to provide evidence that an area of service is a priority for customers and that customers will accept the service improvement and subsequent reward.		advance, to increase year by year. This ensures there is sufficient incentive for companies to outperform current leading performance. The difficulty with dynamic commitment levels is that they are less transparent to customers and stakeholders and the time lag involved in collecting audited industry information means the dynamic level is any case usually two years out of date. Companies need to engage with their customers on their overall ODI packages.	
Poor performing companies should be encouraged to improve above the enhanced penalty threshold. Setting the penalty threshold at the average performance level at the start of the price control period will incentivise all below average companies to improve. These companies should be expected to have an action plan to improve.	CCWater	We expect that the enhanced underperformance penalties would apply at least at the current lower quartile company performance. The enhanced underperformance penalties will give companies a large incentive to improve their performance. Companies only have to propose enhanced underperformance penalties if they have proposed enhanced outperformance payments. A company that performs worse than the enhanced underperformance penalty threshold will be required to submit an action plan to its CCGs setting out the reasons for its poor performance and how it will improve (see appendix 2).	No change
3c) Do you agree with our proposal to remove the RoRE cap?			
This seems to be a good principle, but we note that there will be a preponderance of downside risk for	AFW, SEW, WSH	We are removing the aggregate RoRE cap and collar to give companies an opportunity to propose higher outperformance and underperformance payments in their	No change on RoRE cap and collar.

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
companies if performance commitments are based on upper quartile performance. The removal of the cap and collar in effect increases the risk with an insufficient offsetting 'upside' so that the incentives are diminished or irrelevant on the reward side. When this issue is considered in conjunction with the other downside risks proposed in this paper, there is a concern that the overall level of regulatory and performance risk that the companies are being exposed to could be challenging particularly where this is not reflected in the underlying WACC. This is potentially damaging to our customers long term interests and the industry in terms of trust and confidence. Moody's has pointed out the likely negative impact on credit ratings of Ofwat's proposals, given the removal of glide paths and the increased use of ODIs. Ofwat's proposed measures are designed to strengthen customers' value for money, but if they increase the cost of debt they will have the opposite effect. There is also a risk that removing the cap will create further pressure on financeability.		business plans, where customers support this. We expect companies to develop their ODIs in consultation with their customers, and obtain customer support for the overall RoRE range for ODIs proposed in their business plan. We do not consider our proposals skew potential returns to the downside. Our proposals are targeted to incentivise companies to be ambitious, and in so doing, deliver more of what matters for customers. Companies are able to manage downside risk by ensuring they deliver for customers. By proposing a wider range for the RoRE impact of ODIs, and by increasing the exposure of companies to the impact of management decisions, for example, through the form of the bioresources price control, we have flattened the overall distribution of possible outturn returns. Our reasoning for broadening the range of expected returns is to align the interests of companies and their investors with customers. It is also to encourage investors to take more interest in the actual performance of the companies. The wider range of potential outturn returns is a diversifiable risk and not, therefore, a factor which leads investors to require a higher return. We intentionally carry out our financeability tests, excluding the impact of ODIs. To maintain the incentives on management, we will make reconciliation adjustments relating to incentive mechanisms after carrying out our financeability assessment. This ensures that customers do not pay more to address financeability constraints arising from poor performance. Similarly, it ensures that the value of financial incentives for performance against regulatory	Major change on approach to setting performance commitments.

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		incentive mechanisms is not eroded as a result of adjustments made, following the financeability assessment.	
Removal of the +/- 2% cap on the Return on Regulated Equity (RoRE) for ODI rewards, which opens the door for significant bill increases. Ofwat will need to show that rewards relate to tangible service improvements that customers accept and are happy to pay higher bills for rewards achieved under this regime. The collection of rewards should also be spread over time to avoid bill spikes for customers. Removal of the % cap opens the door for significant bill increases, which could increase the risk of companies being biased towards delivery of those PCs attracting the greatest financial rewards. Therefore, we consider the continuing use of caps and collars is appropriate and necessary to give customers protection against potentially unlimited rewards.	CCWater	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. At PR19 our approach to outperformance payments should ensure they are only available for stretching levels of performance. We are also requiring companies to engage with their customers and stakeholders on their performance commitment levels and ODI rates. We expect companies to propose approaches to protecting customers in case their ODI payments turn out to be much higher than their expected RoRE ranges for ODIs. These could involve companies' own aggregate caps and collars, caps and collars on individual ODIs or linking ODI payments to relative performance. We set our further information on setting caps and collars for individual ODIs in appendix 2. In relation to bill volatility, companies must strike a balance between linking incentives more closely in time to performance and a smoother path of bill change year on year. In some cases, it may be appropriate to apply the in-period ODIs over several years to smooth bills while still capturing some of the benefits of bringing forward incentive payments closer to the performance that generated them. We expect company business plans to include how they propose to manage bill volatility over the period.	Clarification

Q4. Do you agree with our proposed Customer Measure of Experience (C-MeX)?

In the draft methodology we consulted on a new Customer Measure of Experience (C-MeX). We explained that we wanted to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain.

The consultation responses generally agreed with our proposal for C-MeX as a replacement for the SIM, especially on the inclusion of customers who have not contacted their water company.

There were mixed responses about our proposed survey methodology, mainly in relation to sample sizes and the channels to be used. There were some concerns about using UKCSI as a cross-sector benchmark for higher performance payments and the potential impact on C-MeX, of the new General Data Protection Regulation, due to come into force in 2018. Additionally, respondents raised some concerns around our proposal to leave complaints out of the financial incentive and not having a customer experience incentive for independent retailers' experience of the service they receive from wholesalers.

This section outlines respondents' views and our responses on C-MeX that are not covered in appendix 3 (customer measure of experience and developer services measure of experience). The sub-questions we refer to in the table were included in the Water 2020 draft methodology response template.

Table 3.4 Summary of issues raised in response to outcomes, question 4

Q4 Do you agree with our proposed Customer Measure of Experience (C-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
General			

Q4 Do you agree with our proposed Customer Measure of Experience (C-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
C-MeX could better support debt collection and affordability issues.	BRL	We are addressing affordability and debt collection through separate dedicated tests that we will apply during the price review.	No change
Incentives			
The strength of incentive associated with this ODI reflected on RoRE is too low and not proportionate to its importance to customers when compared to other ODIs. We would suggest that the level of incentive as a proportion of the overall package of incentives' impact on RoRE should increase to be at least equivalent to other ODIs.	BRL	We are increasing the performance payments available for high performance on C-MeX. We think the size of the incentive is proportionate and balances improved customer experience against improved performance on service quality metrics that matter to customers such as leakage, supply interruptions and sewer flooding.	No change
Rewards and penalties should be based on all of the appointees' revenue and split across price controls, rather than limited to residential retail revenue.	SES	We consider that performance on C-MeX is primarily, although not exclusively, driven by retail activities. As C-MeX is an Ofwat incentive mechanism we consider we need the payments to apply to the same price controls for all companies. Therefore we are requiring C-MeX payments to be related to the residential retail price control.	No change
There should be more clarity on who will receive rewards and penalties - 'Incentives work best if you know what the potential rewards and penalties are in advance.'	SES	We consider that our PR19 final methodology contains sufficient information about the overall design of the C-MeX mechanism, including the potential size of the payments. We will develop further detail in relation to C-MeX through the pilot. C-MeX payments will be made for annual performance in 2020-25. This will mean companies will learn more about how the C-MeX payments operate compared with their experience under the current SIM - where we determine payments once every five years.	No change

Q4 Do you agree with our proposed Customer Measure of Experience (C-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The suggested mechanism for achieving a maximum reward actually renders the rewards/penalties asymmetrical. Further clarity on how rewards [performance payments] will be awarded would be helpful.	SES	We consider that our PR19 final methodology contains sufficient information about the overall design of the C-MeX mechanism, including the potential size of the payments. We are clear that in our final methodology that access to the high performance payments is contingent on three factors: the cross-sector performance threshold, satisfactory performance on complaints and being one of the top three performers on C-MeX. This is to ensure the C-MeX high performance payments are only available for stretching levels of performance on customer experience.	No change
Cross-sector benchmarking			
When considering the use of UKCSI, we believe Ofwat should make some allowance for affluence controls in the customer sample dataset. This would then be factored into any comparison between UKCSI scores and C-MeX scores on a fair basis.	SEW	We are not minded to make adjustments to C-MeX on the basis of company-specific factors because this could lead to a large number of adjustments, complication and a lack of transparency in C-MeX results. However, we will not make a final decision on this point until after the C-MeX pilot, in case it demonstrates a clear case for a specific adjustment.	No change
Definitions			
Important to clarify what is meant by a complaint. It is possible that customers' definition of a complaint can differ from the industry's so it is worth considering ways that the survey is able to record and measure complaints as defined by the customers themselves.	Institute of Customer Service	The Consumer Council for Water (CCWater), as the body that captures data on customer complaints, is working on updating its complaints guidance to take forward the implementation of a wider definition of 'complaint' that companies will apply during PR19. We are supporting CCWater with its work on the complaints guidance.	No change
Kier's experience is that rather than the inclusion of complaints encouraging companies to avoid customer	Kier	We are working with the CCWater to modify the definition of "complaint". We are aiming to widen the definition of	No change

Q4 Do you agree with our proposed Customer Measure of Experience (C-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
contact, from the perspective of a contractor dealing with operational issues, the requirement of avoiding unwanted contacts made the business case for investment in required system and culture changes to ensure they communicate proactively. For this reason we suggest that measuring unwanted contacts alongside the customer satisfaction surveys may prove to be a more insightful measure for option 2.		complaint to include expressions of dissatisfaction, which should capture unwanted contacts. We have amended our proposal for C-MeX since our draft methodology proposals and we have decided that the C-MeX higher performance payments will be subject to a gate based on satisfactory complaints performance. We will publish CCWater's complaints data by company, annually, alongside the annual C-MeX scores. This will provide a strong reputational incentive on companies to manage complaints (based on a wider definition of the term), effectively.	
Q4a Do you agree with our proposed methodology for the C-Mex surveys?			
Overall design			
Sampling			
Sample sizes for 'field based' activities are far too small to provide any real insight to enable business improvement. As contractors we have struggled to get the data that is important to us to improve the field aspects of the journey.	Kier	Our consultation proposal was to use samples of 200 people per survey, per company, per quarter. This would mean that C-MeX would be based on surveys of 1,600 people, per company, each year. We still consider this to be a reasonable sample size, but we will look further into sample sizes as part of the C-MeX pilot. Companies can carry out additional sampling or their own surveys for their own purposes.	No change
Suggest using an 'external source of data' for the 'no contact' survey, as this will be less biased/more up to date than companies' own data.	SES	Our preference is to use surveys we commission or those of independent third parties for C-MeX. As mentioned in appendix 3, we are exploring using CCWater's Water Matters survey as part of the data source for the customer experience element of C-MeX.	No change

Q4 Do you agree with our proposed Customer Measure of Experience (C-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Q4b Do you agree with the C-Mex contact survey focusing on customer satisfaction with both contact handling and resolution?			
Definitions			
Suggest that the definition of bill payers is revised as it could be misinterpreted by customers. In many cases we will have more than one name on our accounts for each household. The stipulation of surveying the bill payer only may result in reduced success rates for surveys.	NES	We expect to address issues relating to who should be sampled during the detailed design and piloting phases of the C-MeX implementation process.	No change
There is no need to specifically mention resolution if the questions to customers is "how satisfied were you with the interaction with your water company" - resolution then becomes a significant influencing factor on how the customer answers this question and it picks up all elements.	SEW	In appendix 3 we discuss the consultation responses on using resolved contacts and conclude that we will use all contacts in the customer service survey, not just those that have been resolved.	No change

Q5. Do you agree with our proposed Developer Measure of Experience (D-MeX)?

In the draft methodology we consulted on a new Developer Measure of Experience (D-MeX). We explained that we wanted to incentivise water companies to provide an excellent customer experience for developer services (new connections) customers.

These customers included small and large property developers, self-lay providers (SLPs), and new appointments and variations (NAVs).

There was general support for the introduction of D-MeX and that we were taking more account of developer services customers at PR19. There were some specific concerns relating to its scope, purpose, design and the associated financial incentives.

This section outlines respondents' views and our responses on D-MeX that are not covered in appendix 3 (customer measure of experience and developer services measure of experience). The sub-questions we refer to in the table were included in the Water 2020 draft methodology response template.

Table 3.5 Summary of issues raised in response to outcomes, question 5

Q5 Do you agree with our proposed Developer Measure of Experience (D-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Whether there should be separate measures for water and wastewater is an issue to discuss.	UU	We will consider how to address water and wastewater developer services as part of the further design work on D-MeX, including whether the metric and financial incentives need to be split between water and wastewater.	No change
There is no apparent alignment in the D-MeX proposals with other Ofwat requirements, for example the information and publication stipulations in Ofwat's Code for Adoption Agreements.	Fair Water Connections	As set out in appendix 3, we have taken into account how D-MeX fits with other work that we are carrying out to better enable competition, for example our Code for Adoption Agreements and Charging Rules.	No change
The timely delivery of critical non-contestable work that Self-Lay Providers need from water companies, to deliver their services to developers, is not proposed to be measured through D-MeX so we could end up	Fair Water Connections	Following the consultation we have decided that the D-MeX financial incentive will now partly be based on a quantitative measure of water company performance against a set of key metrics, based on Water UK's existing metrics of service levels for developer services	Minor change

Q5 Do you agree with our proposed Developer Measure of Experience (D-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
rewarding water companies who hold back competition.		customers. This should incentivise companies to deliver critical non-contestable services in a timely fashion.	
In relation to Option 1: Ofwat's approach is too weak to bring about real and meaningful change.	PN Daly	D-MeX is complementary to the steps we are taking to better enable competition in new connections and ensure a level playing field for new entrants, including: Our Code for Adoption Agreements for England, published in November 2017 and our new connections charging rules for water companies in England which come into effect in April 2018. We have amended D-MeX following consultation responses to include a quantitative element (as described immediately above). This should incentivise companies to deliver critical non-contestable services in a timely fashion.	Minor change
We would be interested to understand from a Wholesale Services perspective how D-MeX aligns with the October 2018 plans to bring the deferred Developer Services processes into the open market and the impact this may have on the measure itself.	ANH	Developer service customers will be able to choose whether to continue to interact with the wholesaler or retailer, even when the developer services parts of the market code are fully implemented. This would mean that the D-MeX incentive would still be relevant to incentivise a better customer experience for developer services customers. At the time of publishing our PR19 final methodology, developer services remain suspended from the market codes. We will continue to develop D-MeX and the pilot, but we will coordinate with the business retail market governance arrangements, in order to make sure that the two are fully aligned.	No change

Q5 Do you agree with our proposed Developer Measure of Experience (D-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Q5a Do you agree with our proposed approach to implementing D-MeX, in particular by conducting a satisfaction survey amongst past developer services customer contacts?			
We are keen to ensure that NAVs and SLOs are appropriately represented. There may be limited activity from these types of customers in certain regions and this may be, in part, the result of levels of service they receive. If the surveys are conducted only on the basis of completed jobs they may miss a portion of these customers. The basis on which surveys are undertaken (e.g. completed or resolved jobs), especially when some developments are multiyear, will be an important consideration for the Task and Finish Group.	ANH	We agree that the sampling and survey methodology will be an important consideration for the D-MeX working group. We plan to continue the discussion as part of further working group meetings in 2018.	No change
If a survey based approach is selected, high self-lay volumes increases the number of customers which may make it more difficult for the companies with most competition, and the most customer engagement, to get better customer feedback than in other companies.	Fair Water Connections	As we continue to design the D-MeX pilot and co-ordinate with the D-MeX working group we will take into account the effect varying levels of self-lay volumes might have on the survey and what implications it has for its design. In this context it would be worth noting that following the consultation we have decided that the D-MeX financial incentive will now partly be based on a quantitative measure of water company performance against a set of key metrics (as explained above).	Minor change
NPS could be more relevant within the D-MeX Measure. Developers work across many different water companies regionally and nationally and this could provide a useful insight for developers.	Kier	We can consider whether NPS would be appropriate for this group of customers as part of the D-MeX working groups, and whether it would be suitable to include NPS in the pilot of D-MeX. Feedback from one of the D-MeX working groups suggests that the relationship and engagement with	Minor change

Q5 Do you agree with our proposed Developer Measure of Experience (D-MeX)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		developers is different to household customers. This might make collecting NPS data via SMS surveys more challenging.	

4. Securing long-term resilience

Q1. Do you agree with our resilience planning principles?

Our proposed resilience principles covered the following areas:

- Principle 1: Considering resilience in the round for the long term;
- Principle 2: A naturally resilient water sector;
- Principle 3: Customer engagement;
- Principle 4: Broad consideration of intervention options;
- Principle 5: Delivering best value solutions for customers;
- Principle 6: Outcomes and customer-focused approach; and
- Principle 7: Board assurance and sign-off.

Respondents generally supported the resilience planning principles. Key issues raised by respondents were:

Engagement with other parties beyond customers – Thames Water, Environment Agency, CCWater and WWF-UK considered that we should emphasise engagement with a wider range of parties and other stakeholders. The Committee for Climate Change and WWF-UK commented that customers may not always be best placed or have a full understanding or the correct risk appetite to make judgements about resilience

There should be a greater emphasis on the environment – CIWEM and WWF-UK were concerned that the balance between resilience, customers and the environment needed to shift towards the environment.

Resilience and its interaction with wastewater management plans – WWF-UK and Blueprint for Water suggested that we should do more to encourage wastewater management plans, as well as water management plans

Short term and long term risks – Wessex Water and British Water were concerned about balance across the long and short term. Safe and SuRe suggested that the principles account for a socially and economically resilient water sector.

Collaboration – Thames Water, Safe and SuRe, CH2M Hill and the Committee for Climate Change stated that resilience options should consider cooperation and collaboration at a regional or even national level.

Table 4.1 Summary of issues raised in response to resilience question 1

Q1. Do you agree with our resilience planning principles?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Engagement with other parties beyond customers			
The resilience principles should emphasise the need to engage with third parties and other stakeholders, not just customers. Resilience is not just an issue for the incumbent.	TMS, EA, CCWater, CCC, WWF-UK	Our draft methodology already states that we expect companies to work together with other companies and stakeholders to identify the most efficient and cost effective resilience solutions. Our Resilience in the Round document, published in September, provides examples of good practice that companies should consider when developing their business plans and possible approaches to engagement document.	No change
There should be a greater emphasis on the environment			
The balance between resilience, customers and the environment needed to shift towards the environment. One respondent stated: “The focus is entirely on meeting customer expectations (however	CIWEM, WWF-UK, Waterwise	We continue to consider the balance between customers and the environment in the resilience principles is appropriate. The environment is an important aspect of resilience and we expect companies to account for environmental obligations and impacts as	Minor change

Q1. Do you agree with our resilience planning principles?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
realistic or unrealistic), at affordable prices without apparent regard to the need for increased care in the use of water, under threat of increasing scarcity and increasing competition for resources between customers. Nor does it consider the changing needs of nature and the environment"		part of their engagement with customers. However, customers pay bills. To maintain trust and confidence, it is important that they understand and support proposals that go beyond a water company's obligations. We will expect water companies to have regard to the EA and Natural England's WISER strategic steer (found on our website) and Natural Resources Wales PR19 Expectations and Obligations from Natural Resources Wales. The Resilience in the Round document, provides examples of good practice in dealing with environmental issues and responding to future challenges. We have amended the final methodology to more clearly set out our expectations on water companies with respect to the environment.	
Natural capital should be considered more prominently.	EA, WSH, ANH	Companies should consider mechanisms and methods for assessing the environment as part of their business plans. The Natural Capital approach provides an opportunity for the value of ecosystems to be better incorporated within the evaluation of resilience. As suggested in Resilience in the Round, we will expect companies to consider the use of the Natural Capital approach in business plans. We have made this clear in the final methodology.	Minor change
The principle for a naturally resilient water sector should not be limited to "as far as this is consistent with companies' role as providers of water and wastewater services"	Blueprint for Water, WWF-UK, Natural England	It is important that water companies' role as providers of water and wastewater services is explicitly recognised to ensure we do not ask water companies to go outside their obligations and duties. This does not mean that water companies should not take forward schemes with environmental benefits, in particular, given water companies general biodiversity duty. However, it would not be appropriate for water companies to go outside their role as water and wastewater providers.	No change

Q1. Do you agree with our resilience planning principles?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
We support the continuation of customer-focused challenge groups, and believe there should be an equivalent to represent the interests of the environment.	CIWEM	We expect companies as part of their development of their business plans to engage their customer challenge groups (CCGs). All CCGs have an environmental representatives, such as the EA, NRW, Natural England or environmental NGOs to reflect on customers' views and relevant environmental issues. We also facilitate meetings between environment bodies, such as the EA, and Natural England and the CCGs chairs. We do not consider that we need to set up a separate challenge group on the environment.	No change
Resilience and its interaction with wastewater management plans			
Ofwat should do more to encourage wastewater management plans, as well as water management plans	WWF-UK, Blueprint for Water	In the draft methodology, we proposed each company set out a long term bioresources strategy. The strategy should explain how it will use a market based approach, to improve efficiency and create value for money over the long term; taking into account the wider costs and benefits to the economy, society and the environment. We have also worked with the EA and others to develop the Drainage Strategy Framework, and we expect this framework to form the basis for planning of future wastewater investment.	No change
Short term and long term risks			
The methodology does not adequately consider both short and the long term risks and resilience. For example, Wessex Water felt that, "In our view the current proposals will discourage long-term resilience planning. This raises particular concerns	WSX and British Water	We agree - resilience should be considered over both the short and long term. This is reflected in our performance metrics. While most performance metrics focus on the immediate period and reflect historical performance, the inclusion of forward looking metrics promotes a longer term focus.	No change

Q1. Do you agree with our resilience planning principles?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
in the light of the resilience duty, which we interpret to require a longer term view to be taken."		Our final methodology emphasises that we expect companies' plans to consider resilience over both the short and long term. We have adjusted the initial assessment of business plan test 1 to include reference to short term, as well as long term resilience.	
Ofwat should consider including revised principles, which explicitly account for a socially and economically resilient water sector, to balance the principle for a naturally resilient water sector	Safe and SuRe	We have reviewed the principles and are satisfied that the principles already sufficiently take into account the social and economic perspective, particularly in principles 2 and 3, and the approach to customers and the environment.	No change
Enhancements to resilience that require additional investment need to be reflected in companies cost allowances.	NES	Companies should include the costs for maintaining and, where appropriate, improving resilience within their business plans. We will assess resilience related expenditure, in line with our resilience planning principles and our overall cost assessment approach. Where companies are making proposals for adjustments to our cost baselines (for example, due to additional resilience expenditure), we will assess this in line with our adjustment process. We consider that expenditure related to resilience is appropriately covered in our methodology.	No change
Collaboration			
Resilience needs to be considered on a national, as well as regional basis. Also, there is a need to explicitly consider options that involve cooperation and collaboration at a regional, or even national level, where they offer best value (such as transfers and cross border planning)	TMS, Safe and SuRe, CH2M, CCC	This is already addressed in the resilience principles, where we state that: companies should consider options that involve cooperation and collaboration with other companies, at a regional and national level. In Resilience in the Round we emphasised the benefits of collaboration through schemes such as, catchment management and system operation models, which have the potential to offer widely applicable benefits. We therefore consider that no explicit change is required in the final methodology.	No change
Customers			

Q1. Do you agree with our resilience planning principles?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Customers may not be best placed or have a full understanding or the correct risk appetite to make judgements about risks to resilience. For example, while Wessex Water CCG supported the inclusion of financial and corporate resilience, it considered that, unlike water resource planning, it may be harder to get as meaningful an input from customers on such issues.	CCC, WWF-UK and Wessex CCG,	Customers pay for water and wastewater services, and customer views should form a significant part of the evidence to support companies' business plans. Where there are potential bill impacts, we expect companies to communicate and explain the risks and impacts of proposals, regardless of whether they reflect financial, corporate or operational resilience.	No change

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?

Our proposed initial assessment tests were:

1. How well has the company used the best available evidence to objectively assess and prioritise the risks and consequences of disruptions to its systems and services, and engaged effectively with customers on the risks and consequences?
2. How well has the company objectively assessed the full range of mitigation options and chosen the interventions that represent, the best value for money over the long term and support from customers?

Respondents generally supported our approach to assessing resilience, and responses were received in the following areas:

Measuring resilience – Blueprint for Water and CIWEM commented that the tests should take into account the full range of mitigation options, considered against tests, such as, best value and social and environmental factors. Blueprint for Water also suggested that the Water Framework Directive good ecological status, could be used as an indicator of resilience.

Past investment – Wessex Water, Portsmouth Water and CIWEM were concerned that the draft methodology did not adequately account for past investments or incentivise additional investments to create a resilient water sector

Performance Commitments – Portsmouth Water suggested that there should be an aggregated PC for resilience. Portsmouth Water strongly disagreed that the standard performance commitments adequately reflected companies' long-term historical strategic investment to manage resilience risk of the water supply network. However, Southern Water was concerned that low probability, high impact risks could be missed in an aggregated metric. Another suggestion by Safe and SuRe was to consider how a PC or outcome is not met rather than look at the- likelihood of a bad outcome.

Treatment of Risks - Blueprint for Water and CCWater stated that the resilience risk assessment should be publicly available. Safe and SuRe commented that it was often easy to conflate risk management with implementing resilience.

Table 4.2 Summary of issues raised in response to resilience question 2

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Measuring resilience			
The assessment should take into account the full range of mitigation options that represent, the best value economically, socially and environmentally	Blueprint for Water	In line with principles 4 and 5, we expect companies to provide clear evidence that they have objectively considered the full	Minor change

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
over the long-term, and support from customers. Where appropriate, it should be mapped for cumulative risks and opportunities.		range of resilience management options, with a view to providing the best value for customers over the long term. Companies and the evidence that needs to be provided will be dependent on their business plans, and in particular, should reflect the complexity, scale and cost of proposed measures. We feel it would therefore be inappropriate, given our principles based approach to regulation, to provide specific measures or a checklist to companies. During customer engagement, companies should ensure that any projects or solutions are sufficiently evidenced to provide customers with the confidence that their plans are robust. As such, we would also expect such evidence to be deemed sufficient for their business plan when submitted to us. In 'resilience in the round', we highlighted the importance of companies using smart approaches to resilience. We have reemphasised this in the final methodology.	
The second test should mention economic, social and environmental resilience, and should explicitly reflect environmental resilience.	Blueprint for Water, CIWEM and WWF-UK	Companies will need to deliver environmental schemes where they have a legal duty to do so. Or where, consistent with the company's role as providers of water and wastewater services, it is the best value way of delivering an outcome in line with customers' preferences and priorities and is affordable.	No change
The assessment of resilience is likely to require engineering judgement	SWB	When using engineering judgement, we expect companies to be able to demonstrate that they have considered objective and robust evidence, and have developed proposals in line with customer priorities	No change
The assessment needs to consider adaptation, coping, and recovery and response options which are not explicitly covered by 'mitigation'	Safe and Sure	We have amended our discussion of the initial assessment test, to ensure that it encompasses recovery and response options.	Minor change

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
We should use the Water Framework Directive good ecological status as an overall indicator metric of ecosystem resilience.	Blueprint for Water	We consider that the environment is well covered by our common performance commitments (which include leakage, per capita consumption, pollution incidents, drought risk, flooding risk and treatment works compliance relate to the environment) and by our requirement for companies to have at least one bespoke performance commitment on the environment. We have included "Water Framework Directive water body status improvement" as a suggested performance commitment to cover the environment in appendix 2 (delivering outcomes for customers).	Minor change
We would like to see a robust, comparative assessment and ranking of companies' existing risk management of resilience, prior to planning proposals, to improve resilience	PRT	The Water and Wastewater Resilience Action Group (WWRAG) Task & Finish subgroup, and the UKWIR project on resilience, have been working intensively with us to develop resilience metrics, which could be used as common performance commitments. Alternatively, companies could use the metrics as their bespoke performance commitments. They have found that resilience metrics can be difficult to develop. We appreciate the efforts made and the complexity of the task, especially to deliver a comprehensive metric on the resilience of water and wastewater services. We expect work to develop such metrics to continue.	No change
Past investment			

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Our approach does not take appropriate account of previous investments to improve resilience, as these will not be reflected in the performance metrics. This, in part, reflects the position that all companies are starting from a different point in developing resilience. For example, Wessex Water suggested that some companies were more resilient than others as a result of long-term strategic investment, whilst others are exposed to higher levels of risk. This variance of the tolerance of resilience risk between companies, is not transparent to stakeholders. Portsmouth Water highlighted that the DWI have moved away from Mean Zonal Compliance, a measure of outcome, to the Compliance Risk Index, a measure of risk. They suggested that a similar approach should be taken to assessing the resilience of individual plans.	WSX, PRT, CIWEM	Our draft methodology stated that when putting forward resilience proposals, companies should also bear in mind the funding provided in previous price controls to maintain assets, and that we would not expect customers to pay twice for the same activity. We consider that the draft methodology already has measures to encourage a long term focus, such as the longer term focus of business plans, the resilience principles and 2035 indicative performance commitments. If a company has under invested in resilience in the past, then there is a greater risk that future commitments will not be met. It should be emphasised that past investment does not mean that companies should not consider further improvements to resilience. Our focus on forward looking metrics will continue to measure improved resilience and will not dis-incentivise future investment. We continue to consider that our focus on a combination of outcome and asset health based metrics, and longer term risk based metrics on resilience, provides an appropriate focus on the outcomes that customers receive, while incentivising longer term resilience.	No change
Performance commitments			
There should be an aggregated PC for resilience based on overall resilience risk, and resilience should be ranked. Although, Southern Water was concerned that low probability, high impact risks could be missed in an overly aggregated summary metric.	PRT, SRN	Based on industry work to date and our own analysis, it is unlikely that there is a single comprehensive measure of resilience. In the draft methodology, we proposed ruling out aggregated PCs, which respondents supported. We continue to consider that the current balance between outcomes, asset health and longer term resilience metrics,	No change

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		together with more detailed definitions of those metrics, will ensure an appropriate focus on the outcomes that matter to customers, while incentivising long term resilience.	
Instead of a 'risk score' with a 'likelihood of a bad outcome occurring', it may be preferable to consider how a PC and metric is not met.	Safe and SuRe	We consider it important that companies focus on whether or not an outcome or metric is met, rather than the reasons why that metric might not be achieved, as it is the end outcome that customers receive.	No change
Treatment of risks			
The resilience risk assessment should be publicly available to provide transparency, and should be mapped to risks. There was some variation in stakeholder views. Southern Water suggested that metrics should be easy to understand and simple to measure - to aid customer understanding. Whereas, United Utilities considered that the resilience assessment should be more sophisticated and innovative.	Blueprint for Water, CCWater, UU, SRN	We consider that transparency is beneficial, and we have reiterated this in our draft methodology by encouraging companies to publish their business plans. Companies should be able to simply explain resilience to their customers, so that they can understand resilience and the companies' proposed interventions. However, this does not prevent companies from using sophisticated and innovative ways to understand resilience to underpin their business planning.	No change
There is a tendency to conflate risk management with implementing resilience	Safe and SuRe	As stated in Resilience in the Round, risk management and resilience require different approaches, and we expect companies will need to adapt their approach to corporate, financial and operational planning. We have added a line in our methodology to reflect the importance of distinguishing the two	Minor change

5. Wholesale controls

Q1. Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?

Our draft methodology proposed to set total revenue controls for network plus water and network plus wastewater on broadly the same basis as wholesale controls in PR14. We also set out detailed proposals for developer services and for the revenue forecasting incentive. We received strong support for our overall approach to network plus controls, though there were mixed responses to our proposals for developer services and to a lesser extent the revenue forecasting incentive.

In the table below we set out respondent's views and our response on key policy areas covering:

- form of wholesale controls;
- developer services; and
- revenue forecasting incentive.

Full details of our final approach to network plus controls is provided in appendix 7 (network plus water and wastewater controls). Note at the draft methodology water trading incentives were also part of this appendix but have moved to water resources for the final methodology and comments on this area are covered under Q2 (table 5.2 below).

Table 5.1 Summary of issues raised in response to wholesale controls, question 1

Q1. Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Form of wholesale controls			
There should be a visible split between pre and post 2020 RCV.	YKY	In the final determination we will make a distinction between pre and post 2020 RCV for the purposes of calculating the allowance.	No change
Greater transparency is required in the split between household and non-household controls, with more simplified wholesale non-household price controls to reflect fewer customer groups.	NWG Business	The wholesale controls fund the costs of wholesale activities. Wholesale charging rules provide the basis for ensuring that companies set wholesale tariffs to recover these revenues in a transparent and cost reflective manner. It would not be appropriate to set separate wholesale controls for different customer types.	No change
Requested an assessment of the systematic risk of difference in inflation pressure between price controls.	SWB	We have set out our approach to assessing cost efficiency at PR19. We expect companies to evidence claims that different input price pressures exist.	No change
Asked for commentary on how cross price control decisions will be made and applied.	SWB	When considering setting cost allowances, performance targets, and ODIs, in developing the final determination we will take into account the interactions between the controls and propose appropriate adjustments as required to ensure that the overall balance between the controls is appropriate.	Clarification
Asked for clarification on status of post 2020 investment in the network plus RCV.	NES	We have extended the RCV guarantee for pre-2020 investment at PR19. We will reconsider whether there is a need to extend this guarantee to the post 2020 investment at PR24. This is consistent with the regulatory approach adopted at past price reviews.	Clarification
Developer services			

Q1. Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Some or all developer services should fall outside the scope of the network plus revenue controls. Volatility within developer services charges had not resulted in volatility within wholesale charges.	AFW, NES, SVT, UU	We acknowledge that in principle, competitive markets enable and encourage greater efficiency, higher quality and innovation in the provision of services and deliver long-term benefits to developers and customers more generally. Nevertheless, where the market is not effective, or where services are not contestable, then targeted price regulation has an important role in protecting the interests of water customers and developers. Removing developer services from the scope of the controls will dilute regulatory protection for developers, particularly in areas where incumbents face limited competitive pressure, relying more on the effectiveness of ex-post regulatory tools (such as licence enforcement and Competition Act powers) to protect their interests. We will monitor the market during the price control period and revisit this at PR24. To support this, we will require incumbents to report annually on the revenues and volumes of both contestable and non-contestable elements. All of this data will start to reduce the asymmetry in information between incumbents and Ofwat.	No change
Developer services should have its own revenue control.	PRT, SEW	Given the relationship between developer services and network costs we consider that it is appropriate to incorporate them within the network plus control.	No change
Developer services volume adjustment should reflect both the totex and revenue impact; and be based on actual costs and revenues incurred.	TMS, SES	It is important that companies face appropriate incentives to deliver services efficiently. The adjustment mechanism should therefore reflect expected average costs and revenues. We recognise that connection size as much as connection numbers has an influence. To address this, we will adopt connection size banding to ensure changes in costs and revenues broadly align.	Clarification/ minor change

Q1. Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The developer services volume adjustment should reflect the volume of water supplied rather than customer numbers.	UU	For each control, we are allowing companies to define up to five size bands that will be the basis for forecasting and reporting. This can take account of size of development based on characteristics, such as number of connections.	Minor change
Request clarification on whether proposed average costs adjusted at the end of period are company-specific or industry-wide.	ANH	We will propose company-specific revenue adjustments as set out in appendix 7.	Clarification
Request clarification on whether average revenue in the end of period adjustments are in the PR19 price base (uplifted by the relevant inflation index) or to be set in the Final Determination.	ANH	We propose to apply an adjustment to the PR19 price base for the relevant inflation index.	Clarification
Request clarification on the interaction between the developer services mechanism and the revenue forecasting incentive.	ANH, SEW	Developer services are excluded from the revenue forecasting incentive, see appendix 7 for further information	Clarification
Request for clarification on the arrangements of developer services in the business retail market given that some appointees no longer have a retail market.	TMS	The arrangements for retail exit do not appear to prohibit a wholesaler from undertaking customer facing developer services activities.	Clarification
Revenue forecasting incentives			
Request for worked examples of how the incentive will operate and clarification around the deadband allowed under the mechanism	NWGB, SWB, NES	We will publish the revenue forecasting incentive (RFI) model early in 2018 setting out the detail of how the incentive will operate across the wholesale revenue controls. Appendix 7 sets out our rationale for the RFI deadband range.	Minor change/ clarification

Q1. Do you agree with our proposals for the form of control for network plus water and network plus wastewater set out in the 'Wholesale controls' chapter and appendix 7, 'Wholesale revenue incentives'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Consider that the incentive puts pressure on companies not to apply uplifts, even when these are justified by uncontrollable factors (e.g. Housing growth forecasting)	PRT	We do not agree. We consider in July we made it clear that when appropriate and legitimate, companies will be allowed to apply uplifts. In particular in the draft methodology we said that under the revenue control companies have the ability to change charges on an annual basis and have an incentive to do so through RFI which has been put in place to mitigate the impact of substantial annual revenue over (under)-recoveries. The wholesale charging rules alongside RFI are there to avoid the misuse of this flexibility in ways that are not aligned with customers' interests.	No change/ clarification
Consider that the incentive continues to disadvantage companies with high metering and variable weather.	SEW	We recognise that metering introduces some intrinsic degree of volatility, given that it involves a move from charges based on a rateable value to volumetric charges. This potentially results in highly metered companies being more exposed to the impact of variable weather conditions. At the same time, higher metering can result in greater data on customer usage, and there may be other drivers to increase metering by companies. On balance we do not consider the observed impact of metering on forecasting volatility is sufficient to require an alteration to the existing RFI deadband. Please see section 4.2.2 of appendix 7 for analysis on metering.	No change / clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?

Our draft methodology proposed to set total revenue controls with in-period adjustments to account for bilateral market entry, the policy around the control was structured around a number of key areas (see below). There was high-level agreement with our proposed approach across the majority of respondents, disagreements were focused on specific aspects of our proposals. In the table below we set out respondent's views and our response on key policy areas covering:

- post-2020 investment in new water resources;
- the capacity measure for the control;
- charging for water resources;
- water trading incentives;
- the in-period adjustment;
- long-term risk sharing; and
- other issues.

Full details of our final approach to water resources is provided in appendix 5 (water resources control).

Table 5.2 Summary of issues raised in response to wholesale controls, question 2

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Post-2020 investment in new water resources			

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Supported our building-block approach to post-2020 investment.	AFW, ANH, NES, SEW, SVT, SWB, WSX, PRT	Noted.	No change
Exposure to post-2020 investment risk should be time-limited to reflect uncertainty over future market entry after companies invest in long-life assets to avoid supply-demand deficits. This should be considered in the development of the market infrastructure.	ANH	The change in the level of regulatory protection for post-2020 investment is not designed to be time-limited as this would move us away from ensuring a level playing field between incumbents and third party providers in the future bilateral market in England. We provide further rationale in section 4.2.1 of appendix 5.	Clarification
Considered a unit-cost approach merits further analysis for the future.	WWF-UK, CIWEM	We agree and consider that to move to a unit cost allowance would need careful analysis of the benefits and costs for both England and Wales. We provide further rationale in section 4.2.1 of appendix 5.	No change
The capacity measure for the control			
Water resources yield is the most suitable measure for capacity as it closely aligns with the water resources control boundary. One respondent stated that this type of measurement is already in place.	ANH, NES, SVT, WSX	Noted.	No change
Queried whether abstraction licence changes, including those implemented in-period and not previously forecast, should impact on the calculation of pre-2020 capacity.	SWB, SVT	Reductions in abstraction licence quantities will reduce pre-2020 capacity, while any capacity developed to replace licence reductions from 1 April 2020 will form part of post-2020 capacity. We provide further rationale in section 4.2.2 of appendix 5.	Clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
While water resources yield is the most suitable measure of capacity, it is not a sub-component of deployable output for anything other than the simplest water resource zones. This will require significant additional modelling for large water resource zones.	SVT	In designing our approach we worked closely with EA, NRW, and incumbents through our working group, to ensure consistency with water resources planning, particularly the WRMP process. We provide further rationale in section 4.2.2 of appendix 5.	No change
Noted that the average volume of water available from the environment (yield) is dependent on the service level and the planning period, and will need to be defined by a set of values, not a single one. Yield is not a fixed figure, it depends on the assumptions for how the sources are flexibly operated conjunctively during different types of events.	WWF-UK, CIWEM, Lambert and Pearson	All measures used in water resources planning are subject to variability, however, we expect incumbents to apply the same consistent planning assumptions to the calculation of water resources yield as they do for their current WRMP. We provide further rationale in section 4.2.2 of appendix 5.	No change
Charging for water resources			
Agreed with our approach to water resources charges.	AFW, ANH, SVT, NES	Noted.	No change
Broad concerns on the lack of clarity on how new charging arrangements would operate.	AFW, PRT, SVT, Thames Tideway	We have provided greater clarity on how we expect charging arrangements will operate including providing a worked example. We provide further rationale in section 4.2.3 of appendix 5.	Clarification
Our proposals may introduce a potential increase of complexity for retailers around settlements in in the non-household market.	ANH	There is potentially greater complexity in the near-term from incumbents needing to develop notional charges to retailers for raw water. However this will not directly impact retailers, as the charges are required for compliance purposes and will not directly impact the business market. We provide further rationale in section 4.2.3 of appendix 5.	Clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The next price control should have a common structure for charges to avoid complexity for retailers.	SWB	Requiring incumbents to provide notional water resources charges for compliance purposes as part of the business plans provides time and opportunity for any practical issues or complexities to be worked through at the industry level. We provide further rationale in section 4.2.3 of appendix 5.	Clarification
Proposals will result in alterations to the Wholesale Charging Rules and this should be done in good time and in collaboration with incumbents.	WSX	Any changes to the wholesale charging rules will be worked through collaboration with the industry and wider stakeholders.	Clarification
Water trading incentives			
Supported our approach to water trading incentives.	ANH, NES, WSX, PRT, SES, CIWEM	Noted.	No change
Requested discussion on how to calculate lifetime economic profits, and clarification on who pays.	PRT	Lifetime economic profits (sum of economic profit each year for the duration of the trade) are discounted by the real cost of capital to reflect the time value of money. The incentive is paid through an uplift in allowed revenue in the next period, and is then collected from customers. We provide further detail in section 4.3.1 of appendix 5.	Clarification
Requested a rolling account of annual trades agreed and made.	WWF-UK, CIWEM	Information on annual trades between incumbent companies are published annually in the bulk supply register. To improve transparency we have revised the reporting template to provide further information and to make it easier to understand.	Clarification
Water trading incentives should not encourage trades that drive unsustainable abstraction.	Natural England	In order to obtain the incentives incumbents must produce and comply with a trading and procurement code. This requires an incumbent to explain how it will ensure the protection of	Clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		environmentally-sensitive abstraction sites. We provide further detail in section 4.3.1 of appendix 5.	
Water trading incentives should not disincentivise companies from making essential investment in water resources where this is the best value option for customers and the environment.	CCWater	We expect incumbents' WRMP19 plans to account for water trading incentives as an encouragement to commit to a water trade where it is the best value option, rather than as a disincentive to invest in other options where they are identified as better value. We provide further detail in section 4.3.1 of appendix 5.	Clarification
The in-period adjustment			
Supported our approach to the in-period adjustment to reflect bilateral market entry.	ANH, NES	Noted.	No change
Suggested a delay in market design until after the necessary legislation has been passed (that is.at PR24). Later implementation would allow testing of the capacity measure on large complex water resource zones, for Abstraction Reform to be implemented, and the Water Framework Directive impacts on capacity to be absorbed.	NES, SVT	Delayed implementation would not reflect wider policy changes in water resources and would not provide incumbents with regulatory certainty on our approach. We provide further rationale in section 4.4.1 of appendix 5.	No change
Adjustment should only apply to the proportion of capacity related to non-household customers until domestic competition is implemented.	SVT	Our approach does not distinguish between capacity required for household and business customers, as it is inappropriate to make the distinction in this context. We provide further rationale in section 4.4.1 of appendix 5.	No change
The adjustment should only apply where the entrant has signed up a business customer ie not a notional capacity that could be made available.	SVT	The adjustment is linked to the equalisation payment, as there will only be an adjustment made when the third-party provider contributes to the supply-demand balance and has contracted	Clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		capacity in the market. We provide further rationale in section 4.4.1 of appendix 5.	
Asked about incumbents acting as suppliers of last resort for entrants.	ANH, SVT	This ties into wider detailed design of the bilateral market and access pricing arrangements which is outside the scope of the methodology. We provide further details on next steps for these issues in section 4.4.1 of appendix 5.	Clarification
New entrants should be subject to the same sustainability obligations (e.g. abstraction management, catchment risk assessments) as incumbents to safeguard the environment and ensure a level playing field.	ANH	The current and future environmental regulatory framework will apply to all abstraction licence holders (both incumbents and third party providers). Catchment management and risk assessments for drinking water quality should be agreed on a contractual basis.	No change
The timing of the in-period adjustment may dissuade companies from investing in new resources, and may conflict with resilience.	CCWater, PRT	The adjustment will help ensure better planning by incumbents to benefit customers and the wider environment as it provides a financial incentive for incumbents to anticipate bilateral market entry. We provide further rationale in section 4.4.1 of appendix 5.	No change
Long-term risk sharing			
Supported our approach for incumbent-devised risk-sharing arrangements in accordance with Ofwat principles.	SEW, SVT, NES	Noted.	No change
Broad concerns related to the lack of clarity on our ultimate policy intent and what services should be related to new risk-sharing arrangements. This included the links to resilience and demand management expenditure.	ANH, CIWEM, PRT, SEW	This policy is focused on the development of new water resources assets within the water resources control. However, we recognise the importance of the twin track approach of both supply and demand solutions to meet future challenges. One of our long-term risk sharing principles is that it should not distort	Clarification

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		the incentives to meet stretching performance commitments for demand management. We provide further rationale in section 4.4.2 of appendix 5.	
Any consideration of risks needs to be undertaken against the appropriate planning driver rather than year to year usage.	SEW	We expect the risk-sharing arrangements to be calibrated against the appropriate planning scenario used in the design of the option. We provide further rationale in section 4.4.2 of appendix 5.	Clarification
Concern with outturn demand being used to determine the extent to which new incremental capacity is used. New capacity to address climate change, replace lost licences and improve drought resilience is not correlated to short-term variations in demand.	SVT		Clarification
There are costs to the under-development of capacity and more-than-planned use of demand restrictions, as well as costs of over-development of capacity.	CIWEM, WWF-UK	The outcome delivery framework provides a buffer against risks of under-investment, as there is a link between performance and outperformance payments/underperformance penalties. We provide further rationale in section 4.4.2 of appendix 5.	Clarification
It is unclear what proportion of market-wide utilisation risk from post-2020 investment in new water resources will be carried by customers.	CCWater	This policy aims to reduce the current risk that customers face and ensure that incumbents take an appropriate share of the risk. We provide further rationale in section 4.4.2 of appendix 5.	Clarification
Other issues			
Queried the water resources control boundary where it was considered that investment in water safeguarding / catchment management activities will be part of "network plus".	Blueprint for Water	Catchment management is included in the water resources control under the raw water abstraction activity envelope as defined in the RAGs. RAG 4.06 states that "the water abstraction service includes activities related to the identification of new sources, including catchment management, licence management, management of schemes in accordance with acts	No change

Q2. Do you agree with our proposals for the form of control for water resources as set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		of parliament and other legal obligations, and the abstraction infrastructure".	
There is a risk that the cost of a separate control for water resources for purposes of "revealing improved information that will enable us to set better targeted incentives" will not be worthwhile. The benefits depend on third parties being able to sufficiently supply water resources at an acceptable price.	WWF-UK	The introduction of a separate control was part of a package of policies which will have significant benefits for customers. A summary of our impact assessment supporting our changes is provided in section 3.1.3 of appendix 5. Going forwards we will continue to monitor the success of the control and the development of the markets.	No change
Available volume for abstraction remains a key mechanism to ensure protection of designated sites. Ofwat should ensure that company performance commitments and its assessment of Business Plans enable the provision of alternative supplies where needed to protect the environment. We would welcome approaches that complement the aims of abstraction reform.	Natural England	Our approach to the form of control aims to encourage the use of water resources that most benefit the customer, resilience and the environment. This is consistent with water resources planning where incumbents identify solutions as part of a best value plan. The abstraction incentive mechanism (AIM) is designed to further promote sustainable abstraction and forms part of ODI framework (see appendix 2).	No change
Would like reassurance that measures will be in place to prevent a water company from acquiring more water resources than it needs and that the environmental impacts of third party bids to supply water resources will be assessed and if necessary controlled.	Natural England	Our approach does not change any obligations that abstraction licence holders (both incumbent and third party providers) have in relation to their environmental regulations.	No change

Q3. Do you agree with our proposals for access pricing for English water companies set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?

Our draft methodology proposed that as part of business plans companies should submit key information on the costs of new water resource options alongside indicative equalisation payments and charges for water resources. There was high-level agreement with our proposed approach across the majority of respondents, though there were a number of comments on implementation, timing and scope. In the table below we set out respondent's views and our response on key policy areas covering:

- the indirect link;
- annualised unit cost and equalisation payments;
- assessing company data; and
- other issues.

Full details of our final approach to access pricing is provided in appendix 5 (water resources control).

Table 5.3 Summary of issues raised in response to wholesale controls, question 3

Q3. Do you agree with our proposals for access pricing for English water companies set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The indirect link			
Respondents supported an indirect link as being a proportionate approach.	ANH, NES, SVT, TMS, UU, WSX, YKY	We note the general support for an indirect link and will maintain this approach in the final methodology.	No change

Q3. Do you agree with our proposals for access pricing for English water companies set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Supported no link, with access prices managed through an alternative process that allows for a later submission.	SES	Key advantages, such as helping provide assurance of a level-playing-field and certainty around cost recovery for incumbents, would be lost with no link and delaying collecting data. We provide further rationale in section 4.3.2 of appendix 5.	No change
Respondents do not object to providing access prices as part of business plans but note the risk of inconsistency between companies without a clear prescribed methodology.	AFW, TMS, UU	We have streamlined the scope of our data requirements and have dropped the requirement to report indicative equalisation payments as part of business plans. This is in part due to a recognition of the uncertainties in how these will be applied and the links to wider work on wholesale market architecture. We provide further rationale in section 4.3.2 of appendix 5.	Minor change
Concern that the proposals to publish access prices with business plans appear overly onerous and prescriptive, and not proportionate to the scale or risks. Access price publication can be managed more efficiently through an alternative approach allowing later submission (examples provided include an ex-post review, or on application).	ANH, SES, WSX	As noted above we have streamlined the scope of our data requirements. We are dropping the requirement to report indicative equalisation payments as part of business plans. This has resulted in the removal of data table 'Wr8 Water resources forecast charging and equalisation payments'. We provide further rationale in section 4.3.2 of appendix 5.	Minor change
Annualised unit cost and equalisation payments			
Requested clarification on how access prices, equalisation payments and in-period adjustments will be calculated.	ANH, SWB	To increase the understanding of annualised unit costs we commissioned Reckon (economic consultants) to develop an illustrative model and explanatory on its calculation. We have revised table Wr7 to build on the Reckon illustrative model, focusing on key data relevant to the calculation of the annualised unit cost measure. We provide further rationale in section 4.3.2 of appendix 5.	Minor change

Q3. Do you agree with our proposals for access pricing for English water companies set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Requested clarification on which elements of tables Wr6, Wr7 and Wr8 will be required in business plan submissions.	WSX	We provide an example on our requirements for reporting in Box 6, section 4.3.2, of appendix 5.	Minor change
The equalisation payment should be based on a fixed-pot basis (where the amount available is fixed) and only available on a "first come, first served" basis. The payments should also no longer be available when schemes have started, to avoid payments increasing the cost of the incentives.	SVT	Wider questions on how the equalisation payment functions were outside the scope of this methodology and were not part of our consultation. We plan to hold a consultation on how to take forward wholesale markets in early 2018. This will provide indication on, among other aspects, how and when we will further clarify the full mechanics of the equalisation payment.	Clarification
Using the Average Incremental Costs that companies put forward in WRMPs as the price to compete against is a reasonable approach.	SVT	For more information on the difference between annualised unit costs and the average incremental costs used for WRMPs see Reckon's 'Water resources annualised unit cost model: explanatory note'.	Clarification
Assessing company data			
It is not clear how proposed access prices will be assessed by Ofwat. Access prices should protect customers from significant bill changes due to de-averaging, whilst fostering the market Ofwat would like to implement. Welcome clarity on how Ofwat will ensure access prices will achieve this.	CCWater	We agree that transparency on the tests to be applied to data is important, to ensure confidence in the process and to encourage high quality submissions. We outline some example tests in section 4.3.2 that we may apply to annualised unit costs.	Clarification
Other issues			
There are some potential risks with bilateral entry which could mean that it is in conflict with the bidding market (rather than complementary) and puts effective	SVT	We plan to hold a consultation on how to take forward wholesale markets in early 2018. This will provide indication on how interactions with other markets will be managed.	No change

Q3. Do you agree with our proposals for access pricing for English water companies set out in the 'wholesale controls' chapter and appendix 5, 'Water resources control'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
water resources planning at risk. This needs to be considered in the final design.			
The control is based on capacity, but the bilateral market will be based on volume, in particular the amount of volume the retailer actually sells, not the maximum that can be provided. Linked to this in practical terms it must be possible for the supply to reach the retailer's customer(s) on the network or displace supply downstream of those customers.	SVT	We have recognised that there are links between the equalisation payment and the amount of water provided by third party providers, see further rationale in section 4.4.1 of appendix 5. Wider mechanics of how bilateral market supplies will function are outside the scope of the methodology but will be part of our future work on wholesale markets.	No change

Q4. Do you agree with the proposals for company bid assessment frameworks set out in appendix 9, 'Company bid assessment frameworks: the principles'?

In the methodology we set out a principles-based approach to achieve an appropriate balance between transparency and not creating additional regulatory burden on companies. We received responses from the majority of companies and another stakeholder. There was general agreement and strong support for our approach but there were some comments from a small number of respondents about aspects of our proposals.

Full details of our final approach to the bid assessment framework is provided in appendix 8 (Company bid assessment frameworks: the principles).

Table 5.4 Summary of issues raised in response to wholesale controls, question 4

Q4. Do you agree with the proposals for company bid assessment frameworks set out in appendix 9, 'Company bid assessment frameworks: the principles'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
An incumbent's affiliates and subsidiaries should not be prohibited from participating in the bidding process as it may simply deter incumbents from setting up subsidiaries such as water efficiency businesses. Concerns could also be mitigated by rigorous controls to mitigate against conflicts of interest.	ANH, SES, SVT	Our view remains that to allow an incumbent's affiliates or subsidiaries to participate in the bidding process would create a conflict of interest which may be perceived as unfair by third-party bidders and risk undermining confidence in the procurement process. Incumbents are not precluded from developing in-house solutions as part of WRMPs, which they will publish as part of market information requirements and which independent third-party bids will be assessed against. Further, an incumbent's affiliates or subsidiaries are not precluded from bidding for tenders from out-of-area incumbents.	No change
The costs associated with setting up the company bid assessment framework may not be justified by the amount of bidding activity. For example it is difficult for the framework to foresee and account for all eventualities and therefore the framework should be more limited until the extent of bidding activity is clear. Another similar view was that it is important to ensure no undue regulatory burden by creating unnecessary administration, to ensure a lean and efficient process which would not deter third party bidders.	ANH, UU	The aim of the company bid assessment framework is to stimulate bidding activity because it has been limited. A robust, comprehensive approach which gives confidence and clarity but retains some flexibility, is the way to achieve this. While the 3 principles must be adhered to by incumbents and we provide an expectation of a high quality bid assessment framework, some of the proposals are set out as best practice recommendations. If incumbents have good reason not to implement a best practice recommendation they may explain why.	No change
There should be time limited bidding windows rather than the proposed open bidding process as this could lead to inefficiency if bids were still being submitted/assessed when a final solution was being developed.	ANH, TMS, UU	This was proposed as a best practice recommendation. We agree that for each tender an end date should be made clear, and therefore the process should not be left completely 'open'. This should align with business needs. As part of the requirement for companies to provide market	Minor change

Q4. Do you agree with the proposals for company bid assessment frameworks set out in appendix 9, 'Company bid assessment frameworks: the principles'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		information (arising from Condition M1 and the water resources market information guidance) incumbents will be required to update the information to indicate the progress of a tender against standard project lifecycle stages or indicate if project has not yet commenced. This would provide third parties with an up to date understanding of the delivery or progress of an incumbent's preferred options.	
The best practice recommendation for an independent third party arbitrator to resolve disputes could create further issues. It was noted that the arbitrator would be unregulated and there would be no further avenue for appeal of the arbitrator's decision. It was also questioned over the benefit it would offer over entering into a written agreement to adhere to the 3 principles of the framework as this would provide aggrieved third parties with legal recourse through the courts for breach of contract. Another view was that Ofwat was best placed to hear complaints from third parties and offer resolutions.	TMS, UU	Having considered respondents' views on this specific matter and wider views around the need for proportionality, on reflection we feel this best practice recommendation is unnecessary. Our expectation for a high quality bid assessment framework is that companies will have a robust and accessible complaints/challenge process in place, should a bidder consider their bid has not been considered in accordance with the bid assessment framework. We consider giving companies ownership of their approach here will help provide scope for companies to take ownership of this aspect of their bid assessment frameworks. In terms of Ofwat involvement, at present there is no regulatory framework for the regulation of water supply agreements made between incumbents and third parties but Ofwat could potentially be given powers to determine disputes about supplies of water by virtue of section 12 of the Water Act 2014 (WA14), which provides for the regulation of these agreements.	Minor change
Although an independent procurement team should be responsible for the assessment of bids, it is important for the team to understand the specific challenge that bids are seeking to address, otherwise a sub-optimal	ANH	The intention was to exclude those individuals who had been involved in the development of the incumbent's own in house solution or pre-tender preparation to ensure no conflicts of interest arise, rather than experts in the	Clarification

Q4. Do you agree with the proposals for company bid assessment frameworks set out in appendix 9, 'Company bid assessment frameworks: the principles'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
solution may be selected. It was suggested that this knowledge could be provided through the involvement of experts from the relevant part of the business who were not directly involved in the development of the incumbent's solution.		incumbent business generally. The final decision document clarifies this point.	
One respondent expressed their support for the bid assessment framework but questioned why information about the water resource bid assessment is not included in the information requirements for water resources particularly as there is a requirement for information on bids for bioresources, but not for water.	CCWater	Requiring incumbents to provide us with information on bids for bioresources will allow us to assess market activity to help us to monitor market development. This will allow us to identify whether the market is functioning well or whether we need to take further action to address any unintended consequences or further barriers to the development of the market, such as a bid assessment framework. For water resources, our water 2020 work had identified the main barrier to entry in the water resources market as the lack of transparency of the information which would allow third parties to more effectively identify trading opportunities. This is addressed by the requirement for incumbents to publish water resources information and the bid assessment framework.	No change

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'?

Our draft methodology proposed to set an average revenue control with an end-of-period forecasting accuracy incentive, in-period revenue correction mechanism and an in-period trading profit mechanism. The majority of respondents supported our bioresources control proposals with two respondents noting their disagreements. We also received two responses which were not directly

addressing the consultation question but providing commentary on bioresources issues. In the table below we set out respondent's views and our response on key policy areas covering:

- bioresources forecasting accuracy incentive;
- allowed average revenue;
- in-period reconciliation for revenue variance approach to be set out in final determinations;
- revealing trading intentions in business plans;
- environmental impacts;
- balance of risk and return;
- five-year control; and
- cost modelling in bioresources.

Full details of our final approach to bioresources is provided in appendix 6 (bioresources control).

Table 5.5 Summary of issues raised in response to wholesale controls, question 5

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Bioresources forecasting accuracy incentive			
Consider that the average revenue control and exclusion of cost-sharing already incentivises companies to provide accurate forecasts. Therefore it does not consider that a forecasting mechanism is necessarily required.	NES	We disagree. We consider that without intervention there is no incentive for companies to improve their understanding of bioresources production through accurate measurement. This is essential for effective market operation.	No change

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Concerned that the limitations of current equipment and natural variation of sludge production mean that variances could or would fall outside of the 3% deadband. The impact on revenues from substantial variances would be material. One company was also concerned that having this level of accuracy would result in additional costs from increased maintenance of measurement devices.	ANH, SRN, SVT	We have listened to the concerns, and are increasing the deadband but also increasing the penalty rate. However, by using values at a five year total level to calculate the incentive penalty we remove some of the impact of individual instrument accuracy and natural variability. The impact on revenues from variances is due more to the way the proposed average revenue control would work than to the forecasting incentive penalties. We are changing both the deadband and the way the average revenue control works to address these concerns.	Minor change
Note that there is a potential two-year window of opportunity to request a reset of forecast, however for this to be an effective risk mitigate it is important that the specific steps/asks are detailed.	SVT	In appendix 6 we have provided further information on the circumstances when we would consider adjusting the forecasting accuracy incentive. We shall set out more detail of the process prior to the start of the price control period.	Clarification
Consider that the forecasting mechanism should differentiate between fixed and variable costs.	SVT	We agree and are confirming a refined approach to the average revenue control which will distinguish between fixed and variable costs. This is explained further in appendix 6: bioresources control.	Minor change
Propose the volume of tonnes of dry solids (TDS) from new trades over 2020-25 are excluded from the Actual TDS in the forecasting incentive calculation to ensure that there is no disincentive for trading.	NES	We agree. The forecasting accuracy incentive applies to the quantity of bioresources produced by treating the wastewater from the company's in-area customers.	No change
The NEP requirements in the Water Framework Directive will affect the volume of sludge. As these requirements will not be defined at submission, there needs to be a mechanism that recognises its impact.	SRN, UU	We are including the uncertainty of the NEP requirements for phosphorus removal as an additional reason for companies to make representation to ask us to modify how we apply the forecasting incentive. We have also increased the deadband which means companies are more likely to be able to manage NEP uncertainty within the	Minor change

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		deadband and not incur a penalty. See appendix 6 for more details.	
Forecasting incentive mechanism should provide the same level of risk to both upside and downside scenarios.	WSX	Agree. We have refined our approach from draft methodology to ensure that the incentive is meaningful and symmetric. This should ensure companies are not incentivised to game the control by biasing their forecasts.	Minor change
Clarification on what to include in the forecasts and whether it only relates to existing trading arrangements and not to possible trading in the future.	SWB	The volume forecast should reflect the volume of sewage sludge produced by in-area wastewater treatment and exclude sludge volumes treated on behalf of third parties However, we clarify in appendix 6 why companies need to provide information to us about planned or expected future trading arrangement. We will need this information to help us to protect customers from the risk that companies ask them to pay for additional unnecessary capacity.	Clarification
Call for industry debate on the incentive prior to finalising the methodology. Concern that its design and calibration need to be proportionate.	ANH, SRN, WSH	We held a workshop on 4 October 2017 to explore the issues around the forecasting accuracy incentive and sludge measurement. Presentation materials and meeting notes can be found on the Ofwat website.	Clarification
Allowed average revenue			
Consider that profit sharing from trading (importing) could hinder the development of the market and that companies should be able to keep profits from any trades agreed within the price control period until the next control period.	NES, WSH	We disagree. Customers should benefit immediately if assets they are paying for are providing income to the non-appointed business. Some of the profit margin will remain with the non-appointed business so there is still an incentive to participate in the market. We clarify this in appendix 6.	Clarification
Concerned that we have not set out how we would protect customers if companies fail to measure sludge	UU	We are setting out the expectation that companies should be using instrumentation to measure sludge quantities by the	Clarification

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
quantities at the boundary between the network plus and bioresources controls.		beginning of the price control and at the latest by the second year of the price control. We shall consider how companies have complied with this requirement through our approach at the price review in 2024.	
Concerned if the average revenue control could lead to potential stranding of efficiently-incurred pre-2020 assets.	SWB	Our refined approach to the average revenue control for final methodology minimises the risk of stranding. More information is provided in appendix 6.	Minor change
In-period reconciliation for revenue variance approach to be set out in final determinations			
Consider that we should consult on the mechanism for dealing with in-period revenue variations as soon as possible and no later than the draft determination stage.	WSH	We have provided further details on how we expect this mechanism to work in appendix 6. This mechanism will work in a similar way to the revenue forecasting incentive mechanism used for other wholesale controls, but excluding the incentive penalties. We expect to publish a model of how this mechanism would work early in 2018.	Clarification
Revealing trading intentions in business plans			
Clarification on whether forecast of sludge volume include potential future trades. Future forecasts would be speculative as it would require knowledge of the future operation of the market.	SWB	Sludge volumes should include the in area wastewater treatment sludge produced, which was set out in our draft methodology proposals. We will want information regarding any contractual commitments to export or import sludge that is in place at the time of the business plan submission and the degree to which that commitment continues in the 2020-25 period.	Clarification
Question the need for providing information on future sludge strategies and third party delivery when the control is set up to promote markets. It is important that the regulatory framework is proportionate and targeted.	SVT, SWB	Sludge strategies which consider third party delivery of services are required to support any companies' plans to invest in future sludge treatment capacity. We require this information so we can protect customers from the risk of companies investing in new capacity at high risk of not being needed, or being proposed	Clarification

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It is not apparent how this information will be used for the purpose of setting price controls.		primarily to provide capacity for the non-appointed business to exploit in the market using appointed customers' money.	
Clarification on how information interactions between the appointed business and the bioresources trader will work, due to commercially confidential information.	NES	We do not agree that the appointed company will not know what the profit margin shared as part of the transfer price will be. We are not expecting a company to publish its total profit margin on a case by case basis, but rather account for the proportion of profit paid to the appointed business in aggregate in its APR. We will need this for a company to demonstrate compliance with the average revenue control set in its final determination. Companies should refer to the RAG 5.07 guidance which requires companies to include part of the profit margin in the transfer price. As this guidance does not specify the proportion of the profit margin to be shared with the appointed business, the total level of profit made from the trade will remain confidential. We expect companies to share the profit margins obtained through their transfer price with customers. We provide clarification in appendix 6.	Clarification
Environmental impacts			
Note that opening up the market for bioresources (sewage sludge) will require a review and assessment of the existing environmental regulatory framework in Wales.	NRW	This is to note rather than requiring a response.	Not applicable
Assurance that bioresources will be subject to effective controls and best practice to ensure atmospheric emissions do not result in harm in sensitive locations, such as, sensitive wildlife sites.	Natural England	The companies retain their "duty of care" when contracting with a third party to provide any bioresources services to them. So we would expect companies to set appropriate controls in their contracts to ensure that best practice and environmental	No change

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		protection is maintained by the third parties undertaking the treatment and recycling operations on their behalf. The industry has developed a Biosolids Assurance Scheme (BAS) and we expect companies to ask third parties to gain BAS accreditation before they treat and recycle bioresources.	
Balance of risk and return			
Would be interested in understanding if PWC had considered the retention of regulatory controls on revenue (the 3% forecasting penalty and +7% volume recovery cap) at the time they drew their conclusion on the impacts of beta associated with reform of the bioresources market.	SVT	PwC's analysis looked at the potential impacts based on the size of the loss of market share against proportion of costs which were fixed. Our final methodology puts less revenue at risk than was envisaged in the PwC assessment of the balance of risk and reward across the value chain. We consider that the differences in exposure to systematic risk for the bioresources price control in 2020-25 is negligible. For 2020-25, we consider the cost of capital, and its components, to be consistent across the bioresources and other wholesale price controls. See chapter 10 for further details.	Clarification
Concern that the potential for bioresources asset investment to have shorter depreciation than water asset investment it may disincentive capital investment	British Water	We would expect companies to adopt run-off rates that are broadly consistent with the natural rates for the bioresources assets to ensure that assets are replaced when needed. We would not expect the run-off rates to be the same as for other asset types (e.g. water resource assets) This should ensure that investment decisions are not distorted by the regulatory framework.	No change
Five-year control			

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'wholesale controls' chapter and appendix 6, 'Bioresources control'			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Consider a 5-year control won't incentivise companies to make long-term investment decisions when totex decisions are made over a 5-year period.	British Water	Companies are expected to demonstrate that they have taken a long term approach when putting forward their expenditure requirements for the next AMP. As set out in the previous Water 2020 documents (including the May 2016 decision document) we feel that a 5 year control balances the needs of protecting customers and providing sufficient incentives for efficient investment decisions.	No change
Cost modelling in bioresources			
Consider that 'availability of arable land' is a better cost driver than 'transport costs' for bioresources recycling.	UU	The point is noted and will be considered as part of the on-going development of the cost models. The availability of arable land is challenging to measure objectively and consistently across the sector.	No change
It is important that the cost assessment for bioresources is based primarily on a TDS cost driver. Any mismatch between the drivers of revenue and of costs risks windfall gains or losses that result from divergence between the drivers rather than from actual performance.	NES	We agree it is important that the independent variables used in these models should genuinely reflect cost drivers that are outside company control. Though our cost models are still under development, our work to date suggests it is likely that sludge production (in TDS) will be a key cost driver.	No change

6. Direct procurement for customers

Q1. Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)

Our draft guidance set out our expectations around the projects that would be suitable for consideration for Direct Procurement for Customers (DPC). We stated that we expect companies to consider using DPC for suitable projects, focusing on cases where competitive tendering is likely to deliver the greatest customer benefits. We set out our view that companies should consider DPC for relatively discrete, large-scale enhancement projects expected to cost over £100m based on whole-life totex.

Respondents generally welcomed the introduction of DPC. However, some respondents suggested the threshold for projects which should be considered for DPC was too low, and that companies should be able to bid for their own projects.

Appointees have helpfully provided lists of potential projects based on our guidance that they considered might be in scope at PR19. We acknowledge that appointees are currently developing their Water Resource Management Plans for 2019 and that the responses supplied were indicative and subject to change.

One respondent expressed strong disagreement on the basis that the policy design might not meet the policy aim of achieving value for customers, largely because the threshold was insufficiently high.

Issues raised by respondents are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 6.1 Summary of issues raised in response to direct procurement for customers, question 1

Q1. Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The scope of DPC arrangements			
The £100m totex threshold is set too low to be effective for DPC. Because the metric is whole life totex, it may capture more projects than originally envisaged. This could present a risk to customers. A capex threshold may be more appropriate.	BRL, PRT, SRN, SEW, ANH, CCWater	We presented our rationale for the £100m totex level in 'Water 2020: our regulatory approach for water and wastewater services in England and Wales' (May 2016). The £100m totex threshold is a threshold above which companies must assess whether DPC is suitable. It is not a requirement that every scheme above £100m totex must become a DPC scheme. Where a value for money assessment shows that DPC will not bring customer benefits then there is no requirement to proceed with DPC. We consider that totex is the appropriate metric to encourage innovation and remove incentives for capital intensive solutions. In circumstances where a company can clearly demonstrate robust customer savings for a project that meets the criteria and sits below the £100m totex threshold, we may consider this at the initial assessment of plans for PR19.	No change
The option to choose projects below £100m totex should be allowed if the company thinks DPC could deliver a better outcome for customers.	SWB		
Consideration of the best value for customers may include environmental, biodiversity and community benefits.	PRT	We set out in chapter 7 and appendix 9 (direct procurement for customers) the factors which companies should take into account when undertaking a value for money assessment for a potential DPC project.	Clarification
The capex/opex split (or ratio) that would deliver greatest benefit should be considered. Higher opex ratios would lead to higher interoperability issues,	ANH		

Q1. Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
reduce benefits to customers, and potentially limit investor interest.			
A suitable comparator should be used to demonstrate that there is value for money in delivering the project through DPC. It might be appropriate to run parallel tenders (such as for finance, build and operate contracts alongside build and operate contracts) to obtain the best results for customers.	TMS		
Appointees should generate a reserve price to judge bids against, with the award reverting to the appointee if bidders could not beat the reserve set by the appointee.	BRL, SVT		
Ofwat should provide cost-benefit guidelines, including setting out the relevant counterfactual.	Thames Tideway		
It is not clear why DPC is focused on new assets. There is scope to bundle existing assets and tender these for 25 year contracts under DPC.	British Water	There is currently no restriction on companies outsourcing operations and maintenance. We have not been presented with evidence around the marginal benefit of this activity being undertaken via a DPC approach.	No change
Who can bid in the tender process?			
Incumbent companies should not be excluded from the bidding process. Any risks presented in terms of conflicts of interest could be mitigated, perhaps through an independent process.	SEW, YKY, PRT, UU, SVT, SWB, ANH, Hastings	We have not seen any persuasive arguments that the potential advantages of allowing appointees or their associates to compete would outweigh the real or perceived conflicts of interest. We consider that our policy design has appropriate safeguards that ensure that where	Clarification

Q1. Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
An incumbent should be allowed to have a minority stake in a successful bid or be party to a joint venture.	ANH, TMS	circumstances are such that an appointee delivering a project would provide the best value for money for customers then this can happen. In chapter 7 and appendix 9 we have clarified the wording around the restriction.	
Other issues raised			
There is uncertainty as to whether benefits that can be achieved under a contract-based approach are as great as under a licence-based approach.	Thames Tideway	We set out in chapter 7 our policy on the use of contracts and the circumstances under which the use of a licence may be appropriate.	No change

Q2. What are your views on the type of tender model (ie an early or late tender model) appointees should use? Do you have any views on whether or not we need to specify a tender model companies should use?

Our draft methodology proposals set out that there were a range of possible tender models that might be suitable for appointees to use for DPC. We noted that we did not have a preference and were open-minded about whether or not it was necessary for a particular model to be specified for DPC. Respondents generally agreed that it was not necessary for Ofwat to specify a tender model.

Issues raised by respondents are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 6.2 Summary of issues raised in response to direct procurement for customers, question 2

Q2. What are your views on the type of tender model (ie an early or late tender model) appointees should use? Do you have any views on whether or not we need to specify a tender model companies should use?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat specifying a tender model			
There is no need for Ofwat to mandate a particular tender model, but should instead leave this to the discretion of each company to allow them flexibility to use the most appropriate approach for each project.	WSX, PRT, NES, YKY, SRN, UU, SVT, ANH, SEW, TMS, BRL, AFW, Thames Tideway, CCWater, CH2M, British Water	We indicated that we were open-minded as to whether we needed to specify a tender model or not. Taking into account the views of respondents, we agree that there is no need to specify a tender model, but rather leave this to the discretion of companies.	Clarification
Preference for an "early" model. Significant benefits, such as innovation and productive efficiency, can be captured through this approach.	SWB, WSH		
Other issues raised			
Ofwat should require companies to justify the approach to tendering that companies choose to take and explain how it is in customers' interests.	UU, CCWater	Given it is our intention not to specify a tender model, we clarify that as part of their value for money assessment of schemes, companies should explain and justify their tendering approach and explain how it is in customers' interests.	Clarification

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?

We set out our overall commercial and regulatory model for DPC, which was that appointees should be responsible for procuring services on behalf of their customers and should do so by tendering high-value schemes and managing these via a contract. We set out that we expected that, following a successful tender process, we would change an appointee's licence to allow them to recover the revenue for the winning bidder (the Competitively Appointed Provider – CAP) from their customers. We provided some detailed proposals for principles for procurement and contracting under DPC.

Respondents were generally supportive of our proposals, but raised a range of detailed points for us to address in relation to both the scope of the principles and their content, as well as around the treatment of costs associated with DPC. Issues raised by respondents are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 6.3 Summary of issues raised in response to direct procurement for customers, question 3

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The scope of the contract and procurement principles			
It is important to minimise the costs of the procurement process and this could be achieved through some kind of standardisation.	ANH, Thames Tideway	In appendix 9 we set out our principles for procurement and contracts under DPC. We also set out our intention that a DPC licence condition will require companies undertaking a DPC process to do so in line with our principles. We held a workshop with stakeholders in October 2017 to explore	No change
Standardised documentation could be developed by industry and Ofwat.	ANH		

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Companies should be able to determine when they apply these principles for each individual arrangement providing they can demonstrate that they have behaved appropriately and in a manner that accords with the principles.	WSX	approaches to procurement and contracting. It was clear from this event that the different features of projects and procurement processes would best suit a principles based approach.	
It is not necessary for all arrangements to be set out in advance of setting price controls. Licence changes could be made separately from the price control. Guidance could evolve over time as lessons are learned.	NES	We set out our approach to licence changes in appendix 9. Our methodology applies for PR19, without prejudice to methodologies for future price reviews.	Clarification
It may limit innovative opportunities to exclude bioresources projects from DPC.	YKY	We disagree. We have developed separate arrangements for the bioresources market. We have not seen persuasive evidence that there would be benefits to extending DPC arrangements to the bioresources market.	No change
Customers are key stakeholders within the DPC process.	BRL	We expect companies to consult their customers as part of their business plan preparations. DPC might be an area that is explored with customers in common with other areas.	No change
It could be sensible for appointees to maintain operation of the asset to ensure that they can comply with their statutory obligations.	WSH	We note that appointees are already able to contract out operations and maintenance and a number of appointees do so. We have not seen evidence that arrangements for DPC are materially different in this respect.	No change
Projects that involve more than one appointee (such as a water transfer scheme) might present additional complexities and require bespoke arrangements.	TMS, CH2M	Such schemes would present similar complexity whether or not delivered through DPC. Our policy design has been developed to incorporate best practice in procurement and contracting.	No change

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Companies should have the same level of operational and strategic control over DPC assets as they would over their own assets. The incumbent's statutory duties cannot be contracted to or adopted by the CAP.	TMS	Appointees are already able to contract out operations and maintenance and a number of appointees do so. We set out in chapter 7 and appendix 9 that statutory obligations remain with the appointee and cannot be contracted away. DPC does not change this.	No change
Historically it has proved difficult to manage statutory environmental compliance through contracts.	WSH, Natural Resources Wales		
Detailed comments of the contract and procurement principles			
The tender process should be halted if it becomes obvious that a good outcome cannot be reached.	YKY	We expect appointees to adhere to the procurement principles which we outline in appendix 9. We set out in appendix 9 our policy around contingency arrangements.	Clarification
Contingency arrangements need to be defined in advance of a failed tender process.	TMS		
It is unreasonable that the cost of a failed tender process should fall on the appointee.	PRT		
There is a balance to be struck between within-contract flexibility and the use of reopeners. This can be difficult to manage and evidence from PPP contracts show that getting it wrong can be costly. The balance will affect prices bid.	SRN, SVT, WSH, Thames Tideway	The contract and procurement principles place a strong emphasis on appointees to manage these areas in the interests of their customers. We have clarified in appendix 9 that we do not expect contract reopeners except in very limited circumstances. This will provide certainty over future revenue. Appointees are best-placed to understand their own requirements and to manage them through strong contract management on behalf of their customers.	Clarification
Entering a long-term contract for operation when demand is unknown would introduce complexity in	PRT	We set out in chapter 7 and appendix 9 the factors which companies should take into account when undertaking a	No change

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
changing contracts. This risk would be reflected in the contract price.		value for money assessment for a potential DPC project. We also set out in appendix 9 our contract principles, which cover both risk allocation and operation and maintenance.	
Consideration should be given to how the design and quantification of Outcome Delivery Incentives will interact with DPC contracts.	SEW	Contract principles 18 and 19 (set out in appendix 9) encompass our expectation that appointees should manage performance requirements through contracts, including through the use of financial incentives where appropriate.	No change
The principles should allow for step-in rights beyond just the failure of the CAP. Further clarity is needed on how to deal with the failure of a CAP. Safeguards should be in place to ensure that customers do not bail out a failed project or suffer degradation of service.	WSH, TMS, Thames Tideway, CCWater	Arrangements with respect to step-in rights are covered in appendix 9.	Clarification
The tax and accounting treatment of assets constructed under DPC need consideration.	UU, ANH, TMS, Thames Tideway	Contract Principle 2 (set out in appendix 9) sets out that a pass through of revenue from customer to CAP via the appointee should commence on the acceptance of the asset by the appointee. This arrangement should not have any tax impacts for appointees. If appointees negotiate a contract term that differs from this approach (as is allowed for under this principle) it will need to satisfy itself that it is complying with relevant tax legislation. DPC assets (in common with some other non-DPC assets that appointees control) may fall under the definition of a lease under IFRS16. It is for companies to satisfy themselves that they are applying the correct accounting and tax treatment.	Clarification
There is regulatory risk because the role of Ofwat within the sign-off process that sanctions the revenue	ANH, SRT, Thames	We do not consider that this risk is material or credible where appointees have run an efficient tender process in line with the procurement principles.	No change

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
to the CAP at the conclusion of the tender process is not sufficiently clear.	Tideway, British Water		
What arrangements should be made for assets at the end of the contract term?	SRN, TMS	We have provided further clarification around this issue in the contract principles set out in appendix 9.	Clarification
Treatment of costs			
The incentives around conducting a DPC are asymmetrical and place only downside risk on appointees.	ANH, UU	We consider that running a robust and efficient procurement process is in the best interests of both customers and appointees.	No change
What happens if tenders take place in advance of submissions to Ofwat?	BRL	Having reviewed information submitted by companies of possible projects >£100m totex and their associated timings, we do not consider this to be a material concern.	No change
The project development costs for a DPC will be higher than average because of the scale of the project. This is particularly true for WOCs.	PRT	We have set out arrangements for cost assessment for DPC projects in appendix 9.	No change
DPC projects should be treated consistently with non-DPC projects with respect to cost assessment and utilisation incentives.	NES		
Other issues raised			
It is important that risks that arise through innovative approaches are not unduly penalised. Companies can play a role by promoting new regulatory approaches and tools to increase operational resilience in the sector. The guidance fails to highlight this.	Blueprint for Water	We set out in in appendix 9 our guidance the factors that companies should take into account when assessing whether a project is suitable for DPC.	No change

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers'?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The benefits of pressure management are worth considering.	A. Lambert & D. Pearson		

7. Retail controls

Q1. Do you agree with using a weighted average revenue control, where appropriate taking account of different costs by customer type for the residential retail price controls for English and Welsh water companies?

At PR14, we used a weighted average revenue control. This was expressed as a total revenue control with annual adjustments for the outturn number of customers by customer type. In our draft methodology document, we proposed to retain this approach for PR19.

Everyone who responded to this question agreed or strongly agreed with this proposal. The only issues raised are considered below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 7.1 Summary of issues raised in response to retail question 1

Q1. Do you agree with using a weighted average revenue control, where appropriate taking account of different costs by customer type for the residential retail price controls for English and Welsh water companies?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Implementation			
Suitable econometric models will be needed to ensure this control is implemented appropriately. Otherwise, there is a risk of issues. For example, metering could be dis-incentivised or economies of scope might not be appropriately accounted for.	SEW, WSX	We agree in principle, so we will consider this when we undertake our assessment of water companies' retail costs. See appendix 11 (securing cost efficiency) for further discussion.	Clarification

Q2. Do you agree with using an average revenue control for business retail price controls for Welsh companies not subject to competition?

We proposed setting an average revenue control for business retail activities for Welsh companies. This control would be for all wastewater services, and for water supplies of less than 50 megalitres a year.

Everyone who responded to this question supported our proposal. The only issues raised are considered below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 7.2 Summary of issues raised in response to retail question 2

Q2. Do you agree with using an average revenue control for business retail price controls for Welsh companies not subject to competition?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Comparable outcomes and customer engagement			
Business customers in Wales should get efficient prices and service levels that are at least equivalent to the better performing retailers in England.	CCWater	We set out in the main document where our regulatory approach is the same, or different, for England and Wales. Our approach to assessing business retail costs for companies in Wales is set out in chapter 9. We expect water companies in Wales to use their bespoke performance commitments to commit to providing excellent quality services to their business customers. This will require them to engage with this set of their business customers. We discuss how this could be incentivised in chapter 4.	Clarification / Minor change
Water companies need to continue to engage with non-household customers in Wales to ensure their issues are not neglected. Companies should research non-household customers' views on services and charges, to identify any billing related issues that they face.	CCWater		

Q3. Do you support price controls for business retail activities for English water companies that have not exited the business retail market?

Three water companies have currently not exited the retail market in England. We asked whether we should set price controls for these companies, saying that if we did so we would use the same approach as used in the 2016 price review (PR16).

Everyone who expressed a preference, agreed or strongly agreed with this question. Issues raised are considered below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

In some answers to these questions, stakeholders also made comments about the general operation of the business retail market. Only comments about the form of control for retail activities are considered below. However, we acknowledge the other points raised and will consider them appropriately in our wider work. For example, some stakeholders commented on the number and complexity of wholesale tariffs and the impact this has on retail competition. This is something we shall consider as part of our work on price transparency.

Table 7.3 Summary of issues raised in response to retail question 3

Q3. Do you support price controls for business retail activities for English water companies that have not exited the business retail market?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Incentives for retailers to bring voids / gap sites into charge			
Ofwat should create a financial incentive to bring gap sites / voids (ie vacant properties) into charge.	Clear business	We are strengthening the incentives on water companies to bring gap sites and voids, where appropriate, into charge in a number ways. This is described in chapter 8.	Major change

Q3. Do you support price controls for business retail activities for English water companies that have not exited the business retail market?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
	water, Water Plus		
Interactions with the Retail Exit Code (REC)			
These price controls should be comparable to the price requirements of retailers operating under the Retail Exit Code in order to ensure a level playing field.	Anglian Water Business, South East Water Choice, Water Plus	If appropriate, we will consider aligning our approach to regulating exited and non-exited companies. We would do so as the review of the retail exit code progresses and we come to implement our price control.	Clarification
Clarity on when the price requirements of the Retail Exit Code will be reviewed.	NWG Business	Our retail exit code sets out our commitment to review the price requirements by the end of the current price control period. We intend to publish an initial consultation early in 2018.	Clarification

Q4. Do you support price controls for water service customers of Welsh companies using more than 50 megalitres a year?

In Wales, a small number of business customers with a requirement of at least 50 megalitres of supply, can procure water services in the competitive market. In the draft methodology, we stated that we would continue to consider whether to set price controls for business retail activities, for Welsh water companies, in relation to water supplies of at least 50 megalitres of water a year. If they were required, we would set an average revenue control, based on a gross margin cap.

Four respondents out of six supported our proposal. The remaining two companies disagreed with our proposals on the basis that customers can obtain the best deal for their water retail services, so price controls are unnecessary. Issues raised (by both those in support and those in opposition to our proposal) are considered below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 7.4 Summary of issues raised in response to retail question 4

Q4. Do you support price controls for water service customers of Welsh companies using more than 50 megalitres a year?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Is regulation necessary?			
There was strong support for the continuation of price controls for Welsh companies using more than 50 megalitres a year, given the level of development in that particular market.	TMS, WSH, PRT, UU, CCWater	We consider there is merit in continuing to have a control in place for customers of Welsh companies using at least 50 megalitres of water per year. Our reasoning is set out in chapter 8.	No change
Business customers in Wales using more than 50 ML of water a year have access to the competitive market. Therefore, it would seem unnecessary to put price controls in place for those customers.	SVT, SWB		No change

Q5. Do you support a three year price control for residential retail activities and business retail activities?

Apart from the business retail controls in PR14, water and wastewater sector controls have been set for five-year cycles. In the draft methodology, we proposed that for the residential retail activities in England & Wales, and the business retail activities in Wales, a three-year retail control may be appropriate.

The majority of the thirteen respondents supported our proposal, including water companies in the competitive market, non-exited water companies in England and CCWater. However, six water companies disagreed with our proposals. Issues raised (by both those in support and those in opposition to our proposal) are considered below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 7.5 - Summary of issues raised in response to retail question 5

Q5. Do you support a three year price control for residential retail activities and business retail activities?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
What happens in 2023?			
A five year control with "reopener" would be more appropriate and flexible than a three year control.	SES, WSX, WSH	We have decided to set a five-year duration for retail price controls. This is discussed in chapter 8. We assess key options in appendix 10 (assessment of the duration of retail controls and measures for the appropriate management of voids and gap sites). This includes consideration of a "reopener".	Major change
A subsequent two year control (2023-25), if proposed by Ofwat, would impose a disproportionate regulatory burden.	WSX		
The cost of managing price controls on a three year cycle need to be considered against the benefits.	SWB, WSH, WSX		
Do the benefits of a three year price control outweigh the costs?			
A shorter control weakens the incentives and ability of companies: to invest, to make savings, innovate and / or improve service levels for customers.	SES, PRT, WSX, SVT	We have decided to set a five-year duration for retail price controls. This is discussed in chapter 8. We assess key options in appendix 10.	Major change
How will / can appropriate data be collected, given business and residential customers are different (e.g. rights of disconnection) and much of the information will reside in separate, exited, retail businesses?	ANH, SVT		

Q5. Do you support a three year price control for residential retail activities and business retail activities?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
A one or two year price control period would be more appropriate to allow greater flexibility.	Clear Business Water		
Interaction with five year wholesale controls			
Whether companies will be able to separately appeal their retail household control from the wholesale controls.	ANH, UU	Condition B sets out the circumstances in which price control determinations can be referred to the Competition and Markets Authority. It makes clear that any such reference must comprise of all the water company's price controls determined at the same time (which will, for PR19, mean all price controls). Where price controls for retail activities are (as at PR16) set at a different time, that determination will be separately appealable.	Clarification
How companies should expect to recover any costs associated with the development of a future potential household retail market, noting that the majority of these costs are borne by the wholesale business (which is still subject to a 5-year price control period).	ANH, UU, SSC	The UK Government has not decided to introduce competition for residential retail customers. As described in their strategic policy statement, they first want us to work with them to develop the evidence base further, to enable the government to understand fully the case for extending competition.	Clarification
Water companies' boards must provide assurance of financeability over the five year period, but there is too much uncertainty for the last two years (2023-25) to be able to provide this. Note that household retail is of much greater magnitude than non-household retail.	SEW, NES	We have decided to set a five-year duration for retail price controls. This is discussed in chapter 8. We assess key options in appendix 10.	Major change
Interaction with performance commitments / ODIs			

Q5. Do you support a three year price control for residential retail activities and business retail activities?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Why are five year performance commitments required for a three year control?	TMS	We expect companies to set performance commitment levels for all performance commitments for five years and projections for at least a further ten years. As we have decided to set a five-year duration for retail price controls, this issue is no longer of relevance.	Clarification
De-alignment with wholesale price controls may pose practical challenges in the future given that customer engagement on outcomes encompasses wholesale and retail elements.	BRL	We have decided to set a five-year duration for retail price controls. This is discussed in chapter 8. We assess key options in appendix 10.	Major change
As the C-MeX reward / penalty will only be able to be reflected in prices for the last year of the control, it may be more appropriate to make it an end of period adjustment.	TMS		

8. Securing cost efficiency

Q1. Do you agree with our overall approach to cost assessment?

Our overall approach to cost assessment includes the use of aggregated and disaggregated econometric benchmarking models, a separate assessment of certain cost areas, such as quality enhancements and business rates, and the use of historical and forecast cost performance data as well as relevant information from other sectors. We received broad support for using a combination of aggregated and disaggregated econometric models for cost assessment. Respondents used this question to raise other general issues about our approach. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.1 Summary of issues raised in response to cost efficiency, question 1

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Efficiency challenge			
Respondents raised concerns over the use of frontier benchmarking, given imperfections associated with econometric modelling, and the expectation on companies to catch up with frontier performance.	ANH, SRN, SVT, SWB, UU, WSH, WSX, YKY, BRL, PRT, SES, SEW, SSC	We maintain the view that customers should not pay for inefficiency and companies should catch up with the efficiency frontier. We will consider the appropriate efficiency challenge in the round, including consideration of modelling quality, when we set draft and final determinations.	No change
The respondent questioned the view that there is significant scope for a step change in cost efficiency in the sector.	PRT	We consider that the outcomes and totex framework enable and incentivise innovation	No change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		better than before. We have seen significant efficiency gains among regulated energy transmission and distribution companies that have moved to the totex and outcomes framework. We have also seen businesses in the competitive sector responding to cost pressures from a changing economy by improving efficiency. Our PR19 framework which allows and incentivises greater use of market. We expect monopoly water companies to play their role too.	
Setting cost baselines			
Respondents suggested that Ofwat's overall approach to setting cost baselines does not sufficiently consider interactions with performance measures such as quality of service and resilience. Respondents noted it is important to ensure that companies remain incentivised to deliver a high level of service to customers, and that the most efficient companies are not targeting lower levels of service. Respondents also noted that Ofwat's efficient cost baselines should accurately account for current outcome performance and future customer-supported targets.	WSX, WSH, SWB, SES, SSC, TMS, SVT	Our approach allows companies to raise well-evidenced cost adjustment claims, if they consider that the cost models do not make a sufficient allowance for service quality. However, we have seen no evidence to suggest that delivering a high quality of service necessarily drives higher costs. We consider that our overall approach to PR19, including the initial assessment, the outcomes framework, and our cost assessment approach, will incentivise companies to deliver a high level of service at value for money for customers.	No change
The respondent notes that it will not be subject to cost assessment in PR19, but that Ofwat's proposal to use benchmarking as the main tool for cost assessment may not be appropriate for Thames Tideway Tunnel given the unique nature of the project. It argued that that a cost adjustment claim may be best way to ensure efficient baseline is set for the company.	Thames Tideway	Our approach allows companies to raise well-evidenced cost adjustment claims, if they consider that the cost models do not make a sufficient allowance for service quality.	No change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents cautioned that setting efficient baselines at a granular/individual activity model risks creating an artificially low baseline There was support for assessing the efficiency challenge at a price control level to enable companies to balance business operations and provide efficient outcomes in the round.	SWB, SVT	We will not set efficient cost baselines at a more disaggregated level than a price control unit.	No change
The respondent argued that we should avoid an over simplistic approach to the 'triangulation' of different models. Rather than applying equal weights to different models, we should apply lower weights to weaker models, or even consider bespoke, company-specific weightings, if different models are appropriate for different companies.	SEW	Noted – we will consider the appropriate weightings to apply to our models once the models have been developed.	No change
Respondents cautioned over the use of evidence from other sectors to set the efficiency challenge. They argued that such evidence should be relevant, robust and comparable.	ANH, WSX, BRL	We recognise the difficulty in performance benchmarking across sectors. We remain of the view that where appropriate, evidence from the wider economy should be used to inform the level at which we set our cost baselines so that the interest of customers are fully protected.	No change
Respondents raised concerns about our proposal not to use a glide path. They argued that such decision needs to be taken once we have sight of the gap between companies' forecast of total expenditure and our view of efficient baselines.	ANH, UU, WSX, BRL, PRT, SRN, SEW	We consider it important that customers do not pay for inefficiency. We intend to set efficient cost allowances for companies from the beginning of the control period. If companies do not deliver their service at the efficient cost, they will have to fund a share of the inefficient expenditure during the transition period to the efficient benchmark, We will consider the use of a glide path in the new resources controls. See chapter 9 for further discussion.	Minor change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents argued that our proposals, which include more stringent efficiency targets, no glide path to upper quartile positions and no deadbands, are skewed towards penalties and do not provide a reasonable risk adjusted return on investment.	Hastings, Kelda Investor Group	Please refer to our discussion on the balance on incentives in chapter 10.	
Use of benchmarking analysis for cost assessment			
The respondents broadly agreed with the approach to cost assessment and the use of econometric models. Some respondents raised concerns about the robustness of benchmark models, for example, regarding accounting for local circumstances and for trade-offs across the value chain among granular models.	ANH, SVT, SWB, TMS, UU, WSH, YKY, AFW, SEW, CCWater	We agree with the respondents that benchmarking is a powerful method to assess cost efficiency. We recognise that our statistical models will have limitations We will assess the statistical robustness of our models, whether the cost drivers and their estimated coefficients are sensible, and the usefulness of the models in informing our view of efficient baselines for companies.	No change
Respondents argued that totex models are not feasible for some costs (eg enhancement costs) and separate approaches may be required including detailed deep dive assessments and unit cost analysis.	ANH, BRL, YKY	We recognise that some areas of enhancement expenditure may not be appropriate to be included in a total cost benchmarking model. This is reflected in our approach. But we consider that there may be areas that could be included in such models. We provide more information in chapter 9.	No change
Sharing the cost models with industry			
Respondents said that it would be appropriate to share the cost assessment models with the water companies ahead of the May submission of cost claims or the September submission of business plans. This may help avoid challenge from companies who develop their own (different) models, and will allow	NES, YKY, AFW, BRL, SES, SEW, WSX,	We will consider further whether it would be helpful to publish some details on our intended cost models ahead of business plan submission. However, there are disadvantages to sharing our cost models and companies' business plans should not be driven by regulatory models of cost	No change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
companies to raise more informed and better justified cost adjustment claims.	CCWater, SEW	assessment. We consider also that in the few instances where they are needed, companies can raise well justified cost claims irrespective of precise model specification. If the claim does depend on model specification, companies can explain to us the nature of this dependency and we will consider this accordingly.	
Model drivers and data issues			
The respondent noted that enhancement activity may require opex as well as capex. Ofwat should consider how enhancement opex is captured in the data tables.	ANH	We have amended the Business Plan data tables to include enhancement opex.	Minor change / clarification
The respondent argued that Ofwat should recognise where data comparisons are not valid eg inconsistent measurement and reporting of data by companies.	UU	We are working with the industry and engineering consultants to identify and resolve issues with inconsistencies in data reporting and misinterpretation of line definitions.	Clarification
The respondent argued that companies with significant 3rd party service provision, eg for bioresources, may appear inefficient compared to those who have not participated in the market. Allowances should be made for contract / non-totex costs of any 3rd party provision.	UU	We are evaluating what will be included in our cost assessment econometric models and we will share our decisions when we share the models.	No change
The respondent raised concerns that using certain items as cost drivers in the wholesale models could penalise companies for their effort in addressing issues in other policy areas, eg distribution input as a cost driver when companies are encouraged to reduce demand.	SRN		
The respondent argued that pumping head is a key cost driver that should be represented appropriately in the modelling of power costs. It argued that power cost should be compared on a		We have collected average pumping head data from companies and we will evaluate whether it is appropriate to use it as a cost driver in our	No change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
like-for-like basis, for example that power generation from sludge should not offset power costs in the water network-plus price control, as WoCs inherently do not have this generation option.	SSC	benchmarking models. We have addressed the issue of power generation in our RAGs.	
Miscellaneous comments			
The respondent argued that compensation payments are no longer relevant to water companies so subsistence charges alone should be used to assess the materiality of abstraction charges and determine the best approach going forward. It agreed that there should be an efficient allowance for abstraction charges but do not have a view on whether charges should be included in benchmarking models or not.	EA	An efficient allowance for abstraction charges will be included within our totex allowance. We are still evaluating whether abstraction charges should be included as part of our benchmarking models or as a separated cost component.	Clarification
The respondent agreed that abstraction charges should be excluded from benchmarking.	ANH		
The respondent suggested Ofwat should consider a 'true-up' mechanism for 'other' costs outside of companies' control that are difficult to forecast eg business rates, environmental taxes, Ofwat licence fee and MOSL fees.	SES	Our intention is to set an efficient totex allowance that would be sufficient to cover all charges for an efficient company. If there are certain costs or fees that are highly uncontrollable and have a material impact on totex or on our cost models, we will consider a different treatment for such costs. We think that companies have a degree of control over business rates and we will set an efficient allowance for these.	Clarification
Respondents raised concerns that the proposed approach to assessing costs may constrain the use of long-term sustainable catchment management solutions. For example, how will Ofwat ensure the models do not penalise companies that have already avoided asset-intensive approaches in favour of sustainable,	WSX, DWI	We consider that our benchmarking approach to cost assessment and the totex approach to cost recovery provides appropriate incentives for companies to seek the most cost effective solutions for customers in the long run. Our	No change

Q1. Do you agree with our overall approach to cost assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
opex-based solutions? There is also a risk that companies may opt for expensive treatment options to reduce uncertainty.		benchmarking approach to modelling should ensure that companies that avoided asset-intensive solutions in the past are not penalised.	
The respondent noted that Ofwat's proposed approach to cost assessment does not acknowledge the IFRS16 leasing standard or the 'principal use' accounting changes.	UU	We are aware that IFRS16 will impact financial performance in two ways, firstly the impact on reported debt and secondly the ongoing accounting change which will impact from 2019-2025. At this stage no company response to this issue has been able to provide a detailed quantification of the impact which will not be known for sure until the 2019-20 accounts, after the final determination has been set. We expect companies to make a strong case in their business plans if they believe that the impact of the new accounting standard and principle use approach will have a material impact on our assessment of company costs. We will continue to work with companies to understand the impact of IFRS16.	Clarification

Q2. Do you agree with our proposed cost sharing incentive? We welcome thoughts on the calibration of the incentive.

It was clear from many of the respondents that there was overall support for discontinuing the menu approach adopted in PR14. Respondents supported the move to a simplified cost sharing incentive. But while the new mechanism is a much simpler than the menu approach, there were concerns that it may result in companies bidding too low, regardless of true expectation of costs, to get access to favourable cost sharing rates and without consequences to their cost allowance. We think that the risk of "under-bidding" is small. Companies are required to provide credible assurance with their business plan forecasts. Moreover, under-bidding has a reputational risk, and the company risks that its low forecast of cost will lead to a lower cost determination than if it had submitted credible forecasts. Nevertheless, we adjusted our cost sharing rates to further mitigate such concerns.

Issues raised by respondents who are in general support and those in opposition to our proposals are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.2 Summary of issues raised in response to cost efficiency, question 2

Q2. Do you agree with our proposed cost sharing incentive? We welcome thoughts on the calibration of the incentive.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Removal of menu incentive scheme			
Perverse incentive			
Respondents considered that the proposed cost sharing mechanism provided a perverse incentive to bid "too" low, irrespective of true expectation of costs,	ANH, NES, SRN, SVT, UU, AFW, BRL	We think our cost sharing proposal will provide a strong incentive on companies to submit efficient plans. This will benefit customers.	Minor change

Q2. Do you agree with our proposed cost sharing incentive? We welcome thoughts on the calibration of the incentive.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
which can lead to undesired outcomes for customers and companies.		We recognise that in theory our proposed incentive can lead to unintended behaviours by companies. However, in practice, we consider that such risk is low. • Companies have to provide Board assurance that the plan is credible and financeable and explain strategy to their investors. • Companies risk reputational damage in the eyes of investors and customers if actual performance is much poorer that business plan performance. • Companies risk a potential impact of their low forecasts on their actual determination. Nonetheless, to better protect customers, we re-calibrated the incentive to substantially mitigate such risk. See discussion in chapter 9.	
The respondent questioned whether the fact that Ofwat intends to use company forecasts to set company cost baselines affect the incentive?	TMS	Our proposed cost sharing incentive provides an incentive to submit efficient costs regardless of whether we use or do not use forecast company data. We will use benchmarking analysis to set cost baselines. This means that there will be no extrapolation or roll forward of each company's historical expenditure to generate its baseline. Companies do not have perverse incentives to underperform towards the end of the control period in order to influence their starting position in the next control. Similarly, companies do not have a perverse incentive to submit high forecasts in their business plans because our cost allowances are not directly based on business plan forecasts. As such our	Clarification

Q2. Do you agree with our proposed cost sharing incentive? We welcome thoughts on the calibration of the incentive.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		proposed mechanism will provide an incentive for companies to submit efficient business plans.	
Cost sharing rates			
The respondent welcomed better sharing rates for outperformance to reward ambitious companies.	SWB	We have increased the outperformance sharing rates further for efficient/ambitious companies.	Minor change
The respondent considers there to be a direct link between cost sharing rates and risks faced by investors so it is important that the cost sharing mechanism is commensurate with the allowed cost of capital.	TMS	We have considered the overall balance of risk of our proposals and have set out responses on this within our discussion in chapter 10.	Clarification
The respondent supports a 'straight line' incentive mechanism over s-shape curves for simplicity.	AFW	We considered that the s-shape mechanism had some advantages over the linear one. To retain simplicity, we kept a linear mechanism with two slopes. This essentially achieves a similar outcome to the s-scheme but with a simpler mechanism.	Minor change
Implementation of cost sharing scheme across price controls			
Respondents shared the view that Ofwat should consider whether it is appropriate that cost sharing rates differ across all controls.	WSH, SES	We considered whether different cost sharing rates would apply to the relevant controls– water resources, water network plus and wastewater network plus. We decided that the same cost sharing rates will apply at the water resources and water network plus controls. These rates may not be the same as the ones in the wastewater network plus controls. We discuss this further in chapter 9 and appendix 11 (securing cost efficiency).	Minor change

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?

Many respondents acknowledged and supported the need to protect customers in the face of uncertain environmental requirements, some remarking on the importance of sharing risk appropriately. However, there were mixed views as to whether, despite the divergent regulatory timelines, the degree of uncertainty would be greater in PR19 than in the previous price review. The Environment Agency stated that the PR19 environmental measures are more certain than PR14. Natural Resources Wales commented that many of the investigations scheduled in the current period to inform the 2020-25 environmental programme will not be reported by the time business plans are submitted in September 2018.

A number of companies considered that the approach taken at PR14 afforded customers sufficient protection and two commented that the examples of variation in the scale of environmental programme between company business plans and the final NEP were not representative of the industry as a whole.

Overall, companies were fairly evenly split in their preference between Options 1 and 2 – refer to section 3.1 in appendix 11 (securing cost efficiency) for description of options, with those favouring the latter often commenting that it was akin to the PR14 ODI approach which they saw as working well. The views among other respondents, including regulatory bodies, ranged from ambivalence to a strong preference for Option 2.

Issues raised (by both those in general support and those in opposition to our proposals) are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.3 - Summary of issues raised in response to cost efficiency, question 3

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
General comments			
Respondents noted that the risk that both options are meant to guard against, namely the funding of environmental obligations that do not get confirmed, did not materialise for all companies at PR14.	ANH, UU	We agree that for many companies the final NEP closely matched the scale of the programmes funded in price limits at PR14. However, while the risk did not materialise for all companies at PR14, the inherent uncertainty in parts of the environmental improvement programme means that the risk of there being further occurrences of over-funding could be at least as great at PR19.	No change
The respondent commented that if Ofwat has concerns about company behaviour, then the appropriate approach would be a company-specific response rather than a blanket approach that applies to all.	UU	Companies will be able to propose a unit cost adjustment that reflects their individual circumstances. We consider this should prevent any company from being penalised as a result of what is happening elsewhere in the industry.	Clarification
The respondent noted that Ofwat's proposals do not provide an incentive to develop innovative solutions and could be improved by allowing companies to use existing mechanisms.	SVT	We recognise that both options have weak incentives for challenge but scope for challenge is limited anyway and changes in scale are more likely to be the result of regulatory intervention. Our proposals do not preclude companies' use of existing mechanisms to manage changes in the environmental programme, eg substituting alternative schemes of equivalent cost or environmental benefit.	No change
The respondent commented that they would not like to see customers pay an excessive cost for a scheme that	CCWater	This level of granularity will not be visible at the time of setting the control. However, the aim of both options presented in the consultation is to protect customers	No change

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
may be smaller than envisaged at the time the costs were set.		against a reduction in the scope of a project or programme.	
The respondent commented that they believed both options presented will limit the ambition for Water Framework Directive delivery. While a unit price approach is preferable this could be linked to customer willingness to pay, with Ofwat requiring companies to consult on a range of 'glide paths' to good ecological status. Engagement should include a discussion about risks of leaving the investment late.	Blueprint for Water	We are supportive of linking customers' WTP to enhancement schemes that go beyond statutory requirements. Our outcomes approach and use of ODIs allows for this. We remain of the view that in this way we will not limit the ambition for Water Framework Directive delivery.	No change
Comments on Option 1 - proportion of unconfirmed programme funded in advance			
Respondents noted that Option 1 appears to conflict with the requirement that a company meets its statutory obligations or may be in conflict with Ofwat's duty to finance functions.	WSX, AFW	We disagree. Both options recognise that the 2027 deadline for delivering Water Framework Directive measures has to be met. The difference between the options is the timing of funding which may result in different profiling of investment but should not jeopardise statutory deadlines.	No change
The respondent commented that Option 1 would significantly disrupt industry supply chain by back-end loading investment in the 6-year RBMP cycle with consequent impact on efficiency and costs to customers.	WSX	Depending on the scale of the uncertain elements of the environmental programme when we make our final price determinations, there is a risk that we fund only a small proportion at PR19. A transition programme would help to reduce such risk.	No change
The respondent noted that Option 1 appears to be in conflict with Environment Agency guidance on the profiling of quality enhancement schemes.	WSX	We acknowledge that option 1 may result in the deferral of some schemes while still meeting statutory deadlines. This is for companies to manage. We are aware that if suitable evidence can be provided the guidance document does allow for companies to agree	No change

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		with the EA a completion date beyond 2025 for certain schemes.	
Respondents commented that a transition programme is important in making Option 1 an efficient and effective process and is necessary to allow companies sufficient time to complete post-2025 schemes.	ANH, NES, SRN, SVT	We accept the point. Given that the WFD's 2027 deadline relates to achieving the environmental outcomes and not merely scheme completion, we will retain the transition programme for the Water and Wastewater Network plus price controls.	Confirm transition programme
The respondent considered that Option 1 would create additional financial risk and uncertainty for companies and their investors and have an adverse impact on cash flow.	SWB	We acknowledge the additional uncertainty but consider that companies are well positioned to manage any associated risks. The impact on cash flow is not without precedent as there are numerous examples of where enhancement schemes unfunded at one price review have been the subject of (successful) logging up claims at the next.	No change
Respondents commented that establishing the proportion of expenditure being funded in Option 1 is important and will be a challenge. The proposal to fund only 25% of the anticipated programme may generate a burden of adjustment to be made in 2024-2027.	WSH, AFW, BRL, PRT	This is a possibility if, as suggested, we fund only a small proportion at PR19. However, owing to considerations such as the impact on the supply chain, this is unlikely to be the case, and a transition programme would help to reduce any risk.	No change
The respondent commented that, should Option 1 be implemented, it would be helpful for Ofwat to set out the criteria by which companies will be assessed when deciding the proportion of funding they will be allowed at PR19. This proportion should be determined company by company.	YKY	Noted. However, we are implementing option 2.	No change
Respondents commented that Option 1 carries the risk that companies will not be motivated to complete associated investment in 2020-25 thwarting the	SEW, WSX, YKY, NRW	This is a risk but one that has to be balanced against the potential benefits of deferring investment, for example, where there are affordability concerns or	No change

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
objective of delivering required improvements (or not giving them appropriate priority). This could result in the deferral of cost beneficial environmental benefits.		where schemes, though required to meet legal obligations, are not cost beneficial.	
Respondents noted that Option 1 would benefit from the development of a set of rules / principles to govern the prioritisation of uncertain ('Amber') schemes and/or the proportion of funding at PR19. These could reflect the degree of certainty of Amber schemes in WINEP3 and cost/benefit ratios.	NES, YKY	This would be for individual companies to develop their own rules and principles. We consider that regulatory guidance in this area may weaken company ownership of business plans.	No change
Comments on Option 2 - ex-post adjustment to account for uncertainty			
Respondents considered that Option 2 would be overly complex and would not take account of specific circumstances or economies of scale that could have a bearing on unit costs.	NES, SWB	Option 2 does not preclude the use of company-specific unit costs, if considered appropriate. Companies will be able to propose a unit cost adjustment that reflects their individual circumstances.	Clarification
The respondent commented that Option 2 would have weak incentives for any challenges on the scope and scale of the programme.	NES	We recognise that both options have weak incentives for challenge but scope for challenge is limited anyway and changes in scale are more likely to be the result of regulatory intervention.	No change
The respondent noted that, as there is little or no correlation between totex and outcome, Option 2 gives a risk to either companies or customers if there is a material change in scope of the environmental programme.	TMS	We recognise that a unit cost adjustment will not exactly reflect the savings or additional costs resulting from variations in the scope of the programme but expect that the 'swings and roundabouts' will broadly balance.	No change
Respondents commented that setting cost allowances based on all green and amber schemes will ensure water companies are able to fulfil their (WFD) obligations to protect and enhance the water environment. There is support for linking efficient	EA, NE, NRW	We agree.	No change

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
funding to a clear and transparent adjustment mechanism that both penalises companies for non-delivery and also rewards them for delivering more / faster where there is customer support.			
Respondents commented that Option 2 would incentivise companies to be efficient, but the approach to calculating the unit costs and related outcomes needs to be developed and further detail is needed about how and when the adjustment mechanism would be applied.	SWB, SEW	We have developed the approach. Further details are provided in chapter 9.	No change
The respondent considered that Option 2 may not provide customer protection given the difficulties in agreeing the actual outputs (and appropriate unit costs) for all unconfirmed environmental requirements.	BRL	These difficulties are no greater than the sector has faced at PR14 and we consider that option 2 can only improve the protection customers currently enjoy.	No change
Alternative proposals			
The respondent suggested Ofwat considers a modelled central estimate of uncertain investment requirements, supported by a 2-sided ODI to protect customers from de-scoping and enable confirmed obligations to be delivered without excessive financial risk if scopes increase. Caps could further protect customers.	TMS	A 2-sided ODI attached to uncertain requirements is essentially exactly the approach at PR14 that has given rise to the occasional 'windfall' benefit to a company, the potential recurrence of which our proposals are intended to prevent.	No change

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?

The adjustment process in PR14 allowed companies to submit claims for additional costs (on top of the efficient modelled costs), due to their unique circumstances. We proposed to retain the process in PR19, but to make the process more symmetric, with cost reduction as well as cost increases.

There was strong support for the retention of the cost adjustment process in PR19. There was support for the principle of applying symmetrical, negative adjustments, where appropriate, although companies were concerned about the complexity of applying such adjustments in practice, and their ability to respond with counter evidence to such adjustments. There was also support for the inclusion of natural and social capitals within the cost benefit assessment of cost adjustment claims.

Respondents raised some concerns with the proposed approach, for example on the availability of information on our cost models to inform cost adjustment claims, particularly if the quality of claims will be taken into consideration for IAP categorisation.

Issues raised (by both those in general support and those in opposition to our proposals) are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.4 Summary of issues raised in response to cost efficiency, question 4

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Quality of cost adjustment claims and interaction with IAP			

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents comment that, to ensure high quality cost claims, Ofwat should publish information early on its cost assessment models. Anglian Water suggested 'simultaneous reveal' of Ofwat models at the same time as business plans are submitted, to allow further work on SCF claims for inclusion in the IAP.	ANH, NES, UU, TMS, SVT, WSX, YKY, AFW, SES, BRL	We will consider whether it would be helpful to publish more details in early 2018 on the development of our cost models. We do not consider that the publication of our cost models is an essential input to company business plans - companies should focus on developing efficient business plans that deliver for their customers. Companies' business plans should not be driven by regulatory models of cost assessment.	No change
Respondents were concerned that the quality and quantity of cost claims could influence IAP categorisation if companies do not see the models in advance. If companies have not seen the models it does not seem appropriate to penalise them for including SCF claims that could be deemed unnecessary because the issue is dealt with in the cost models.	ANH, NES, UU, TMS, SVT, WSX, YKY, AFW, SES, BRL	Companies can anticipate which costs they expect to incur in PR19 are unique and are therefore unlikely to be adequately captured by benchmarking models, whatever their form is and whatever cost drivers are included. We expect companies to raise claims only if they are materially more expensive then industry average (after controlling for differences in scale) due to factors beyond their control or due to a well-justified large investment. We also expect companies to consider whether in the round there are favourable circumstances that offset their unique costs. Nonetheless, if companies have not seen the models in advance, we will take this into account in the assessment of cost claims.	No change
The respondent expressed disappointment that Ofwat is creating reputational and potentially financial barriers to cost adjustment claims. Symmetrical adjustments will potentially reduce spurious one-way claims, therefore it is not necessary to discourage adjustment claims further.	SEW	Our symmetrical adjustments will not address issue of spurious claims. We retain our decision to consider the quality of cost claims in our IAP assessment. We note that CCWater was in support that Ofwat should only make upward adjustments for well evidenced, exceptional and unavoidable claims.	No change

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The respondent requested a clear and transparent assessment criteria be published for all companies to understand how Ofwat will assess claims.	BRL	We agree and provided details about our criteria and the type of evidence we expect companies to submit in appendix 11.	Clarification
Symmetrical adjustments			
Respondents commented that for some special factors where the past is not a good predictor of future cost eg company-specific environmental programmes or 'large projects', it is unlikely that symmetrical adjustments would be appropriate.	YKY, AFW, UU	We agree. We explained in our draft methodology that the symmetrical adjustment mechanism is not appropriate to all types of claims, namely atypically large claims.	No change
Respondents requested that companies should have the opportunity to challenge downward adjustments that Ofwat is considering to apply to them, in order to provide counter-evidence before adjustments are made. Clarity on this process and timescales would be welcomed.	ANH, NES, SVT, SWB, WSH, WSX, YKY, AFW, BRL	Companies will have the opportunity to challenge symmetrical adjustments in their responses to our draft determinations.	No change
Respondents noted that companies would need sight of the submissions made by others in order to review their proposed claims and provide the necessary evidence to counter any potential downward adjustments, particularly if submissions are made early in May 2018.	SWB, YKY, BRL		
Respondents commented that Ofwat should only apply downward adjustments if they are material, just as there is a materiality threshold for upward adjustments.	NES, SVT, SWB, WSH	We do not think a materiality threshold should apply for symmetrical downward adjustments. Such adjustments are made to counter an upward adjustment, which had passed the materiality threshold.	No change
The respondent noted that any downward adjustments due to regional factors being removed from baselines, for	PRT	We will explain the rationale and basis to our downward adjustment when we publish a decision in the IAP and in our draft determinations. Companies will	No change

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
example, will need to be properly explained and the impact understood by companies.		have the opportunity to challenge our approach in their representations.	
The respondent commented that in certain circumstances the application of special factors may not be linear, eg density. It is important to consider the impacts of this type when making adjustments.	TMS	We will apply negative adjustments as appropriate on a case by case basis.	Clarification
The respondent suggested that, rather than pro rata the adjustment to all companies, Ofwat could assess the relative impact for all companies and as such adjust for each company individually based on its circumstances.	YKY	This seems to be consistent with our approach. For each symmetrical adjustment, we will consider the appropriate metrics to base our negative adjustments on.	No change
The respondent commented that, while they welcomed a more symmetrical approach to cost adjustments in order to provide a more level playing field, they do not think the approach illustrated by Ofwat is robust. If, for example, Thames Water is the company proposing a £10m uplift in Ofwat's example, given Thames' size, it is likely that their high labour cost base would rotate the cost function rather than shift it. As a result, some companies may already have costs predicted below their efficient level, yet the proposed adjustment would further reduce this. They consider that this area warrants further development and perhaps lessons from academic work in this area could be informative.	SWB	Our consultation example was illustrative only. It is possible that the cost uplift in our example had an impact on the slope of our cost function, and at the extreme it is possible that 1-2 companies had their cost underestimated as a result. In practice, regional costs that are not controlled for in our models could impact both the intercept and slope parameters in our models, but the impact on the sector as a whole would be an overestimation of costs. We will estimate the downward adjustment for each company using an appropriate approach on a case by case basis.	No change
Early submission of information on cost claims			
Respondents requested clarification on the level of information expected for the early May 2018 submission of cost claims.	BRL, NES	We said in our consultation that companies can submit any information they have to support their claims. We	Clarification

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents asked whether companies will receive feedback on their early submission of cost claims in time to inform their business plan submission.		also discussed the evidence that we expect to receive in support of cost adjustment claims in appendix 11. We do not intend to provide feedback to companies on their early submissions, except where we seek further clarification.	
Materiality threshold, implicit allowance and other issues			
The respondent commented that the materiality threshold should be the same for wholesale and retail claims, given that the retail business unit is treated as a standalone business for regulatory reporting, therefore it does not seem right that it has a higher materiality threshold.	SES	We have decided to set a separate materiality threshold at each control level of PR19, and not at the wholesale level. We have increased the thresholds to strike a balance between a proportionate regulatory approach, customer protection against an asymmetric adjustment process, and companies' exposure to claim costs, taking into consideration the materiality of the control across appointed companies. We discuss this in chapter 9.	Major change
The respondent commented that the cost assessment process makes no specific consideration of the development costs for significant water trades (which may take place over a long timeframe), and therefore they would be at the company's expense. That is despite it not being a core function of that business, as it does not support the delivery of water to its own customers. They suggest that the development of significant water trades could be better supported by (for example) removing the triviality threshold, and any assumption of implicit allowances, for special factor claims related to future water trades.	UU	The cost assessment approach considers all costs reported by companies. We do not intend to have special treatment of water trading costs as part of the cost assessment process as it could conflict with other incentives. For example to encourage water trading we have water trading incentives.	No change
The respondent requested that a set of definitive principles for the implicit allowance be set out so that companies can	SVT		No change

Q4. Do you agree with our approach to cost adjustment and our proposed approach to make the process more symmetric?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
appropriately consider what cost adjustment submissions to make.		Implicit allowance remains an important part of our assessment process. We will consider this further once our models have been developed.	
The respondent commented that the quality of the SCF claims is dependent on the company being able to understand the value of any implicit allowance. This is important in order for the IAP 'one-shot' process to work.	TMS		
The respondent questioned whether Ofwat intends that company-specific SCF submissions be apportioned to the appropriate model / business unit? Eg a claim regarding water resources should only be related to water resource & totex models.	BRL	Each business unit will have one or more models to estimate its efficient cost baseline. We will consider whether, and to what extent, the relevant models cover the cost claim before making any cost adjustment.	Clarification

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?

For the residential sector in England and Wales, our draft methodology proposed a move away from the average cost to serve (ACTS) approach of PR14 and use econometric benchmark modelling instead, with no gradual catch-up (glide path) to the efficient frontier. We also proposed to use evidence on efficiency in provision of retail services in other sectors to inform our retail cost baselines for water companies.

For relevant business retailers we proposed a proportionate approach to assess efficient expenditure, comparing projected costs to historical levels and to use evidence from relevant comparators including evidence from the English business retail market.

The majority of respondents support our overall approach for assessing retail costs. However, three water companies (SVT, PRT, SEW) disagreed with our proposal to develop econometric models to assess residential retail costs, and to use evidence from other sectors to inform our assessment of bad debt costs. Seven respondents cautiously agreed with the latter provided care is taken to ensure cross-sector comparisons are relevant and reliable.

Issues raised (by both those in general support and those in opposition to our proposals), are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.5 Summary of issues raised in response to cost efficiency, question 5

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Replace PR14 average cost to serve (ACTS) approach with econometric modelling			
Respondents commented that it was challenging to establish stable econometric models for residential retail and preferred to retain the PR14 cost to serve approach as this approach is simple and well understood.	SVT, PRT, SEW	Analysis from both Ofwat and a number of companies suggests that suitable econometric models can be developed to assess residential retail costs. As outlined in our draft methodology proposals, we will use a non-econometric approach similar to the PR14 cost to serve approach as a fall back option.	No change
Respondents supported the use of a range of econometric models to assess retail, including a separate benchmarking model to assess the efficiency of bad debt costs (including bad debt management costs).	TMS, YKY, NES	We remain of the view that it is appropriate to model bad debt costs separately due to the materiality of bad debt (including debt management) and the unique drivers of these costs.	No change

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents noted the challenges comparing levels of bad debt due to differences in data reporting across water companies eg provisioning policies.	BRL, PRT	While there may be different debt provisioning polices across companies, we consider that it is appropriate to compare bad debt levels across water companies. Ofwat undertook a targeted review of accounting separation cost allocations in May 2013[3]. The review looked at reporting of bad debt and did not identify any areas of concern with the treatment of bad debt across companies. We acknowledge that using a single year of bad debt data may not reflect underlying performance across companies as it may also reflect different provisioning policies. But data averaged over a number of years could provide a more robust indication of comparative levels of bad debt across water companies.	No change
Respondents were in agreement with the cost drivers discussed for residential retail; meter penetration, single and dual customer numbers, plus bill size and deprivation for debt-related costs. Specific issues were also raised on:	TMS, UU, WSX	We welcome feedback from companies on appropriate drivers and are continuing to work with the industry to explore suggested cost drivers for retail models.	No change

[3] Targeted review of accounting separation cost allocations, Ernst and Young, May 2013
http://webarchive.nationalarchives.gov.uk/20130702093708/http://www.ofwat.gov.uk/publications/rags/rpt_com1306costallocey

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
• Deprivation levels - vary significantly within water company areas. Using an average measure of deprivation aggregated to company level is not a robust cost driver as it is the prevalence of extreme levels of deprivation that drives differences in levels of bad debt. Extreme levels of deprivation within a water company area are lost through averaging. • Transience - the impact of high occupancy turnover and a higher proportion of rented accommodation in an operating region - is a key driver of bad debt costs and should be considered as cost driver in our econometric models.			
The respondent commented that water-only companies should not be penalised where increases in bad debt cost originate in increases in the sewerage element of final bills rather than the water bill.	AFW	We expect companies to be efficient in recovering their allowed revenue by recovering charges from customers. It is for companies to choose the billing strategy that works best for their customers.	No change
The respondent suggested that an adjustment process is not needed for retail as a limited number of relevant variables should facilitate development of a model which adequately captures all companies' costs.	BRL	We remain of the view that statistical models are imperfect and cannot take into account all relevant factors that affect retail costs. Companies will be able to make a cost adjustment claim where they consider that our baseline fails to capture a specific, material cost in their retail totex projection. However, we consider that our econometric approach for residential retail, and the use of richer data should result in fewer adjustments than we had in PR14.	No change

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The respondent noted that it is important to ensure that companies correctly allocate costs, otherwise the incentives and efficiency challenge set will be inappropriate.	WSX	We have addressed cost allocations between retail activities in our regulatory accounting guidance. We will take account of data quality when undertaking our benchmark assessment.	No change
Setting efficient retail baselines			
The respondent disagreed with our proposal not to allow a glide path towards efficient benchmarks. This coupled with no indexation and thin retail margins is an exceptionally tough challenge and could have unintended consequences for customers.	AFW	We remain of the view that retailers have had five years of the residential retail controls to catch up to the efficient level of retail costs. Therefore we do not intend to allow a gradual catch-up (glide path) to the efficient frontier at PR19.	No change
The respondent commented that companies should not be allowed a glide path – particularly as inefficient companies will have had the five-year AMP6 period to catch up.	CCWater		
The respondent challenged our proposal to set an efficient baseline at the frontier level of performance. Econometric models are imperfect therefore it is more appropriate set the efficient baseline at upper quartile or better, rather than frontier company performance	YKY	We recognise that econometric models are not perfect and will consider the appropriate level of challenge when we set draft and final determinations. We remain of the view our retail baselines will be independent and we will move away from an average baseline towards a more stretching challenge for PR19. Retailers have had time to catch up to average performance at PR14 and we expect to see efficient costs proposed at PR19.	No change
The respondent suggested that, when adjusting for legacy retail depreciation, the reduction for legacy depreciation in company totex allowances should be the implicit pre-2015 depreciation allowance experienced by the efficient company. This will ensure that only efficiently incurred post-April 2015	UU	We agree that only efficiently incurred post-April 2015 costs will be allowed as part of the adjustment for legacy retail depreciation. We do not think that the legacy depreciation adjustment should always be based on the	Clarification

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
costs are allowed whilst preserving the full RCV protection for pre-April 2015 investments.		legacy depreciation experienced by the most efficient company. But we agree that it should be informed by the company, or companies, that set the efficiency benchmark.	
Use of evidence on retail efficiency from other sectors			
The respondents disagreed with our approach to compare bad debt levels in the water sector with other sectors – many factors limit comparability.	SVT, AFW, PRT	We commissioned a report from PwC in September 2017[4] to benchmark water sector bad debt and customer service costs against other sectors. The analysis demonstrates that the water retailers can usefully be compared with other sectors.	No change
The respondents cautiously agreed with the approach to compare water bad debt with other sectors, provided care is taken to ensure comparisons are relevant, and the weight placed on cross-sector evidence is proportionate, reflecting the different operating environments across water and other sectors.	WSX, WSH, BRL, SSC, SWB, ANH, Kelda investment Group		
Regional labour costs			
Respondents disagreed with our proposal; although customer service centres can be located anywhere, general and support staff costs are often regionally located. Also customers place value on use of local billing and contact centres.	TMS, SES, Kelda Investor Group	We do not intend to account for variation in regional labour costs in our retail benchmark models. For retail this is a low materiality issue. Unlike wholesale where operations are often constrained by regional locations, the impact of	No change

[4] PwC report for Ofwat, Retail Services Efficiency benchmarking, September 2017 https://064f1d25f5a6fb0868ac-0df48efcb31bcf2ed0366d316cab9ab8.ssl.cf3.rackcdn.com/wp-content/uploads/2017/10/250717-Ofwat-Retail-Services-Efficiency-12.pdf

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents supported our proposal; expressing concern that accounting for differences in regional labour costs in our benchmarking analysis could reward inefficient companies that choose to be located in areas with higher than average wage costs for unrelated services.	WSX, YKY	regional labour costs can be substantially mitigated or removed in retail activities. For example a retailer can chose where to locate its customer service and billing functions. If customers value local functions, we will see this in higher customer satisfaction levels, and remuneration through C-MeX.	
A proportionate approach to assess business retail costs			
The respondent suggested that further consideration should be given to costs for business retail controls. Need to consider customer inertia and the stimulating customer switching, especially for SME's. One approach would be to look at incumbent retailer's costs and those of new entrants and benchmark these costs with other comparative industries.	Clear Business Water	We will allow mandatory business retail costs to be accounted for in our data tables. For example, non-exited retailers should include their unavoidable MOSL fees (ie excluding additional services, fines etc.) as a miscellaneous cost.	Clarification
Respondents commented that any approach to assess business retail costs will need to reflect the realities of the current market structure which is significantly different to PR14. For example, new mandatory costs such as Market Operator (MOSL) fees, Credit Terms which now apply to regulated business retailers operating wholly or mainly in England who have not exited.	Water Plus, Business Stream		
The respondent noted that now the market is open and business retailers are operating as independent businesses, it may be possible to make a more accurate assessment of true retailer costs. Where evidence submitted as part of PR19 suggests that costs were misallocated between wholesale and retail at PR14, this suggests there is a strong	Business Stream	We will not be making an adjustment to revenues at PR19 to account for cost allocation issues at PR14. The PR14 assessment framework was designed so that the risk of misallocation of costs across retail and wholesale was low. A detailed assessment	No change

Q5. Do you agree with our proposed approach for assessing retail (residential and business) costs at PR19?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
case for making a one-off adjustment to allowed wholesale revenues in order to reallocate the costs.		of how costs were allocated was carried out at PR14, this included a targeted review of retail costs[5]. Companies were given clear guidance on definitions and cost allocation principles as set out in the regulatory accounting guidelines (RAGs), which will also be used at PR19.	

Q6. Do you agree with our preferred approach not to index the retail controls to a measure of general inflation, and, if appropriate, deal with input price pressure as part of our totex allowance?

In the draft methodology, we proposed not to index the relevant retail controls[6] to a measure of general inflation, consistent with our approach at PR14. This approach is different from our approach to wholesale controls which is discussed further in chapter 10 (aligning risk and return).

There were mixed views on our approach. Six companies did not agree with our approach not to index the retail controls and one company (AFW) strongly disagreed with our proposed approach. Most companies agreed, or were satisfied with, the wider approach to treating inflation costs through an ex-ante totex allowance if appropriate.

[5] http://webarchive.nationalarchives.gov.uk/20130702093708/http://www.ofwat.gov.uk/publications/rags/rpt_com1306costallocey
[6] This applies to residential and business retail controls.

Issues raised (by both those in general support and those in opposition to our proposals) are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.6 Summary of issues raised in response to cost efficiency, question 6

Q6. Do you agree with our preferred approach not to index the retail controls to a measure of general inflation, and, if appropriate, deal with input price pressure as part of our totex allowance?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Overall challenge on retailers			
Respondents commented that no indexation combined with a move to a more stretching efficiency challenge and no glide-path is an unrealistic challenge for retailers, particularly for frontier performing retailers.	AFW, SWB, YKY,	We will consider the appropriate level of challenge in the round when we set draft and final determinations.	No change
The respondent commented that there is no evidence that retail costs are affected by inflation to the same degree that inflation affects wholesale costs	CCWater	Retailers provide very different services compared to the wholesale services companies provide. This is reflected in the design of the retail control which is different to the wholesale controls. For example, retail is a less capital-intensive business compared to wholesale and the majority of costs retailers face relate to operating costs. Unlike wholesale, there is no RCV in retail controls. These differences require us to consider separately how we address inflation risk across the retail and wholesale controls	No change
Mechanism to deal with input price pressure			
Respondents commented that no indexation is appropriate provided there is a mechanism in place to deal with input price pressure	ANH, NES, SRN, TMS, UU, SEW, SVT, UU	We have provided further clarification on how we will assess input price pressure. See appendix 11 for further discussion.	Clarification

Q6. Do you agree with our preferred approach not to index the retail controls to a measure of general inflation, and, if appropriate, deal with input price pressure as part of our totex allowance?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents stated a preference for setting a central inflation adjustment for all companies, via a single input price pressure model	SVT, NES		
The respondent suggested that use of a time-series variable as part of the econometric modelling, similar to the approach at PR14 for wholesale cost assessment, would be a better way of forecasting real efficiency gains.	AFW	We disagree that the use of a time trend, as in the PR14 wholesale models, is necessarily a better way to forecast efficiency gains. Forecast efficiency gains may look differently to historical efficiency gains and we should consider information from the wider economy into these forecasts.	No change
Inflation risk for the price review period			
Respondents commented that PR14 saw steady (low) inflationary pressures but PR19 macro-economic circumstances are likely to be different with potentially higher levels of inflation. Wider economic conditions are uncertain in the context of Brexit, so it is challenging to forecast input prices.	WSH, SVT, SWB, WSX, AFW	We think that not indexing the retail controls to inflation provides useful incentives for companies to manage inflation risk. We will assess the short term inflation risk at the time of setting draft and final determinations and will make an allowance for inflation if appropriate.	No change
Respondents commented that not only are staff wage costs impacted by input price pressure; but Ofwat also needs to consider other retail costs such as energy, insurance, general inflation from services bought in from third party suppliers.	AFW, PRT	The majority of retail costs are labour costs. Where companies provide robust evidence to demonstrate the effect of different input pressures on their business, we will assess the evidence. We will compare data submitted across all retailers and against external evidence on wider economic conditions. We will make an ex ante allowance if appropriate. We are asking for companies to provide further disaggregated information on input prices in appointed water company tables 24 and 24a to support our analysis. See final guidance for business plan tables for further detail.	Clarification

Q6. Do you agree with our preferred approach not to index the retail controls to a measure of general inflation, and, if appropriate, deal with input price pressure as part of our totex allowance?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents commented that increases in labour wages are often driven by increases in wider regional labour market wage rates. To attract and maintain staff, retailers have to ensure that retail labour costs reflect market conditions which companies cannot control.	ANH, NES, SWB, SES, AFW	Where retailers can provide evidence to demonstrate this impact, we will consider this when we set draft and final determinations.	No change

Q7. Do you agree with our proposals for the transition programme?

In the draft methodology we sought views on whether we should allow a transition programme in PR19 (ie spending in 2019-20 for 2020-25 deliverables). We proposed to allow the transition programme in the water and wastewater network plus controls, but not to allow it in the water resources and bioresources controls (except for efficient investment relating to the Isles of Scilly).

Overall respondents agreed that a transition mechanism should be retained for PR19 due to the flexibility it will provide in enabling companies to deliver their business plans. The main caveat to this general agreement was that the mechanism is used appropriately by companies and that they make a strong case for bringing investment forward.

Issues raised in response to our proposals are considered in the table below. For each issue we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 8.7 Summary of issues raised in response to cost efficiency, question 7

Q7. Do you agree with our proposals for the transition programme?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents argued that the transition programme should be allowed in water resources. One respondent argued that there are likely to be early delivery dates driven by environmental requirements for water resources. Respondents also argued that the transition programme would be appropriate for the delivery of large scale projects, some of which are required to satisfy the WRMP. One respondent argued that the option to allow transition expenditure on water resources and bioresources should be retained for companies to make the case, on an exceptions basis.	NES, PRT, TMS, WSX	We decided to allow the transition programme in the water resources controls (as well as in the network plus controls of water and wastewater). While we also consider that with a prompt start at April 2020 companies can meet early delivery dates of environmental requirements, we recognise that there may be large schemes required to satisfy the WRMP for which a transition programme may be appropriate. In water resources, we will allow transition investment only in exceptional circumstances. We provide more detail in chapter 9 and appendix 11.	Minor change
The respondent noted that WINEP3 will be released in March 2018 and where there is a relatively high degree of certainty around measures (green and amber), companies should be able to start designing and implementing solutions before the start of AMP7, for example, bathing and shell fish waters measures and investigations that will inform PR24.	EA	We will allow companies an early start in the water resources and network plus controls where they submit evidence that an early start would be efficient and justified.	Minor change

9. Aligning risk and return

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020–25 period?

In the past, economic regulators have placed greatest weight on long-run averages of realised returns when deciding their estimate of Total Market Return – a key element of the cost of equity. In our draft methodology we set out evidence that the current low rate environment will persist beyond 2025 – and that this environment has depressed required returns to equity investors below levels implied by long-run historical averages. We proposed an indicative range for Total Market Return, drawing on a range of approaches, and placing less weight on historical evidence.

Overall, 18 out of 25 of respondents to this question expressed disagreement with our proposals (8 of which disagreed strongly), with 2 agreeing, and 4 expressing a neutral opinion. Where respondents expressed a view, they supported the continued use of the Capital Asset Pricing Model (CAPM) to set the cost of equity. However, most who disagreed expressed opposition to our proposals to place more weight on approaches focusing on more recent market data when setting the cost of equity. Commonly cited reasons were that that these approaches were unreliable, that they relied on subjective assumptions, and that they resulted in volatile outputs and therefore bills.

We have updated our analysis and proposed Total Market Return range to reflect responses received in our consultation, new evidence as well as analysis from consultants Europe Economics and PwC. We discuss the results of our work in more detail within appendix 12. The specific issues raised in responses to our consultation are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.1 Summary of issues raised in response to risk and return, question 1

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat's assumption that the period 2020/21 – 2024/25 will be characterised by a low interest rate environment seems speculative and unfounded.	ANH, SEW, SES, E&Y, National Grid, Heathrow, Allianz	We have based our view of 2020/21 – 2024/25 primarily on market-implied estimates of interest rate rises, which continue to suggest that rates will be low by historical levels. We will continue to monitor developments in the economy and financial markets in the run up to final determinations in 2019, to support a final decision on the cost of capital which reflects the most up-to-date information.	Clarification
Ofwat's decision to place less weight on long-run historical averages to estimate Total Market Return (TMR) increases risk to investors and increases regulatory instability, threatening investment in the sector.	ANH, AFW, SEW, SSC, NES, SWB, Allianz, WSX, National Grid, Anglian Water Investors, Hastings, Omers & Wren House	The evidence we have considered leads us to conclude that required returns for equity investors (that is TMR) over the period 2020-21 – 2024-25 are likely to be significantly lower than long-term averages imply. Our view is that the cost of equity would be too high for 2020-25 if we placed too much weight on long-term averages, and this is not consistent with our duty to protect the consumer interest or our financing duty. We discuss this further in appendix 12 (aligning risk and return).	No change
Ofwat's increased weight placed on more recent market data for its estimate of Total Market Return (TMR) seems opportunistic, as this choice drives a lower overall allowance.	National Grid, SEW	We have twice previously set a TMR which was higher than that implied by the UK arithmetic average return to equities. These decisions were taken with heed to the economic conditions at the time. We intend to continue to consider all evidence available to us when setting the cost of capital, taking account of our statutory and license obligations.	No change

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The forward-looking approaches used by Ofwat to support its view of Total Market Return (Dividend Discount Model, Market-to-Asset Ratio Analysis), are subjective and dependant on assumptions.	BRL, PRT, SEW, KPMG, E&Y, ICON, TMS	The use of assumptions and judgement when forecasting future returns required by investors cannot be avoided. We make our decisions within the context of our regulatory duties, and in doing so we look at a range of evidence.	No change
Ofwat's proposed range for Total Market Return (TMR) of 5.1-5.5% (deflated from nominal terms using an RPI assumption of 2.8%) is materially below previous regulatory decisions.	SEW, SWB, National Grid, SRN, ICON	We recognise that no UK economic regulator has set a TMR within our proposed range, but note that our proposed point estimate for the TMR (5.4%) sits within the 5.0-6.5% range for the TMR proposed by the Competition Commission for its final determination of Northern Ireland Electricity Limited's charges in 2014. We note the CMA's determination was underpinned by a long term view of RPI inflation of 3.25%; our early view remains within the CMA range if adjusted to our long term RPI assumption of 3.0%. The Competition and Markets Authority relied on the same evidence to support their TMR point estimate for their 2015 Bristol Water re-determination.	No change
Estimates of Total Market Return derived using a Dividend Discount Model (DDM) are volatile.	NES, ANH, SWB, UU National Grid, SEW, Omers & Wren House	Methods such as averaging across several years can address volatility issues.	No change
Estimates of Total Market Return derived using a Dividend Discount Model (DDM) have worse predictive power than long-run estimates	ANH	Total market return is a measure of return expected by investors in order to venture capital, not a forecast of future returns. Realised returns being different from an estimate of TMR does not therefore necessarily imply that the expectation was measured inaccurately.	No change

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Beta has changed since 2014, and PR19 final methodology changes relative to PR14 (for example indexing the cost of new debt) mean it will change again.	SVT, Kelda Group, NES, SEW, SSC, CCWater	Our provisional view of asset beta is directly estimated from market data from the 2 years leading up to 31 July 2017 and is slightly higher than the PR14 point estimate of 0.3. We will revisit this estimate using more recent data before final determinations in 2019. We recognise the principle that recent data may not reflect the impact on beta changes in the regulatory framework which have yet to be implemented. We have thus considered respondents' arguments on why an ex-post adjustment is necessary. We agree with Europe Economics' conclusion that debt indexation should reduce systematic risk. However, we have decided against a downwards adjustment to reflect this as the extent of this impact is not clear.	Clarification
Beta should be different across the different price controls.	SEW	We consider the impact of the new bioresources and water resources controls on the cost of capital to be minimal in 2020-25; companies can propose risk sharing mechanisms for new water resource investment – we expect very compelling evidence if companies propose a cost of capital increment for new water resource investment. We discuss these issues further in chapter 10.	Clarification
Components of the allowance for the cost of capital should all be estimated using consistent time horizons.	YKY	We agree that assumptions for the forward-looking investment horizon should broadly be consistent, though we do not consider this requires using similar historical periods to estimate components of the cost of capital. Our assumptions for Risk Free Rate and debt are consistent with an investment horizon of 10-20 years.	Clarification
Estimates of the Risk-Free Rate derived from market-based yields on government bonds do not reflect equity investor expectations due to	SVT, KPMG, Allianz	QE can only partially explain the fall in gilt yields - which continued between 2013 and 2016 despite the Bank's Asset Purchase Scheme being dormant over this period. Moreover, the Bank's	Clarification

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
distortions (for example Quantitative Easing (QE) and pension fund demand)		own assessment of successive waves of QE presents a mixed picture of their effect, suggesting that some QE announcements were followed by increased yields rather than decreased yields. Expectations embedded in forward rates imply that the market expects 10 year yields to remain negative in real terms beyond 2020-25.	
There is evidence for a negative correlation between the Equity Risk Premium (ERP) and the Risk Free Rate (RFR), so it would be wrong to use a reduction in the risk free rate to imply a reduction in Total Market Return (TMR).	NES, UU, SWB, SEW, KPMG, Allianz	PwC's June 2017 report, *Refining the balance of incentives for PR19* estimates a negative correlation between ERP and RFR of less than 1, suggesting that increases in ERP do not fully offset falls in RFR.	Clarification
If Ofwat place reliance on their 'lower for longer' hypothesis that a falling Risk-Free Rate (RFR) is causing a lower Total Market Return (TMR), then any predicted increase of the RFR from current levels should also be reflected in an uplift to TMR.	WSX, SVT, YKY	PwC found a negative correlation between the RFR and ERP between 2000 and 2017 of 0.62, and for the period 2010 and 2016 of around -0.88. This suggests it is would be wrong to either dismiss the impact of a lower RFR on TMR, or rely on this relationship to directly forecast future estimates of TMR.	Clarification
PwC's Dividend Discount Model (DDM) inappropriately uses GDP growth forecasts as a proxy for dividend growth. Using analyst forecasts should be more accurate.	SEW, WSX	We do not consider analyst forecasts to credibly represent investor expectations of dividend growth due to the considerable body of academic evidence which suggests that they display an overly optimistic bias. We discuss the strengths and weaknesses of different dividend growth assumption in appendix 12.	Clarification
It is estimated that 75% of the earnings of FTSE-100 companies are earned overseas, therefore PwC's use of GDP growth forecasts for the UK instead of the world is unrepresentative.	SEW	PwC's DDM uses the FTSE All-Share index as its basis not the FTSE 100. In addition, ensuring consistency in CAPM parameters when moving to a world perspective is fraught with measurement difficulties. For example, selecting a representative world index, and calculating a world value of beta and world risk-free rate.	Clarification

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The geometric treatment of returns in PwC's Dividend Discount Model (DDM) fails to compensate investors for volatility in the capital value of their investment (which has historically been much greater than volatility in dividend growth). CMA precedent and analysis in the widely used Dimson Marsh and Staunton (DMS) publication suggests a volatility adjustment of +75 to +150bps.	KPMG	It has previously been argued (for instance by Fama & French in their 2002 paper *The Equity Return Premium*) the that estimates of TMR from dividend growth models are downwardly biased due to the observed historical growth rate of dividends being less volatile than the rate of capital gain. However, when considering the total equity yield share buybacks have become an increasingly important component apart from dividends, and should properly be considered in any such analysis. Once share buybacks are incorporated, analysis of data from the period 2006-2017 by PwC shows that volatility in investor income growth (dividends and buybacks) from the FTSE All Share is almost invariably higher than that of capital growth. This suggests that a volatility uplift is not needed. Similarly, Europe Economics suggest a volatility adjustment is not necessary for their DDMs.	Clarification
Ofwat's use of Dividend Discount Model evidence is selective – both the Bank of England and Bloomberg's DDM imply a higher TMR figure.	PRT, SEW, SWB, National Grid	The Bank of England's model's results imply a higher TMR due to using analyst-derived forecasts of dividend growth which are higher than our consultants' proxy (GDP growth forecasts). Historically dividend growth has been much lower than GDP growth, and analyst forecasts have tended to overstate actual dividend growth. We therefore consider GDP growth forecasts to be a more appropriate assumption. We understand Bloomberg's calculation is based on the FTSE 100, rather than FTSE all share – it is therefore focused on the return expectations for narrower assortment of equities and is thus less suitable for depicting Total Market Return.	Clarification
PwC's Market to Asset Ratio (MARs) analysis is unreliable as it does not capture the impact of factors other than outperformance on the cost of	KPMG, E&Y, ICON	The analysis by PwC featured in our draft methodology document reflected analyst-derived forecast contributions to equity outperformance from outperformance on:	Minor change

Q1. Do you agree with our proposed approach to setting the cost of equity, based on the best estimate of expected returns in the 2020-25 period?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
equity on the relevant companies' share prices (for example unregulated activity). This overstates the contribution of cost of equity outperformance.		• totex; • outcome delivery incentives (ODIs); • service incentive mechanism (SIM); and • cost of debt. This analysis did not include the contribution of non-regulated activities. PwC's analysis suggests that the contribution of including this element on nominal TMR is small (0.3-0.4 percentage points) and largely offset once the previously announced CIS log-down of RCVs at the end of the current control period is reflected in the analysis.	
PwC's Market to Asset Value analysis cannot be used to infer a figure for Total Market Return (TMR), as the two companies focused on are a tiny fraction of the whole market.	National Grid, KPMG	PwC inferred a water sector investor cost of equity from analyst estimates of outperformance and share price data in two companies. They then used the Capital Asset Pricing Model to infer a TMR which would apply to these investors, based on assumptions about asset beta and risk-free rate. This comment applies to the second step in the process. However, we do not consider that the impact of the analysis on our proposals for the cost of equity would be different if the results were used to directly inform a plausible range for the cost of equity as opposed to a range for TMR.	Clarification
PwC's use of a Total Market Return estimate derived from a 2017 survey of UK academics, analysts and managers (Fernandez et al, 2017) is not a valid data point because the authors do not seem to have clarified whether responses should be in nominal or real terms.	KPMG	One of the authors of the piece has provided their view that over 90% of the responses for the UK were in nominal terms.	Clarification

Company-specific adjustments

In previous price determinations, we have allowed for company-specific adjustments to the cost of capital. Our draft methodology set out our view that there was no robust evidence that company size should be a factor in setting the cost of equity and that small companies did not necessary face higher debt financing costs than a company with a notionally efficient capital structure.

Our methodology proposed that companies may make claims for specific adjustments in their business plans. We proposed that where companies do so we would expect to see robust evidence that the proposals balance the interests of customers with those of the company and its investors. We have set out in chapter 10 and in appendix 12 the tests we will apply in assessing requests that are made.

There was no specific consultation question on this issue, however, some water only companies and investors raised issues with our proposals. We consider the issues raised in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.1a Summary of issues raised in responses on company-specific adjustments. (Note this was not a consultation question but a number of respondents commented on it)

Issue raised	Who raised the issue?	Our consideration of the issue	Change to our proposals?
Company specific adjustments – cost of capital			
Ofwat should allow a company specific debt premium for small companies, reflecting their	BRL, PRT, SES, SEW,	Companies may make claims for specific adjustments to the allowed cost of debt in their business plans. We set out in	Clarification

Issue raised	Who raised the issue?	Our consideration of the issue	Change to our proposals?
(efficiently incurred) higher average cost of embedded debt.	SSC, ICON, NERA	chapter 10 and appendix 12 the approach we will apply in assessing company requests.	
Ofwat should apply a 30 bps uplift to the cost of debt for PRT based on empirical evidence on the yields at issuance which show WoC spreads to be wider than for WaSCs.	NERA (for PRT)		
The approach to embedded debt only allows companies to under/outperform depending on the timing of debt issuance, which is not due to efficient raising of finance. The proposed approach incentivises companies towards short-term finance which doesn't reflect the long-term nature of assets. This issue is exacerbated for small companies which do not raise finance as frequently as larger companies. Therefore, there might be a need for a small-company premium.	SEW, Hastings, iCON Infrastructure, SRN, BRL, SES	We expect a range of financial under and outperformance relative to our allowance for embedded debt, consistent with decisions which are the responsibility of company management, such as tenor, type, coupon and the quantity of debt to issue. Given the development of private placement markets for corporate bonds in recent periods, we do not consider it is necessarily the case that small companies with an efficient notional capital structure should necessarily face higher borrowing costs. We observe that three out of the five smaller Water Only Companies were outperforming the embedded debt cost allowance of 2.65% set at PR14 (equivalent to a nominal allowance of 5.5%), based on their reported weighted average nominal cost of debt as of March 2017.	No change
Ofwat should not apply a customer benefits test when assessing claims for company specific adjustments. The CMA determined that there was no causal link between the cost of debt required to finance the companies' operations and the benefits outlined by Ofwat.	BRL, NERA (for PRT)	We consider the benefits assessment is both necessary and appropriate. It gives best effect to our statutory duties and helps companies maintain the legitimacy of the regime. We set out our rationale in appendix 12.	No change
Smaller companies will issue debt less frequently than WaSCs, so it is more likely that actual	SEW, AFW	Companies will need to demonstrate customers support company proposals where a company specific adjustment is	No change

Issue raised	Who raised the issue?	Our consideration of the issue	Change to our proposals?
embedded debt costs will deviate from a notional allowance.		requested and that the additional cost is supported by benefits to the customers. We set out further detail in appendix 12.	
If a single approach to setting the cost of debt allowance is continued to be used, it is likely to prove unsustainable since it could result in serious financeability issues for a company such as SSC.	SSC	We would expect companies to consider options to resolve the issue of financeability in the long-term. The choice of financing structure is a matter for companies and their investors.	No change
Rating agencies recognise different operational gearing for smaller water companies in their rating parameters.	SES	We recognise that the operational costs make up a higher proportion of water only company revenues compared to the rest of the sector. However, we do not agree that company-specific uplifts are the correct way of compensating for higher cashflow risks which may be implied. If operational gearing is a concern, it may be appropriate that this is addressed through lower levels of gearing, which we do not currently see amongst the water only companies in practice. We set out further detail in appendix 12.	Clarification
Ofwat should allow a company specific equity premium.	PRT	There is no clear justification or theoretical basis to support an uplift to the cost of equity. We discuss this further in appendix 12.	No change
Analysis conducted by Bristol Water suggests there is an observable differential for small companies for equity beta warranting an adjustment.	BRL, SEW		

Q2. Do you agree with our approach to indexing the cost of new debt?

In previous price reviews we set a single cost of debt which applied for the entirety of the price review period. We consulted on an indexation mechanism for the cost of new debt in September 2016. We set out that an indexation mechanism would protect

companies when debt costs rise; customers would benefit as they would no longer bear the cost of a forecast risk premium in the cost of capital which is associated with fact that we cannot accurately forecast the cost of new debt. We consulted further on the detailed mechanics of a debt indexation mechanism in our draft methodology proposals. We set out that we will make any adjustment required under that mechanism at the end of the control period.

Eight out of 25 respondents agreed with our approach, with 5 disagreeing, and 12 expressing a neutral or no opinion. Most who disagreed expressed opposition to the principle of indexing, citing wrong timing or allocation of risks between customers and companies.

Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.2 Summary of issues raised in response to risk and return, question 2

Q2. Do you agree with our approach to indexing the cost of new debt?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
General issues			
There should be no ex-ante adjustment to the allowance for the cost of new debt reflecting water company out or under-performance relative to the index.	SEW, Hastings, Kelda group, WSX	CEPA in 2016 found that the iBoxx A and BBB rated non-financial corporate 10 year trailing average has been higher than the water industry cost of debt between 2008 and 2015, on average by 55 basis points with a range between 30 and 80 basis points. Using the same iBoXX index as CEPA, and comparing this with 2016/17 Annual Performance Reports, we found that the sector indicative weighted average nominal reported cost of nominal debt in March 2017 for the sector was 4.6%, versus 5.10% for the iBoXX A/BBB	Clarification

Q2. Do you agree with our approach to indexing the cost of new debt?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		10yrs+ 10 year trailing average for 31 March 2017. Together with Europe Economics analysis accompanying this publication we consider an adjustment is necessary for expected systematic outperformance of the benchmark index. We consider a 15 basis points is appropriate, but conservative. We discuss this issue further in appendix 12.	
The iBoxx A/BBB index doesn't reflect the notional company as WoCs currently do not achieve A-equivalent ratings.	iCON Infrastructure	We set our allowance for the notional company, based on our interpretation of our financing duty. An A/BBB rating is investment grade and represents headroom against the floor for investment grade. We do not interpret our duties as requiring us to set an allowance based on companies' actual financial structure.	Clarification
Having an indexed cost of new debt allowance exposes infrequent issuers of debt (mainly smaller companies) and customers to additional risk that the index could fall or rise after the debt has been raised. It would be sensible if the indexation mechanism was designed to allow for companies to mitigate this risk for both them and customers once all funding for the AMP was completed.	AFW	We note that this type of reset risk already exists under the current framework of fixing allowances for 5 year price controls. The 5 smallest water only companies report a weighted average years to maturity in their ranging from 13 to 26 years, suggesting a degree of comfort with this type of risk. There also exist financial instruments (such as swaps or floating-rate debt) which can reduce company exposure to interest rate changes. An indexed allowance also implies a degree of revenue protection from interest rate rises above the initially set cost of new debt allowance, which would not occur if this was fixed for the 5 year period.	No change
The new cost of debt methodology will attract "passive" investors. Companies need investors who want to take a riskier approach and bring innovation to the sector. Therefore risks should stay with equity.	WSX	We think the legacy approach of setting a fixed allowance for new debt risks would over or under-remunerate the sector relative to its actual debt costs. We consider that innovative financing will still be possible under our proposals, and that the use of a market average benchmark (the iBoXX) will incentivise cost-effective debt issuance strategies. Companies will still keep any outperformance against the index, therefore incentives to issue debt cost-effectively are maintained.	No change

Q2. Do you agree with our approach to indexing the cost of new debt?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Indexation will encourage 'shadowing' the index with shorter term debt, increasing refinancing risk.	Hastings, Icon	Companies have since 1994 faced interest rate risk if they issue debt at tenors longer than a 5 year control period. This has not led to the sector's debt issuance strategy 'shadowing' control periods. Similarly companies have a range of financing policies in place – companies have not, for example, 'shadowed' our assumptions for the proportion of index linked debt in our price determination.	No change
It is unfair for companies to bear inflation risk. Instead of using an ex-ante inflation adjustment to derive the real cost of new debt, Ofwat could adjust the nominal cost of new debt with the outturn inflation, specifically the inflation used to index the RPI-linked RCV and CPI-linked RCV over the AMP7.	SEW	Companies have always had to bear this element of inflation risk. Under an approach that fixed the cost of debt for the duration of the price control, companies would still bear the risk that inflation turned out to be different than the long term rate of inflation that underpinned our cost of debt assumption.	No change
It is not the right time to index new debt when interest rates are low and very likely to increase.	CCWater	A fixed cost of debt would inevitably include a forecast risk premium whether interest rates were expected to increase or decrease. The introduction of a debt indexation mechanism allows us to remove the forecast risk premium that would otherwise be incurred in the customer bill.	No change
Reconciliation adjustment			
The proposed cost of debt methodology adds another layer of complexity to revenue adjustments and regulatory regime in general.	WSH	We recognise there is some additional complexity, but believe it is outweighed by customer and company benefits.	No change
In-period adjustment would be preferred to an end of period adjustment.	SVT, SWB, UU, TMS	The reconciliation adjustment is for changes in the market interest rate. This is different to ODIs where the rationale for promoting greater use of in-period ODIs is to provide stronger incentives on companies to deliver service improvement by reducing the duration between outperformance payments and the behaviour which	No change

Q2. Do you agree with our approach to indexing the cost of new debt?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		generated them. As companies cannot affect changes in the index which drives our reconciliation mechanism, the same logic does not apply.	
The use of a cost-sharing mechanism instead of indexation would be preferred so that companies are not penalised for the tenor and timing of embedded debt.	SVT	We rejected the option of introducing mandatory risk-sharing across the sector as part of our 2016 consultation on the cost of debt. Our concern was that the reconciliation of company performance would reduce the incentives for companies to seek efficient finance. A mandatory approach would cut across the scope for companies to develop their own risk-sharing proposals with customers.	No change
Companies should have the choice between a revenue and a RCV adjustment.	YKY	Adjustments relating to the cost of debt component of allowed revenue would normally be made through revenue. However where a company provides us with evidence as to why it would be more appropriate to make an adjustment through RCV then we will consider their proposals, taking into account the impact on customer bills. We will confirm our approach as part of our PR24 methodology.	Clarification
Calculation methodology			
The proposed proportion of new debt (25:75) is too high. Current methodology implies that 50% of debt will be new debt. Data actually suggests that this figure will be 25% at most. The RCV growth would not account for the remaining 25%. Therefore, the proposed methodology doesn't reflect the assets' life.	NES, iCON Infrastructure, BRL, SVT	Our current assessment is 30:70, but we will revisit this assumption once we have received company business plans. We acknowledge that the approach to calculating the reconciliation adjustment in the reconciliation model should be consistent with this assumption.	Minor change
New-issuance premium on any bonds, fees on debt, standby/overdraft/capex facilities, cost of funding cash that a prudently managed company will hold and cost of pre-funding debt	NES	Our proposed allowance includes 10 basis points on the cost embedded and new debt to reflect issuance and liquidity costs.	Clarification

Q2. Do you agree with our approach to indexing the cost of new debt?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
maturities are not taken into account in the iBoxx index. These should be included in our allowance.			
The initial allowance for new debt set at PR19 should be set with reference to forward rates.	UU, YKY	Our approach for estimating the cost of new debt reflects forward rates.	Clarification
The calculation uses an 'Extending trailing average rate' based on a simple average of the index from the start of the AMP until the relevant year; this approach does not reflect that debt issued in the current year should have a lower weighting, as it will not have a full year's interest cost associated with it; (for example, the cumulative indexation rate for year 2 should give half as much weight to the year 2 index as to the year 1 index, to reflect that year 2 debt is issued on average midway through the year). This could be adjusted in the cost of debt indexation model by changing the weightings of the underlying index when calculating the 'Extending trailing average rate'	TMS	We acknowledge that this change would increase the accuracy of the true-up calculation and propose to incorporate it.	Minor change

Q3. Do you agree with our proposal to index price controls to CPIH (subject to its re-designation as a national statistic before we publish our final methodology)?

In our draft methodology, we set out our preferred option to transition to the CPIH (rather than CPI) inflation index. We noted the UKSA had not designated CPIH as a national statistic when we published the draft methodology, hence our decision to consider the issues in the final methodology. The UKSA subsequently designated CPIH as a national statistic on 31 July 2017.

8 out of 25 respondents agreed with our decision to adopt CPIH, with 1 disagreeing, and 16 expressing a neutral or no opinion. Where concerns were raised, these were largely around the question of whether CPIH would be designated as a national statistic, and difficulties which might be caused by there being a mismatch between CPIH-based revenues and a market currently largely based on RPI-linked (and to some extent, CPI-linked) debt.

The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.3 Summary of issues raised in response to risk and return, question 3

Q3. Do you agree with our proposal to index price controls to CPIH (subject to its re-designation as a national statistic before we publish our final methodology)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Use of CPIH to index price controls			
CPIH should only be used if it is designated a national statistic	YKY, NES	The UK Statistics Authority confirmed re-designation of CPIH as a national statistic on 31 July 2017.	No change

Q3. Do you agree with our proposal to index price controls to CPIH (subject to its re-designation as a national statistic before we publish our final methodology)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
CPIH is untested and is subject to unpredictable fluctuations in the housing market	WSH, ANH, Thames Tideway	We recognise this issue, but CPIH is a national statistic. It is recognised as the most comprehensive measure of inflation and is the primary focus of the ONS in its inflation reports. The 2015 UK Statistics Authority publication 'UK Consumer Price Statistics: A Review' also recommended that regulators should work towards ending the use of RPI as soon as practicable, also stating that CPIH is conceptually the best overall measure of inflation in the UK.	No change
The transition to indexation of the RCV by CPIH will make it harder for companies to match their liabilities to their assets, because there is currently no market for CPIH-linked debt and only a small market for CPI-linked debt.	NES, Anglian Water Investors, Thames Tideway	We note that some companies, including United Utilities, Affinity and Tideway have successfully issued CPI-linked debt in 2016 and 2017, and Severn Trent has announced it has arranged a RPI to CPI swap that will commence in 2020. We expect demand for CPI such arrangements to increase as pension funds which have liabilities indexed to CPI. As set out in Water 2020: our regulatory approach document published in May 2016, we make no assumption that companies need to issue CPI/H-linked debt to manage refinancing risk and note that the transition does not require an efficient company to refinance any existing debt.	No change
The board does not agree with the change of index. There are concerns that the change from RPI to CPIH cannot be made in a value-neutral way between customers and investors.	WSX	We have published a spreadsheet model which confirms how the actual wedge between RPI and CPIH will be reconciled with the wedge we assume in setting our price determination and we illustrate the reconciliation adjustment in appendix 12.	No change

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism?

Q4a. Should the true up mechanism be limited to change in corporate tax rates and capital tax allowances or should we extend that true-up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?

For each of the wholesale controls we are required to set an allowance for corporation tax payable.

In the draft methodology, we set out our proposals for how we would calculate those allowances and proposed to introduce a true up mechanism to enable us to revisit those allowances should there be changes to the prevailing tax rates during the price control period.

The majority of respondents support our proposal. However, three water companies disagreed with our proposals and one respondent disagreed with the use of a true up mechanism.

Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.4 Summary of issues raised in response to risk and return, question 4

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Approach to setting tax allowances			
The calculation of tax allowances could be simplified further by calculating an allowance for the wholesale business and then allocating it across each of the wholesale controls using an appropriate basis.	ANH	While this approach would reduce the regulatory burden, we disagree with this approach as the tax allowances would not reflect the actual revenue and costs of each control.	No change
Where the overall business is not expected to make a taxable profit then there is limited benefit in making separate tax calculations for each control.	TMS	As noted above, tax allowances should reflect the actual revenue and costs of each control. It is only by undertaking tax computations that we can be certain that no tax is payable.	No change
Capital allowances			
Our draft methodology proposals set out that we would expect companies to use all capital allowances that are available to them and that we would make this assumption within our calculation of the tax allowances. Companies can still choose to disallow capital allowances if they wish to do. However at the start of each price control we would take the opening balance on their capital allowance pools reported to HMRC as the opening balance for our calculations. A number of companies commented that this would	ANH,SRN, BRL,SEW	Companies normally only disclaim capital allowances as part of group tax planning arrangements and in most cases we would not expect them to be disclaiming the allowances that are available to them if the business is acting as a standalone entity. We acknowledge that if companies choose to disallow capital allowances in their tax computations then under our proposals customers could benefit from the same capital allowances more than once. If companies believe that their individual circumstances are such that there would be a benefit to customers as a result	Clarification

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
result in customers benefiting from the capital allowances that they had disallowed twice.		of them making a capital allowance disclaimer then they will need to provide us will compelling evidence as to why this would be appropriate and we will consider whether the proposals are appropriate on a case by case basis.	
In certain circumstances if companies use all the capital allowances available then this could result in tax becoming payable earlier and this would prematurely increase bills for customers. Ofwat should confirm that companies would not be penalised for optimising their tax position even if that resulted in not all capital allowances being claimed	TMS	Our initial assumption will be that companies make full use of all the capital allowances that are available to them. Where companies wish to take an alternative approach to using those allowances then they will need to provide us with compelling evidence as to why that is in the best interest of customers. We will consider that evidence as part of the business plan submissions.	Clarification
A number of companies requested further guidance as to how they should calculate the opening capital allowance balances and whether they should reflect actual capital allowance pool balances or notional capital allowance pool balances.	NES,SEW	Opening capital allowance pool balances should reflect the actual full value available to companies and should not be adjusted to reflect the impact of any previous disclaimers etc. If a company believes that any previous capital allowance disclaimers made reflected the most tax efficient approach for the appointed business and were in customers' benefit, then they should present strong and compelling evidence in their business plan. We will then consider the case for allowing an adjustment to the companies opening capital allowance pools to reflect these specific disclaimers.	Clarification
Companies' capital allowance pool balances include items which fall outside the control or which were incurred at companies' expense. Confirmation that an	TMS	We will clarify that we will make an adjustment to the capital allowance balances shown in company tax returns for any assets which are outside the appointed business.	Clarification

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
adjustment would be made for these items when calculating the opening pool balances at the start of each price control period was requested.			
The apportionment of new capital expenditure between pools is inherently subjective and companies are being asked to consider the correct tax categorisation of expenditure before it is incurred. Ofwat may want to consider an approach whereby expenditure is allocated to pools based on, for example, the average capital allowance in the companies' tax returns over the last three years.	SVT	Companies should be able to use their judgement as to how expenditure is added to capital allowance pools reflecting the individual expenditure forecasts of each company, which may not be in line with recent history.	No change
Group relief			
The proposal that any group relief received but not paid for would be acceptable where actual tax charges do not exceed the allowance. However customers would not be disadvantaged if tax exceeds the allowance and group relief is used in respect of the excess charge.	NES	We would not seek to recover amounts from companies which are in excess of the tax allowance funded by customers.	Clarification
The proposed approach to capital allowances and the proposed approach to group relief should not be used together. It should be either but not both. The utilisation of available group reliefs should be encouraged as this benefits customers. The benefit	SRN	To the extent that we have given companies an allowance for tax payable then where they do not require that allowance - as a result of using available group relief - we will recover 100% of the allowance that was not required for customers.	No change

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
should be shared between company and customer (50/50).			
Proposed true up mechanism			
A view was expressed that the suggested timing of the true up adjustment at the end of the period could lead to counterintuitive outcomes, therefore it was suggested that an adjustment to true up the corporation tax allowance should be made in the price review period	NES	One of the key inputs into the tax computations is the cost of debt. Therefore it makes sense to make any adjustments to the corporation tax allowance at the same time that we make any adjustments required under the cost of debt mechanism – which we have said will be at the end of the period	No change
South West Water's WaterShare mechanism already shares the impact of changes in corporation tax rates with customers along with a basket of other variances. They requested the flexibility to determine how to share any outperformance	SWB	We want to ensure that the tax allowances we calculate reflect the actual corporation tax rates which are in place. Companies are still encouraged to share any out performance with customers.	No change
There was a suggestion that the proposals on tax and debt will encourage a rate of return culture by attracting passive risk averse investors. Consequently it was recommend these changes are removed so that these risks remain with equity investors who are best placed to manage them	WSX	In line with the position set out in the methodology we are proposing to introduce a tax adjustment mechanism to allow us to amend the tax allowances to reflect changes in the headline rates of corporation tax and capital allowances. We consider this is necessary to ensure an appropriate alignment of risk and return between customers and companies.	No change
Companies should have the choice between a revenue and a RCV adjustment.	YKY	Adjustments relating to the tax component of allowed revenue would normally be made through revenue. However where a company provides us with evidence as to	Clarification

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		why it would be more appropriate to make an adjustment through RCV then we will consider their proposals, taking into account the impact on customer bills. We will confirm our approach as part of our PR24 methodology.	
Interest deductibility			
Tax should be funded based on the notional capital structure and notional levels of debt	TMS	Companies which have elected to have gearing which is higher than the notional gearing level are able to benefit from a higher interest shield which reduces their tax liabilities. As at PR14 and in previous reviews and we consider that it is appropriate for companies to pass the benefit on to customers. Our policy ensures companies do not increase gearing levels simply to benefit from a higher tax allowance.	No change
Deloitte note in their report that in principle water companies should qualify for the public benefit infrastructure exemption (PBIE) - in practice some restructuring may be required to meet the requirements. There was a suggestion that for those companies with gearing below the notional level, Ofwat should calculate the tax allowances using the actual gearing levels as this would better align the treatment of interest in the allowance with statutory tax environment	SVT	For companies which are geared below the notional level this approach would result in an increased tax allowance. This would not be beneficial to customers and this impact would not be offset by the benefits of companies' actual tax returns more closely reflecting the tax allowances.	No change

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The PBIE which gives companies full deductibility for all their third party interest may not be available for all companies. WSH noted that they may not be eligible for the PBIE but would still be able to gain full tax relief via the group relief rule, however AFW suggest making an adjustment for any interest which is not deductible	WSH, AFW, BRL	We consider that we should assume full deductibility. Where companies have gearing in excess of the notional level but are unable to deduct all their interest we will calculate the interest tax shield for any amount above the notional level which is deductible. (that is where a company is 80% geared but can only deduct interest on debt equivalent to 75% gearing we will use 75% in our calculations)	Clarification
Other computational issues			
The models do not currently appear to have an input line for deferred revenue expenditure	SVT	We have included additional inputs in the business plan tables to allow companies to reflect this type of expenditure.	Change
If there is a requirement for companies to reconcile actual tax paid to the actual tax allowances provided in the tax computation then this should be in the form of a tax computation	SVT	Reporting actual performance against determinations will be covered in the Annual Performance Reports. And we will set out the requirements within the RAGs.	Clarification
SVT said it had traditionally treated its provision for bad debts as being part specific and part general for tax purposes. To the extent that HMRC require them to continue to treat part of their bad debt provision as general this could be material in the context of the retail control and may require a computational adjustment.	SVT	We do not calculate a separate tax allowance for the retail controls. Instead retail controls receive an EBIT margin from which companies need to pay any relevant corporation tax.	No change
Where Ofwat is challenging companies to increase innovation it is important that it is aligned to the ability	PRT	Companies are only able to claim R&D allowances when they are undertaking innovative research and development	Clarification

Q4. Do you agree with our approach to setting tax allowances at PR19, including the proposed true up mechanism? **Q4a. Should the true up mechanism be limited to changes in corporation tax rates and capital allowance rates or should we extend that true up mechanism so we can also make adjustments for other changes in tax legislation or accounting regulations which have a material impact on the amount of tax companies are liable to pay?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
of companies to retain the tax benefits of any associated R&D allowances		work. In line with our key theme of encouraging innovation we would not seek to recover the tax benefits of R&D allowances from companies.	
Extension of the true up mechanism			
The true up mechanism should include the ability to make adjustments for other items which have a material impact on corporation tax and which are outside of companies' control. To mitigate the regulatory burden a materiality level should be set	TMS, NES, WSH, SEW	The majority of companies preferred our proposed simple true up mechanism which avoided unnecessary complexity and minimised additional regulatory burden. We consider a simple true up mechanism in - which makes adjustments for headline rates of corporation tax and capital allowances only – provides the best balance between complexity and benefit to customers and companies.	No change
The true up should also include other forms of tax, notably cumulo rates.	SVT	Our proposals relate to the allowance for corporation tax only. Property and payroll taxes are included in the totex and retail cost allowances that companies receive and are subject to totex cost sharing rates for example.	No change

Q5. Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?

In the draft methodology, we proposed companies should carry out scenario analysis to show the impact on RoRE of changes in revenue, totex, ODIs, C-MeX, D-MeX, retail costs and the cost of new debt. This is a smaller list of scenarios than we required at PR14.

All respondents that commented agreed with our proposal to reduce the number of prescribed scenarios for PR19. Respondents also agreed it would be helpful to give companies the flexibility to put forward company specific scenarios where they considered this would add to the understanding of the particular risk/return balance.

The adaptation of the financial model to facilitate RoRE analysis was supported by respondents. There were only two responses on the guidance provided to companies on how to determine the high and low of sensitivities: both were in agreement, though one felt more prescription on the part of Ofwat would be appropriate.

Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 9.5 Summary of issues raised in response to risk and return, question 5

Q5. Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Three companies disagreed with our proposal not to publish a common set of economic assumptions for companies to use in scenario analysis.	TMS, WSH, AFW	We confirm that we will not publish common economic assumptions. The majority of companies agreed or did not state a preference on this point. Our view on the cost of capital is underpinned by a view on inflation for the period 2020-2025, which companies can use as a base for their assumptions on inflation.	Clarification
Of the six companies that commented on the use of the financial model, one stated it wanted to reserve the right to use its own model as a backstop in the event there were issues with the Ofwat model.	YKY	We confirm that we expect companies to use the financial model, business plan tables and prescribed RoRE scenarios. Our financial model has the prescribed scenarios built in. However, we do expect companies to demonstrate how they have assessed risk in delivering the plan, using an assessment that is relevant to their circumstances. So companies could provide additional evidence using scenario analysis using a different financial model.	No change
One company stated there was a need for Ofwat to be more prescriptive regarding the approach companies take to the upper and lower bounds of P10/P90 probabilities, particularly in regard to ODIs.	UUW	Each company will need to determine its own approach to assessing the P10/P90 scenarios reflecting its own circumstances and so we consider it is best to leave each company to determine its approach. However, we expect the explanations and support given to the upside and downside scenarios to be compelling. Upside and downside scenarios may take account of historic evidence, where available, and be assessed on the basis of expert judgement.	No change

Balance of risk and return

We did not explicitly ask a question about the balance of risk and return. However, several respondents gave comments on the overall balance of risk and return in their responses. We summarised those responses below.

The key concern was that the overall balance of risk and return was skewed to the downside for companies. We address this concern in the narrative around the balance of risk and return in chapter 10.

Table 9.5a Summary of issues raised in responses on the balance of risk and return. (Note this was not a consultation question but a number of respondents commented on it)

Q5. Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Fifteen respondents noted that the balance of risk and return appears to be skewed to the downside for companies under our proposed methodology. It was speculated that a well performing company could earn below its cost of capital, respondents highlighted that the cost of equity needs to be considered within the context of the overall incentive package.	ANH, SVT, SRN, TMS, UU, WSX, YKY, AFF, BRL, SEW, SSC, Anglian Water Investors, iCON Infrastructure, Allianz, Hastings	A company with average current performance that maintains the same absolute level of performance into the next price control period would incur underperformance penalties on its ODIs. This is because we are expecting companies to improve and are setting challenges for performance commitments, including a forward-looking, upper-quartile challenge. Average performance now will not equate to efficient performance in the future. It will be possible, if unlikely, for all companies to outperform their performance commitments and earn net ODI outperformance payments in the next price control period. We discuss this issue further in appendix 12.	Clarification
Two respondents considered that the incentives package, combined with a short-term approach to assessing total market returns (TMR) could result in a higher cost of capital	SEW, Hastings	Broadening the range of expected returns should align the interests of companies and their investors with customers. It should also encourage investors to take more interest in the actual performance of the companies. The wider range of potential outturn returns is a diversifiable risk and not, therefore, a factor which should lead investors to require a higher return. We discuss this issue further in appendix 12. As interest rates and market equity returns are expected to remain low beyond 2020-2025, relying on long-term historical average approaches is likely to overstate the true	Clarification

Q5. Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
for the industry in the longer term.		cost of equity for 2020-2025. If allowed equity returns are overstated, this will increase the legitimacy challenge to the sector, so it is not the case that setting market returns in line with expected market rates will increase the required, long term, cost of capital. We consider that our approach to assessing total market returns is appropriate. We discuss this issue further in chapter 10 and appendix 12.	
Two companies considered that the incentives package could cause current investors to withdraw from the sector or require investors to take on more risk.	SWB, WSX	Broadening the range of expected returns should align the interests of companies and their investors with customers. It should also encourage investors to take more interest in the actual performance of the companies. This is consistent with the objective of incentivising equity investors to hold company boards to account for their performance in delivering what matters to customers. We discuss these issues further in appendix 12. It is important to note that investors in the water sector will still have very high level of protection compared to in other sectors. We discuss this issue further in chapter 10.	No change
Two companies requested further clarification of our assumptions about the performance of the efficient company, in terms of outcomes and totex as well as financial performance.	UU, TMS	Our view on what constitutes an efficient company is summarised below. Costs - We are expecting companies to improve cost efficiency, consistent with improvements in previous periods and the wider economy, therefore cost levels that represent the average for the sector today do not reflect our expectations for the efficient company in 2020-25. The efficient company will be efficient compared not only to their peers in the water sector now and into the future, but also against other sectors. We expect to incorporate forward-looking upper quartile measures of cost efficiency, as used by other regulators such as Ofgem. Totex allowances will implicitly assume an efficient pension allowance; the policy for funding pension deficits was set at PR09 - we have already confirmed with companies that we will not revisit the policy as companies and investors are responsible for managing an efficient pension strategy. We discuss this issue further in chapter 6. Performance - The expected performance of the efficient company in 2020-25 would be targeted at our benchmark of upper quartile or frontier performance, but efficient companies may over or under perform in some areas. Evidence from current	Clarification

Q5. Do you agree with the set of scenarios for RoRE analysis we have prescribed, the guidance we propose and to use our financial model to provide the suite of prescribed scenarios?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		performance suggests there is significant scope for companies to improve performance. This is why penalties as well as outperformance payments are important to incentivise performance. It remains possible, if unlikely, for all companies to outperform our benchmarks. We discuss this issue further in chapter 4. Financial structure - We set out our view of the capital structure (including proportion of index linked debt) that underpins the cost of capital and financeability assessment in appendix 12. We have not set expectations of target financial ratios as companies need to own their proposals to ensure their plans are financeable. We do however share the suite of ratios we will use for our financeability cross-check. We discuss this issue further in chapter 11.	
Experience from retail market opening suggests that the retail margin is insufficient to compensate for the risks being borne by retailers.	Business Stream	Our assessment takes account of the relevant comparator benchmarks that are set out in the Europe Economics report which draws on market evidence and other regulatory decisions. Our view is preliminary and will be updated for the draft and final determinations in 2019, to take new evidence into account. We discuss this issue further in chapter 10.	Clarification
One company raised a specific concern that in bioresources, although companies will be swapping regulated risk for market risk, which may be considered broadly similar, the retention of regulatory controls on revenue (the 3% forecasting penalty and +7% volume recovery cap) means companies will be under both market and regulatory risk.	SVT	The bioresources control will be subject to some volume risk, but exposure will be limited and companies will retain direct control over the treatment of bioresources. Our modified average revenue approach provides mechanistic protection to fixed costs such that there is no stranding risk for efficient investment. Our refined approach to the average revenue control acts to align the incremental revenues allowed for changes in volume with the costs of providing bioresources services. While there is more exposure to volume risk for the bioresources control than the network plus price controls, we consider the impact on the cost of capital to be minimal for 2020-2025 because of the revisions we have made to the form of control. For 2020-2025, our view is that the cost of capital, and its components, will be consistent across the wholesale price controls. We discuss this issue further in chapter 10.	Minor change

10. Financeability

Q1. Do you agree with our overall approach to assessing financeability?

We interpret our financing duty as a duty to ensure that an efficient company is able to finance its functions, in particular by securing reasonable returns on its capital. Our approach will assess whether revenues, relative to allowed costs, are sufficient for an efficient company to finance its investment on reasonable terms, while protecting the interests of customers now and in the long term.

Our approach to assessing financeability at our 2019 price review (PR19) is consistent with the approach we used at our 2014 price review (PR14). We will assess financeability at appointee level by reference to the notional capital structure that underpins the cost of capital. We will also carry out a cross check to ensure that individual controls are financeable.

Companies will need to submit a plan that is financeable. We expect companies to clearly explain how they have determined their business plans are financeable. Companies should explain the key financial ratios they have considered, and how they have determined the pay as you go (PAYG) and regulatory capital value (RCV) run off rates, which underpin the plan. We expect company Boards to provide assurance that the plan is financeable on both the notional capital structure and the company's actual capital structure.

The majority of respondents supported our proposals. However, three water companies (WSX, BRL and PRT) and iCON Infrastructure, disagreed with our proposals. Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 10.1 Summary of issues raised in response to financeability, question 1

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Company assurance of notional financeability			
Two respondents raised questioned about the appropriateness of asking Boards to assure financeability based on the notional capital structure. One respondent commented that it is Ofwat's duty to ensure that companies can finance their functions, and the notional company does not actually exist. They went on to say that if this requirement is retained in the final methodology, they recommend that it is accompanied by a clear articulation of how this relates to the Board's or to our duties, (either as defined under the operating licence or elsewhere) and therefore how it adds value to the PR19 process.	WSX, YKY	We see no reason why company Boards cannot provide this assurance. We will be providing an indicative view of the notional financial structure and the cost of capital. We are not asking company Boards to provide this assurance as part of their obligations under the licence. The legal foundation for this request is, our methodology itself. Specifically in relation to our financing duty and our need to be satisfied about the financeability of the company on a notional basis.	No change
Financeability of individual controls			
There was agreement that the financeability for sub-controls is of some interest, and agreed that we are right to **consider** whether any adjustment for financeability is made at this level, rather than **to require** it. It was noted that individual controls would only need to raise their own finance and pay dividends if they were separate companies	SVT	Consistent with our duties, the financeability assessment will be carried out at the appointee level. However, individual controls are separate and binding. It is important that there should be no cross subsidy between them because this could result in customers who are not receiving all the services provided by each company, being disadvantaged.	No change
Use of PAYG/RCV run off levers			
There was a question regarding our methodology assumption that the default rate for PAYG is consistent with the accounting rate. A	PRT, BRL	Companies should explain how they have determined the appropriate PAYG and RCV run off rates included	No change

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
transition between PAYG approaches between AMPs, can heavily impact financeability. In addition anticipated efficiencies will reduce bills over time.		in their plans. We have suggested that companies start with the "natural" accounting rates in their explanations. We will accept alternative rates, providing company choices are appropriately explained and evidenced, and companies have the support of customers for the impact on bills.	
Respondents highlighted that, the credit rating agency, Moody's, has stated its intention to make an adjustment for any fast money brought forward in excess of the "natural rate" in their interest cover ratios. This will limit the ability of companies to use PAYG to deal with financeability issues. Therefore Ofwat should reflect this adjustment in its ratios, as this in in line with the adjustment the rest of the industry will face in practice.	ANH, YKY, BRL, SEW	The PAYG and RCV run-off financial levers, allow cash flows to be moved between periods in an NPV neutral way. Where financial levers are used to bring cash flows forward, then investment is recovered more quickly and this may improve cash flow ratios. However, we will seek to ensure that financial levers are not used in such a way that the RCV is depleted over the long term. From our discussions with rating agencies, only Moody's make this adjustment. Our approach is consistent with PR14.	No change
Respondents suggested that PAYG levers and their impact on future bills is a complex technical area. It is difficult to explain to customers, to get the necessary support for any changes.	SVT, YKY, BRL	It is important that companies take the views of customers into account when setting bills, and companies will need to ensure that they engage with customers in an effective way. While we acknowledge that it may be challenging to explain PAYG to customers, companies should be able to explain the impact of those choices on bills	No change
There was disagreement about us proposing to intervene where companies use PAYG levers to address financeability concerns relating to the actual company structure. It was noted that the use or PAYG levers in this way, simply re-profiles the bills from the future to the present	SEW	Application of financial levers has consequences on the balance of customer bills between the short and long term. We must assess companies' proposed use of financial levers to meet our duty to customers. We would not support the use of PAYG levers to address an issue with the financeability of the actual company,	No change

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		unless it could be demonstrated that there is customer support and there is a benefit to customers by doing so.	
It was suggested that customer views, both in the short and the longer term, should play an important part of the assessment of PAYG rates The PAYG rates should not be allowed to increase, to compensate for a lower WACC Where evidence has indicated that companies have received more through PAYG than they needed at PR14, then an adjustment should be considered to recover the excess Small company premiums should only be granted where there is evidence of a financing constraint and there is evidence of a benefit for customers.	CCWater	We agree that customer views should be taken into account, and this is reflected in the methodology. Companies will be required to clearly explain and evidence their choice of PAYG and RCV run off rates, and demonstrate that they have customer support. Financial levers can be used to smooth bill impacts between periods in a way that is NPV neutral to customers. Therefore, we do not intend to reopen the determinations that were made at PR14 in respect of PAYG. Our approach to assessing any claims for company specific cost of capital adjustments, are considered in the chapter 10.	No change
Assessment of financeability over the longer term			
Given Ofwat's long-term resilience duty, it is no longer appropriate for us to consider financeability only over a single price control period. This is especially true, where this results in a company delaying, rather than resolving, financeability issues.	SWB, WSX	Our financeability assessment will focus on 2020-25 but we will also take into account the impact of companies' choices on subsequent years. This is to ensure that companies are not running down the RCV too quickly, which could result in issues in future years. In their business plans, companies are required to provide evidence of the impact of their choices on company bills over the longer term.	No change
Definition of notional capital structure			

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Respondents commented that, as well as notional gearing levels, we should set out details of the assumptions that they are making for a notional company so that Boards are able to sign off on the financeability of companies. This should include: • ensuring that WACC is consistent with notional gearing assumptions; • notional credit rating; • notional credit rating definitions and targets; • proportion of new debt to notional embedded debt; • assumed proportion of index linked debt, and whether that can be adjusted to address financeability issues; and • the assumed level of any pension deficit. The assumptions need to be consistent with the rest of the price control package	TMS, UU, SEW	We set out our early view on the cost of capital, proportion of new to embedded debt and proportion of index linked debt in chapter 10 and appendix 12 (aligning risk and return). Our credit metric definitions are set out in the methodology document in chapter 11. We will not be publishing targets for individual metrics as companies should own their plans. We do not want to influence companies' discussions with customers. Companies should clearly set out the levels at which they are targeting individual metrics and explain why they are appropriate.	No change
It was suggested that, if we reduce the level of gearing under the notional capital structure to address financeability constraints, then this should be reflected consistently within the WACC assumptions and modelling.	SVT	The basis on which we set the WACC is set out in the chapter 10 and appendix 12. The level of gearing that underpins the WACC, will reflect our assumptions regarding the notional capital structure for the financeability assessment.	No change
The draft methodology proposals note that the notional capital structure is efficient. Respondents said that we had suggested that more highly geared structures are inefficient. There was a challenge to that assumption, including the provision of evidence for the costs and benefits of more highly geared structures for customers.	ANH, SEW	The notional capital structure is considered to be for a company that is efficient. We do not comment on the efficiency or inefficiency of actual capital structures – that is a matter for companies and their investors.	No change

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat have a duty to ensure that an efficient company is able to finance its functions. Respondents suggested that where companies have raised finance in the past, which at the time was efficient, then this should be reflected in Ofwat's financeability duty and Ofwat should not be judging companies with hindsight.	PRT	Ofwat's calculation of an allowance for the cost of embedded debt that companies face is set out in appendix 12. Companies are also able to submit a claim for a company specific adjustment to the cost of debt where there is sufficient evidence that there is a benefit to customers from doing so, see chapter 10 and appendix 12. This does not change our overall approach to assessing financeability	No change
We indicated in our proposals, plans to transition away from the use of RPI in 2016. ANH suggested that that prudent companies are actively taking steps to reduce exposure to RPI and, in principle, companies should not have raised new RPI linked debt since 2016. Therefore, under the notional capital structure, companies should not be assumed to have the same level of RPI linked debt as at PR14.	ANH	The amount of index linked debt included in the notional capital structure, is considered in appendix 12.	No change
It was suggested that applying the cost of debt adjustment mechanism at the end of the period, exposes the company to a timing risk if the market rates move significantly. Historically, we added a contingency to our forward looking cost of debt for this reason. Given the current economic certainty, companies may need a higher level of resilience to withstand any interest rate shocks than in previous price controls.	ANH	Our proposed notional gearing is lower than PR14, and so provides greater resilience to the shocks described. Our assumed new cost of debt takes into account forward curves through the 2020-25 period, and so represents an uplift compared with current interest rates. This is an issue that companies will need to manage in the same way as they manage other cost allowances (such as totex and retail cost allowances). The basis on which we set cost of debt is set out within chapter 10 and appendix 12.	No change

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
An issue was raised that S&P have raised the concern that changes to our incentive mechanisms, will result in there being more focus on high powered ODIs. This could result in increased revenue volatility. Increased volatility will mean that companies will require increased headroom to credit metrics to allow them to manage financial resilience. It was suggested that the introduction of these changes means that the notional company we suggest for financeability, is now much further away from the reality of actual companies. We therefore need to ensure that the tests for financeability are aligned with the statutory financing duty.	ANH, BRL, SEW, iCON Infrastructure	In appendix 12, we confirm the increased revenue at risk from the incentive mechanisms is one reason why we have reduced notional gearing to 60% in our early view.	Clarification
Impact of incentives on financeability			
At previous price reviews, legacy revenue was excluded from the financeability assessment. Following changes to the true up mechanisms at PR19, it is more likely that a number of companies could have negative legacy revenue. Excluding this revenue could artificially inflate the financial metrics, potentially leading to an incorrect financeability assessment. Respondents noted that, we have a duty to ensure that companies are able to finance their functions, acting in the long term interest of customers. Negative adjustments may arise due to totex outperformance which will reduce revenue, but not due to poor performance. Consideration needs to be given as to whether all negative adjustments are penalties and should be described as such The use of PAYG to address financeability constraints, simply moves cash between periods and does not result in an increase in	YKY, SVT	Where companies have negative revenue adjustments due to the operation of incentive mechanisms relating to the previous period, for example due to totex outperformance, those companies have benefited from additional revenue in the previous period. It would be inappropriate to allow companies to increase revenue to address a financeability concern when they have already had the benefit of additional revenue in the previous period. Therefore, we do not propose to change our approach to adjustments arising in respect of incentive mechanisms relating to the previous period when assessing financeability. However, we will clarify our wording in this area to make it clear that adjustments do not only relate to poor performance.	Clarification

Q1. Do you agree with our overall approach to assessing financeability?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
bills to customers over time. Therefore, if PAYG adjustments are made to deal with financeability adjustments arising as a result of including these incentive adjustments, it should not be seen as negative for customers.			

Q2. Do you agree with the calculation of the metrics that we are proposing to use in our assessment?

In our draft methodology proposals, we set out that we would use a standard suite of financial metrics in our financeability assessment. These financial metrics are also incorporated into the financial model that we will be using at PR19. This will ensure that the data provided by all companies is presented on a consistent basis. We also set out that we did not intend to specify targets for these metrics. We said that companies should determine the credit rating that they are targeting, and confirm that the metrics that underpin their plan are consistent with that target.

We set out that companies could provide additional information, including alternative metrics, to support their view of financeability within their business plan submissions.

The majority of respondents support our proposal. However, two water companies, WSX and BRL, disagreed with our proposals. Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 10.2 Summary of issues raised in response to financeability, question 2

Q2. Do you agree with the calculation of the metrics that we are proposing to use in our assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ratios should be aligned to Rating Agency methodology			
It was suggested that our financial ratios should be aligned to the metrics used by the credit rating agencies. Presenting metrics that are calculated differently does not foster trust and confidence and Company Boards need to consider the actual metrics the credit rating agencies use when assessing creditworthiness, as companies have a licence requirement to maintain an investment grade credit rating. In particular the adjusted cash interest cover ratio ("ACICR") should adjust for PAYG variances in line with Moody's methodology. Respondents also suggested that rating agencies' methodologies could change as a reaction to our methodology, and that we should consider updating their metrics to reflect any future changes.	WSX, BRL	Each of the credit rating agencies has their own methodology and uses slightly different calculations for particular metrics. The credit rating agencies also make company specific adjustments when calculating those metrics. We do not intend to align our methodology with that used by any individual credit rating agency. Companies also have slightly different calculations of certain metrics embedded within their covenants. The metrics that we have set out are representative of the typical metrics used to assess credit quality. Our methodology allows companies to submit additional evidence to support their assessment of financeability. A number of companies actively supported this approach, particularly in relation to the assessment of financeability of the actual company structure. We are in regular dialogue with the credit rating agencies and will monitor any changes that they make to their methodology.	No change
It was suggested that we should include the S&P FFO/Debt ratio within our metrics, as most companies now use this metric	ANH	We do not intend to change the calculation of the FFO/Debt metric. As noted above companies can submit additional metrics, or other evidence, to support their assessment of financeability.	No change
It was suggested that in the calculation of the ACICR metric, no adjustment should be made for the indexation accretion on index linked debt, as it does	SWB	The ACICR metric is a cash interest cover metric. It is therefore appropriate, that the denominator includes cash interest only. In our financial model, all new investment is funded by fixed rate debt.	No change

Q2. Do you agree with the calculation of the metrics that we are proposing to use in our assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
not reflect the financeability implications over the longer term. In line with this we should assume that all new debt should be issued at a fixed rate, rather than a proportion being index linked			
The approach to financial metrics should be consistent with current performance measures to enable comparability in performance and returns between the regulatory periods. The calculation of the return on regulated equity (RORE) has been included based on the PR14 methodology (calculated on EBIT) and not the approach developed for regulatory reporting over the current AMP which is calculated on a Base Returns + outperformance	SWB	This was an error in the financial model which has now been corrected. Our approach to reporting RORE is consistent with that used for regulatory reporting.	No change
In calculating RCF/Net debt, IRE should be added back to the numerator as per Moody's methodology.	UU	We do not follow the approach used by any specific rating agency. We do not propose to make any changes to this metric. It provides an appropriate measure of a company's debt burden, relative to its operational income, after paying dividends. UU have not provided any further justification for their proposal other than it reflects the Moody's approach.	No change
Setting targets for specific metrics			
It was suggested that, as we set financial metric targets at PR04 and PR09, and given the changes proposed for PR19, (particularly the increased revenue risk), we should set out what the appropriate test levels are for a notional company.	ANH	We do not intend to publish targets for any metric. We consider that companies should determine the level of each metric and explain their choices. Published targets cut across the objective that each company should own its business plan.	No change

Q2. Do you agree with the calculation of the metrics that we are proposing to use in our assessment?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Using average ratios across the period			
It was suggested that looking at the average of each financial metric over a five year period could lead to a company being assessed as financeable, even though it was below target in one or two years. This could potentially have a negative impact for a company, if its credit rating was to be downgraded in any way as a result	YKY	We set price controls, which give companies a reasonable level of certainty over their revenue for a 5 year period. We do not consider that if individual metrics fall below target in a single year that should have a negative impact on a company's credit rating. In line with PR14 we will look at the average of each metric over the period. However, we would be concerned in multiple years were poor, or if there was a significantly declining pattern.	Clarification
Impact of DPCs on financeability metrics			
The metrics used for assessing the financeability of a notional company should take account of the impact of IFRS 16 on DPC contracts, particularly to the extent that DPC contracts give rise to debt.	TMS	If there is an impact on company financeability as a result of DPC contracts, then we expect companies to consider this issue in their business plans. We will then address this with those companies affected at the time. The size and structure of each DPC contract will be different and therefore, we do not propose to set out a single approach at this time.	Clarification

11. Accounting for past delivery

Q1. Do you agree with our proposed approach for dealing with PR14 reconciliations and the service incentive mechanism (SIM)? If not, please explain your alternative approach and why this would be in customers' interests.

The PR14 reconciliation rulebook explains how we will take into account performance over 2015-20, along with factors not reconciled from PR09, at PR19. We expect companies to follow the PR14 reconciliation rulebook methodology to calculate their reconciliation adjustments. This methodology produces adjustments for the five PR14 price controls. At PR19, we have split the wholesale price controls further. We have proposed how we would apply the PR14 reconciliation adjustments to the 2020-25 price controls.

The PR14 reconciliation rulebook does not cover the SIM. We proposed that the SIM would not operate in 2019-20, but that we would pilot C-MeX that year instead. For the final year, we proposed that companies that have SIM as a reputational incentive in 2019-20 use: the contact survey part of C-MeX to proxy the qualitative part of SIM; and complaints data for the quantitative part of SIM. There was general support for our proposals for dealing with the PR14 reconciliations, including our proposals not to calculate the SIM in 2019-20 but to pilot C-MeX and use this as a reputational incentive to proxy the SIM.

Issues raised (by both those in general support of and those in opposition to our proposal) are considered in table 11.1. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 11.1 Summary of issues raised in response to accounting for past delivery, question 1

Q1. Do you agree with our proposed approach for dealing with PR14 reconciliations and the service incentive mechanism (SIM)? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Reconciling SIM			
The contact survey element proposed for C-MeX should be used as a proxy for SIM in 2019-20, before the C-MeX measures are introduced fully from 2020. It is important for companies that have reputational incentives based on SIM to maintain their focus on these areas. Abandoning the incentive for the final year of PR14 would not send the right message about the continuing importance of focusing on complaints performance and customer satisfaction.	CCWater	We will pilot C-Mex in 2019-20. Some companies have reputational incentives for SIM in 2019-20. We will use the contact survey part of C-MeX to proxy the qualitative part of SIM and complaints data for the quantitative part of SIM. This will enable companies to assess whether they have met their reputational incentives for SIM in 2019-20.	No change
SIM financial incentives should reflect performance in the final year (2019-20). To be consistent with the approach to other ODIs, and with totex and revenue reconciliations, it would be appropriate to include SIM either in the assessment for the next period, or through a blind year adjustment mechanism for differences between the forecast performance submitted at PR19 and the outturn performance.	WSH, BRL	Continuing with the SIM in parallel with C-MeX in 2019-20 would be costly and burdensome as there would be two survey mechanisms running concurrently. Most respondents supported ending the SIM in 2018-19. For 2019-20 we plan to proxy the SIM with the contact survey part of C-MeX to enable companies to assess whether they have met their reputational incentives for SIM in 2019-20. We will reintroduce financial incentives for customer experience with C-MeX in 2020-21. We do not consider that financial incentives for SIM are required for 2019-20. We expect customers to be protected by the reputational incentive that will apply in 2019-20.	No change

Q1. Do you agree with our proposed approach for dealing with PR14 reconciliations and the service incentive mechanism (SIM)? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
We should provide more information about the calculation of SIM penalties and rewards to enable companies to forecast the adjustment for the reconciliation submissions.	SVT, SES	As SIM is calculated based on relative performance, we will ask companies to submit SIM scores. We do not intend to set out more details about how the SIM high performance payments and poor performance penalties will be calculated now. This is to give us flexibility when the final SIM scores are available, to ensure that we allocate high performance payments and poor performance penalties appropriately (and to ensure that small changes in scores do not lead to large changes in payments). We will retain the forecast high performance payment or poor performance penalty in table R10, where companies should insert the value they include in their financial model; this value may be zero.	No change
Flexible application of the RCV adjustments			
Allowing RCV adjustments to be smoothed over the period can help maintain investors' confidence by avoiding large one-off changes in the RCV valuation.	WSX	RCV adjustments will be applied as midnight adjustments at the start of the period. This has been signalled in the PR14 reconciliation rulebook policy document (appendix 2 Outcomes) and the update to the policy document (on the capital expenditure incentive scheme reconciliation issue) to provide certainty around the mechanics of the reconciliations. Making the RCV adjustments in March 2020 avoids complexity, takes the interests of customers into account and retains the approach from PR14. We note that the adjustments are likely to be relatively small compared to the overall RCV.	No change
Publishing PR14 reconciliation models and explanations			

Q1. Do you agree with our proposed approach for dealing with PR14 reconciliations and the service incentive mechanism (SIM)? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
There are certain restrictions on the forecast data that listed companies are allowed to publish. ODIs, totex and other outperformance incentives are, by nature, an adjustment to company returns. Due to these restrictions, companies would strongly resist any publication of such information either with their annual performance report (APR) data or as part of the business planning process.	SVT	We expect companies to be open and transparent about their proposed reconciliation adjustments and, where possible, to publish their populated models and forecast data. Where companies do not publish data, we would expect convincing reasoning why this is not possible.	No change
Timing of submission			
It would be preferable to submit the PR14 reconciliation rulebook at a later date than the APR. Companies will find it difficult to meet the timelines we have set, because there is already a significant volume of work to complete between the end of the financial year and the 15 July APR submission deadline. A later date would allow for a more efficient allocation of resource.	SVT, SES	We ask companies that can submit their PR14 reconciliation rulebook by the 15 July APR submission deadline to do so. We see merit in allowing more time for those companies unable to submit at the same time as their APR, and will extend the deadline by up to two weeks where a company requests an extension.	Minor change

Q2. Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.

Our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans has two aspects.

- How well has the company given evidence for its proposed reconciliations for the 2015-20 period, and has it proposed adjustments by following the PR14 reconciliation rulebook methodology?
- How well has the company delivered its business plan to customers over the 2015-20 period, and how well has it engaged with its customers on its performance?

There was general support for us taking past performance into account when carrying out our initial assessment of business plans. Most respondents on this issue agreed with our proposals. Issues raised (by both those in general support of and those in opposition to our proposal) are considered in table 11.2. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 11.2 Summary of issues raised in response to accounting for past delivery, question 2

Q2. Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Level of stretch in previous business plans			

Q2. Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Any assessment of past performance should take into account cross company performance and the level of stretch in business plans.	ANH, WSX, AFW, PRT	In setting the PR14 final determinations, we took account of cross company performance. Some companies set even more stretching commitments. We consider that whether they have delivered those commitments is a good indication of whether they will deliver future commitments. We therefore expect the level of evidence to be greater, the greater level of stretch included in companies business plans compared to past performance. We expect to take account the level of stretch included in previous targets, for example if the company was intending to extend the frontier for the sector. We have revised the wording of the initial assessment test question in chapter 12.	Clarification
A company's past performance should not prevent it from being categorised as fast track or exceptional, if it can justify performance improvements.	TMS, SES	We agree that no company should be prevented from being categorised as fast track, but this will be more difficult for companies with poor past performance. Companies' performance against the 2018 company monitoring framework assessment will also affect our assessment of the assurance of business plans; companies will need good assurance practices if they want to achieve the highest category under the initial assessment. We have revised the wording of the initial assessment test question in chapter 12.	Clarification
Double counting			

Q2. Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Companies should not be penalised twice for poor performance or rewarded twice for good performance.	ANH, BRL, PRT	When deciding whether to recognise any company as fast track or exceptional, we are taking into account actual and forecast performance to assess the achievability and deliverability of business plans.	No change
Customer engagement/support for proposed adjustments			
Beyond reporting performance over the 2015-20 period, is it necessary/appropriate to show evidence that companies have engaged with customers on the proposed adjustments in the submissions?	ANH, SVT, UU	We expect high quality engagement around the outcomes of the PR14 reconciliations, informed by anticipated performance in the last two years, and around customer choices/preferences on using the flexibility to spread revenue adjustments across the 2020-25 period. But we are not expecting companies to engage with their customers on issues that have already been decided – the outcomes and performance payment and penalty regime set in PR14, for example, or the PR14 reconciliation rulebook methodology.	No change
Scope of 'performance'			
Company performance goes beyond what was in business plans.	EA	We agree that there are a number of areas we should take into account beyond business plans, such as statutory compliance and recovery from incidents, and we have amended text accordingly.	Clarification
The service received by non-household customers and retailers should be part of the assessment of past delivery.	South East Water Choice	We note that the business retail market only opened in April 2017 and the market is still early in its development. We consider that there will not be sufficient wholesale market comparative data available	No change

Q2. Do you agree with our proposed approach for reflecting how well the company is delivering for customers over the 2015-20 period in the initial assessment of business plans? If not, please explain your alternative approach and why this would be in customers' interests.			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		at the time of business plan submission to allow for this inclusion.	
PR14 'enhanced' status companies			
A far more substantial initial assessment should be applied to companies whose plans were awarded 'enhanced' status at PR14 but who have not subsequently delivered their commitments, especially as customers would have paid a reward for the company achieving this status.	CCWater	In setting the final determinations, we took cross company performance into account. Some companies set even more stretching commitments. We consider that whether they have delivered those commitments is a good indication of whether they will deliver future commitments. In this regard, we do not consider it appropriate to differentiate between companies with and without 'enhanced' status at PR14 in the initial assessment.	No change

12. Securing confidence and assurance

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?

The majority of respondents did not comment on the draft business plan and data requirements. Nine water companies and CCWater, agreed that they were clear and sufficiently specified. The remaining water companies were neutral in their view.

Twelve companies completed the consultation response templates. These categorised 629 issues associated with the data tables, from clarity of definition to incorrect calculation or copy rules. Water companies submitted a further 54 issues as part of the extended consultation period on the data requirements and we received an additional 7 issues after this period. We summarise the most significant issues raised in response to the specific consultation questions in the table below and provide our response to each of the issues raised in the data table issues log published with this final methodology.

Overall, there was a general view that for the final methodology we needed to provide complete and improved line definitions and guidance, better referencing to the financial and feeder models and more pre downloaded data. We also needed to consider implementing a query and clarification process following publication of our final methodology.

Table 12.1 Summary of issues raised in response to confidence & assurance, question 1

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Q1. Clarity of data requirements			
Definitions and guidance			
Detailed line descriptions are required for all lines. Further work will be required with the sector before final.	ANH	We have improved the number and clarity of definitions in light of companies' constructive comments on the tables.	Clarification
Helpful if all rows in all tables have clear definitions	TMS		
We would welcome further clarity in areas where new data is required	YKY		
The business plan requirements are mostly clear. There are some data requirements that are not clearly defined and we believe there is some scope to rationalise the requirements.	SES		
Linkages between tables			
Key issue is the accurate linking of tables	SVT	We have brought all the tables together within one excel file and increased the cell linkages between the tables. These will be reflected in the new data capture system.	Minor changes
Helpful for assurance purposes and consistency if "copy" rule cells were directly linked to cells in other tables.	UU		
We would expect the final methodology to present the tables in a single file with all of the relevant relationships (ie copied and calculated cells ready).	ANH		
Want visibility of validation rules and all tables contained in one file to allow easy links between tables.	PRT		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
There is a significant amount of duplication which involves copying and pasting data from one set of tables to another.	SES		
Form and format of business plans			
Clarity required in what Ofwat considers is the “main” business plan and what is considered “supporting evidence”	ANH	We have provided further information on our expectations for company narratives and the form and format of the business plans in section 13.2 of chapter 13.	Clarification
Our only question in this regard relates to the length of the document and whether appendices are acceptable over and above the page limit?	WSX		
Table 13.1 states that "Companies’ main business plan narratives should be no more than 200 pages long for water only companies and 300 pages long for water and sewerage companies, and in a single document" confirming a concise BP is required. However this is followed by the contradictory statement "We expect companies to provide all supporting evidence, analysis and models underpinning their business plans." The amount of models and information is going to be vast and may break the online capture tool!	AFW		
We would like to see Ofwat encouraging companies to publish plain English version of their plans for customers and stakeholders to easily access. We would like to see companies find accessible and engaging ways to communicate their business plans with their customers, and would welcome companies explaining in their plans (and engaging with their CCGs) on how they intend to do this.	CCWater	In section 13.2 of chapter 13, we emphasise the need for companies to produce focused business plans that are well written and easy to follow and understand. We recognise the value of using other engaging ways to communicate business plans with customers. But confirm that we will not treat digital formats e.g. videos, as part of a company’s formal submission due to the source of information in such formats being subject to change.	Clarification

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Consistency of data			
Request that historic data previously reported is pre downloaded from APRs or JRs.	ANH, TMS PRT	We have reconsidered our request for historic data in the business plan that was previously sent to us in July 2017 and will not require this historic data to be part of the business plan submission. Instead, we will require further assurance on the data provided in July 2017 and will progress this with companies early in 2018. We will still require historic cost information for certain areas including retail and special cost factors. These were not included in the 2017 information request and will be needed for cost assessment purposes. In other areas, we have clearly identified the data we plan to download into the new data capture system	Minor change
One initial observation is that Tables WS18 and WWS18: Explaining the 2019 Final Determination should only be used in industry aggregate and cannot be used for comparisons between companies.	NES	We stated that this information would only be used at an industry level. We confirm that our intended use for this information has not changed for the final methodology.	No change
Where data is intended to be the same as other regulatory returns we request that the corresponding table and line be referenced in full and that the line definition should be replicated in the guidance section of each of the PR19 tables. All item references should be included and should match the financial model where applicable.	UU	We have reviewed the information requested in tables WS18 and WWS18 and removed duplication with other tables. We have assigned existing and new item references and included references to other regulatory submissions. We have developed a mapping tool to cross reference business plan data table inputs to and outputs from the financial model.	Minor change
Welcome some indicator on the tables that shows which specific lines will be used in the FM. Also need to show the outputs back into the tables from the FM.	PRT		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ensure consistency of price base across all tables	SVT	We have carried out a consistency check of the price bases required in each table. We have made changes to some appointee and water service tables to align the required price base with our general principles which we set out in section 2.7 of Final guidance on business plan tables. We have also checked to make sure that all tables clearly state the price base on which financial data is to be submitted.	Minor changes
Query and clarification process			
However, until we populate the data tables and run the financial model it will not be possible to fully comment on the data requirements. The shortened consultation period does not provide sufficient time to undertake this task. We expect to be in a position to deliver this prior to the publication of the final methodology. Our request is that Ofwat remains open to discussion of the specific data requirements at least until publication of its final methodology in December.	SVT	We wrote to the Regulatory Directors of all water companies to confirm an extended deadline of 29 September for further issues and comments on the data tables. We also confirmed that, post final methodology, we will endeavour to resolve any issues, in an open, transparent and timely way. We explain our approach in section 15.2 of chapter 15.	Clarification
We are seeking confirmation from Ofwat that issues found after the consultation deadline of 31st August 2017 can still be raised. There is the potential that issues will only be identified during completion of the tables, therefore we are assuming that the usual table clarification process will still be in place.	UU		
We know from experience that some low-level errors and misinterpretations in companies' submissions are inevitable, and will increase proportionally to the volume of data requested. We therefore strongly suggest that Ofwat allows for this in its post	WSH		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
submission planning and continues its policy of open interaction and dialogue with companies as the best way to avoid such problems in practice.			
We will of course have further queries and questions on the requirements as we progress through the process and we hope that you will retain an open dialogues on these matters.	WSX		
At this stage, we haven't fully evaluated the requirements of the Business Plan data tables and Financial Model. However we propose to provide you with periodic updates as we work through the detail.	AFW		
We will continue to review and feedback on any queries / points of clarification throughout the process.	SWB		
Welcome a transparent and accessible process for clarifications whereby any revisions or clarification to definitions are shared with all companies.	PRT		
There have also been a number of mistakes in previous data table capture systems and we would request that you to ensure these are all rectified well in advance of submission – last minute changes have caused issues in the compilation of other tables that need to be avoided here. Board assurance processes will mean that we will find it very difficult to accommodate late changes in guidance and definitions, while retaining the quality of Board assurance that you require	WSX		
Q1a. Areas we need to look at again			

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Where industry-wide data is being collected (e.g. tables WWS18 and WS18) for broader purposes we would encourage the use of well-defined and truly comparable data.	ANH	We have reviewed the information requested in this table and removed duplication with other tables. Our final proposals include more detailed definitions for this industry level information in response to the significant number of comments received on these tables.	Minor changes
Tables WS18 and WWS18 are intended to be collected in a consistent way and this table would benefit from more detailed line definitions to ensure that companies are reporting in a consistent manner, again where numbers appear in other tables then reference should be included.	UU		
App3 could this table be adapted to allow for equivalents to abstraction incentive mechanism (AIM)?	SVT	We have not made amendments to table App3 to address this concern as the AIM already allows flexibility in site selection, trigger thresholds and baseline data.	No change
AIM is a bespoke PC and therefore there should be flexibility on how it is designed. The current table App3 leaves no flexibility.	SES		
Requiring special cost factor claims ahead of sharing the models undermines this objective and potentially creates a significant amount of abortive work for companies.	ANH	We do not consider that publication of our cost models is an essential input to company business plans. And we consider the receipt of early information on expected cost adjustment claims is valuable and will assist the review process. We discuss this in more detail in section 9.4.5 of chapter 9.	No change
The suggestion that companies should submit any special cost factor claims early and without having seen any information on the model formulation or results also risks creating the unintended outcome of an inefficient process.	YKY		
Not clear how a company can submit a cost adjustment claim without knowing what costs will be allowed or disallowed	WSX		
While we can see advantages from Ofwat requiring early information on companies' cost adjustment claims, we would like	CCWater		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat to take steps to ensure that business plans do not become fragmented due to this phasing of data submissions.			
Consider that projecting some data beyond 2025 has limited value in relation to the wider exogenous variables and merits some reconsideration to reduce regulatory burden.	SES	We accept there are challenges in providing this data in some areas which is why we will not hold companies to account for it. But we disagree this information has limited value. We consider it is important for us to have an understanding of what companies' long term ambitions are and be able to assess the impact of companies' proposals on both current and future customers. This information will allows us to assess the affordability of the expected change in bills after 2015.	No change
Some metrics will be difficult to forecast and unlikely to be of high confidence. Systems are not set up this way and would be a significant level of work to complete.	SVT		
Enhancement expenditure may be operational as well as capital expenditure. An example would be the potential enhancement expenditure on water efficiency, which is of particular importance in the East of England. We suggest Ofwat should consider how such enhancement opex should be captured in the data tables.	ANH	We have amended tables WS2 and WWS2 to capture opex and capex.	Minor change
For the PR19 tables, which also form part of the cost assessment, it would be helpful if the guidance could be aligned with the latest versions and include the updated definitions from the Ofwat query logs.	TMS	We have endeavoured to align the Business Plan data tables with the Regulatory Accounting Guidelines and cost assessment submission.	Minor changes
The final data table specifications also need to reflect feedback supplied on the Regulatory Accounting Guidelines and feedback through the query and response process on the 2016-17 cost assessment submissions as a number of the data items are the same	SES		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Appendix 5 Water resource control' states that "The full mechanics of the equalisation payment are outside the scope of the methodology" and "Detailed design questions on access pricing are outside the scope of the methodology". It would be helpful if this was in scope, otherwise we will assume that the table is to be populated based on the table guidance and line definitions provided.	UU	We have removed the requirement to report indicative equalisation payments in the business plans (table Wr8). This reflects the uncertainties around its calculation and operation. Instead future equalisation payments and more widely network plus charges, will be assessed through a different means. However, the information we do collect, on annualised unit cost (table Wr7), is more detailed and will help our future assessment as this forms part of the calculation of the equalisation payment. We provide further detail on this in appendix 5 (water resources control).	Minor change
Rebalancing of costs between household and non-household could be masked in the overall price control because there is no requirement to split the tables between household and non-household	NWG business	We consider there is a sufficient level of granularity of information in the business plan tables between residential and business customers to enable us to identify whether there is any rebalancing of costs between these customer groups. Increasing transparency of wholesale activities between the separate price controls may result in some changes to the overall levels and balance of wholesale tariffs as targeted regulation drives a better understanding of the cost drivers and enables more cost reflective charging.	No change
Q1b. Missing data and data not required			
Tax table (App29) needs clarity of definition and how other allowances such as 'deferred revenue expenditure' are to be included	ANH, SVT, TMS, UU, WSH, YKY,	We considered the 25 comments made on this table. Our final proposals now provide further clarity on key information contained within the table. We have also included additional lines to collect the proportion of	Clarification / Minor changes

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
	BRL, SEW, SSC	deferred revenue expenditure and the amount of tax deduction generated.	
Concern / scope for improvement with customer acceptability and vulnerability lines	TMS, Stepchange debt charity	We have engaged further with our stakeholders on the common metrics of affordability and vulnerability, including through discussion with CCG chairs and a stakeholder workshop (on 25 October). As a result, we have revised our list of common metrics in table App4.	Minor change
WS13/14/15, WWS14 not clear why these tables are needed when all the information is in the models and 3 years of data will have been provided in the APRs. Additional work for companies.	SVT	For the business plans, the annual performance reports provide actual data for the first three years in the 2015-20 period but not the forecast data for the final two years. The tables capture all the data for the reconciliation rulebook in a standard format from all companies. We have aligned the tables with the models and we will pre-populate cells where the information has been published previously. We have also considered how to reduce the complexity and volume of the ODI reconciliation information. We have included three tables in the Appointee set (App5, App6 and App27) and deleted tables WS14 and WWS14.	Minor change
Consider there is a lot of duplication and some scope to rationalise. For PR14 reconciliation tables, consider it would be significantly more efficient if they simply submit the reconciliation rulebook as planned and perhaps had one summary table of all outputs of that rulebook and the subsequent price base conversion carried out in the Revenue Adjustments Feeder Model [WS13,14,15,17]	SES		
WS2a/WWS2a these will be difficult to complete as systems not set up this way. Not sure on purpose. Forward forecasts drive outputs not outcomes mentality.	SVT	We consider tables WS2a and WWS2a will provide useful information as it will allow us to relate project expenditure to outputs.	No change
Data in table WS2a is open to interpretation and likely to be of limited use.	SES		

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Need to allow own / additional financial ratios so extra lines need to be added to table App10	PRT, YKY	We have included an additional ten lines in table App10 to allow companies to provide further financial ratios. Companies can also provide further data in their business plan commentaries.	Minor change
Additional rows in Appointee tables for Thames Tideway Tunnel (TTT) dummy price control are needed	TMS	We have included the necessary additional lines in the appropriate appointee tables. We have also included those wastewater tables relevant to this price control.	Minor change
One key element of data not included is the retail element of developer services for companies which have exited NHH retail. This activity remains part of the appointed business, and Ofwat confirm it should be recorded as business retail activity in the methodology but do not include this input in any of the data tables as there is no Business retail table for exited companies. For ease of submissions, perhaps this line could be moved to the developer services appointee table as a separate block and removed from the retail section of the data tables (including those who are based in Wales and remain as NHH retailers) to avoid confusion between the business retail market and the different, Ofwat definition of business retail.	SVT	Retailers to whom retail businesses have transferred under retail exit are not subject to their own price control, the retail exit code applies instead. We are not collecting information from these companies as part of PR19.	No change
In App7 companies should present the customer bill impacts for non-household customers. Would like to see the wholesale impact on customer bills included in the data tables to provide assurance around affordability to this customer group.	NWG business	Table App7 currently shows the projected wholesale revenues from business retail customers based on more detailed revenue and cost recovery information contained in table R7. We consider it would be difficult for companies to estimate wholesale bills or bill impacts due to the significant number of wholesale tariffs in the business market.	No change

Q1. Are the business plan and data requirements clear and sufficiently specified? a. Are there any areas we need to look at again? b. Is there any data missing, or included but not required?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		Our business planning tables will collect information related to the business retail tariffs of companies wholly or mainly in Wales and companies wholly or mainly in England who have not exited the retail market. Our price controls do not cover companies who have exited the retail market.	

Q2. Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?

Good assurance of business plans is vital if stakeholders, including Ofwat, are to have confidence in the information presented in them. A business plan can only be of high quality where the data and information provided within the plan has been subject to robust assurance processes to ensure it is consistent and accurate and the plan is assured by the company's full Board.

There was support for our proposals on assurance from all but one of those who responded on the issue. Portsmouth Water stated that they disagreed with our proposed approach to assessing assurance, raising concerns regarding the risk and proportionality of our assessment as detailed in the table below. Issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 12.2 Summary of issues raised in response to confidence & assurance, question 2

Q2. Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Assessing the assurance provided			
There is no indication of how Ofwat will apply the principles of 'risk' and 'proportionality' in undertaking the assessment of assurance provided. Without guidance on the framework of the risk based assurance assessment, it will be difficult for companies to design efficient and effective assurance	PRT	As we have done in our assessments under the company monitoring framework (CMF), we will consider the assurance provided in the round, taking into account the individual circumstances of companies and characteristics	No change / clarification

Q2. Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
programmes and there may be a risk that the assurance assessment becomes relatively arbitrary.		of the data being assured. Ultimate responsibility for assurance lies with companies' Boards.	
Ofwat needs to consider data maturity and reporting requirements and to recognise that, for legitimate reasons, there will be inequity in how easy companies find full compliance with newer requirements.	SEW		
Judgement will need to be exercised by CCGs and Ofwat on assurance of the plans.	Thames CCG	We agree that judgement will need to be applied by Ofwat / CCGs when assessing the assurance of plans.	Clarification
Use of company monitoring framework (CMF) process			
CMF assessment must be used in a clear, transparent and objective manner.	ANH	As stated above, we will consider the assurance provided in the round. However, we agree that our reasoning should be clear and transparent.	No change
How could requirements for assurance vary with the CMF rating of a company given business plan submission would precede CMF assessment?	SWB	As well as assessing the quality of business plan submissions, our initial assessment of business plans will also take into account the 2018 CMF assessment. It is for companies to ensure that they have effectively assured their business plan, taking account of their CMF categorisation at the time of submission.	Clarification
2018 CMF should also be published in January 2019 alongside the initial assessment of business plans.	NES	We have decided to align the publication of the 2018 CMF assessment with the publication of the initial assessment of business plans in January 2019 to aid clarity and avoid confusion about different processes. This will not affect the period that the 2018 CMF assessment will cover but we will update our guidance to reflect the change of timing.	Minor change

Q2. Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It could be relevant to consider the company's record under the CMF in years prior to 2018 to establish the company's record in producing high-quality data.	SWB, SEW	We will take account of companies' performance in the 2018 CMF, and not previous CMF assessments as this will represent the most recent review that was able to take account of how the company has handled any of its information.	No change
Board assurance			
We agree that the Board should provide evidence of governance and challenge, rather than guidance and ownership, over the plan as a whole, however, we need to ensure that any statements that the Board is asked to make do not remove the collective responsibility of the Board nor are they asked to undertake a role that is beyond the responsibility of a Board. For example, where the Board is asked to make a statement "in their own words" this should reflect the Board as a whole rather than individually.	SVT	We expect company Boards to own and be accountable for their business plans. We expect a company's full Board to take collective responsibility for assuring business plans. The assurance statement should be from the whole Board, not just one or some executive member(s).	Clarification
Concerned about the growing demands on Boards to provide assurance and the consequences for their ability to fulfil their core functions.	WSH	Company Boards need to have good governance arrangements and ownership of their business plans. In our view this is a core function of the Board.	Clarification
Procedural issues			
With regards to the assurance of the data tables we agree that there should be adequate assurance to ensure the data is high quality and consistent with models. Assurance on this scale will be performed over a period of time; to provide robustly assured, consistent and accurate data final models, data tables	SVT	We acknowledge this risk and will lock down the definitions and guidance by the end of April 2018. The clarification process, which we discuss in section 13.3 of chapter 13 and section 15.2 of chapter 15, must not interfere with companies' ability to construct and assure their business plans. We will endeavour to ensure that all changes to	Clarification

Q2. Do you agree that our approach to assessing assurance can provide us and stakeholders with confidence in the companies' business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
and guidance will be needed to be included in the PR19 Final Methodology. Any changes in guidance, tables and line definitions after this time increases the risk of having insufficient time to deliver the assurance required.		guidance, tables and line definitions are issued in an open, transparent and timely way.	
The increased amount of data and information submissions required for PR19 will generate significant additional assurance activities for companies, their Boards and CCGs. Whilst a timetable is already in place that ensures appropriate engagement with our Board and CCG it is important to note its challenging nature. To assist company Board's and CCGs with the increased data provision and assurance demands, it would be helpful if a process to capture and communicate all company queries on the data tables could be established by Ofwat.	SWB	Our PR19 final methodology aims to reveal more granular information to allow us to set separate price controls and promote new markets. We note that the dataset to be assured has increased in size but we think that the benefits of doing this work outweigh the costs. As stated above, we will endeavour to resolve any issues, in an open, transparent and timely way. We describe our approach in section 15.2 of chapter 15.	Clarification

13. The initial assessment of business plans

Q1. Do you agree with our proposed approach to the initial assessment of business plans?

We proposed a framework for the initial assessment of business plans consisting of four key aspects: the areas we will test (nine test areas); the characteristics we are looking for (high quality, ambition and innovation); the categories we will assign (significant scrutiny; slow track; fast track; or exceptional); and the incentives associated with each of the categories (financial, procedural and reputational).

There was broad agreement from respondents to our proposed framework. We received several comments about the balance of incentives associated with the initial assessment of business plans; and several respondents asked for further detail or greater clarity on our proposed in-the-round approach.

The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.1 Summary of issues raised in response to the initial assessment of business plans, question 1

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
General comments			
Ultimately innovation is important for the outcomes that it promotes as opposed to the narrative and descriptions that are likely to be generated from this proposal. We think innovation is best promoted when the overall package of incentives works in a coherent manner and is not heavily weighted to the negative. Ofwat should seek to promote innovation by ensuring that the incentives work in a coherent manner. The current approach runs the risk of inviting companies to describe a lot of things as being innovative without necessarily delivering the outcomes that matter to customers.	SVT	See 'balance of incentives' below. We have strengthened the incentives for the fast-track and exceptional categories. Our initial assessment of business plan incentives work in conjunction with the delivery incentives we have put in place. Our methodology promotes innovation both through ensuring that companies face appropriate incentives for the results that they deliver during the period, as well as through the incentives on the initial assessment of business plans. We consider that this complementary approach is coherent and provides the strongest incentives in terms of actually driving the delivery of results that matter to customers and the environment. Within the initial assessment of business plans, innovation is embedded across test areas to help ensure that companies consider innovative solutions to deliver results. We will also need to be confident that there is alignment between companies' plans for innovation and their capabilities to deliver on these plans. As part of our initial assessment of business plans, we will also assess companies' capacity and readiness to innovate.	No change
Balance of incentives			

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The financial incentives for fast track and exceptional are too weak; and disproportional to the penalties associated with significant scrutiny. Concrete suggestion that cost sharing rates should be increased for companies with exceptional plans and that the upfront financial rewards should be at least 0.25% on the WACC for exceptional and 0.1% for fast track.	ANH, AFW, BRL, NES, SES, SEW, SVT, Hastings, Kelda Inv Group	We have closely considered the overall balance of incentives associated with the IAP; also in the context of the wider delivery incentives. We are strengthening the incentives for the fast-track and exceptional categories in recognition of the additional effort and risk those companies will have taken in preparing their plans. We have set the bar high, and all customers will benefit from companies putting in place truly stretching plans. We have increased the financial incentives and will provide early certainty on specific elements of the early draft determination for costs and outcomes We will provide early certainty on specific elements of the early draft determination for costs and outcomes. We consider that this package of IAP incentives in conjunction with the delivery incentives will encourage companies to put forward stretching business plans which will benefit all customers. We maintain strong delivery incentives which will include underperformance penalties. This is discussed further in chapter 14 and appendix 13 (initial assessment of business plans).	Major change
Companies should not be financially rewarded upfront on the promise of future delivery. If upfront financial incentives are included then there should be a claw back mechanism in place to refund customers. One mechanism could be to build this into strong ODI penalties for underperformance.	CCWater		
We should adopt a “do no harm” principle.	SVT, YKY, SES		
One-shot approach			
Special cost factor (SCF) claims might need to be reconsidered after the business plan submission, depending on cost models	TMS, BRL, AFW	Our assessment will take into account the fact that companies may not have seen our models in advance. This is discussed further in Section 9.4.5 (adjustments to our modelled cost baselines) of chapter 9 (securing cost efficiency).	Clarification

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat should remain somewhat open to the impact of new information coming to light in the period between business plan submission and final determination.	UU	We will take new information into account where necessary in determining the draft and final determinations. But the IAP categorisation will not be affected by this. For fast-track and exceptional companies we will provide early certainty on specified elements of the early draft determination for costs and outcomes. This is discussed further in chapter 14 and appendix 13.	Clarification
Characteristics: high quality and ambition			
The ambition of companies' plans should be assessed both in terms of the company's level of ambition in previous business plans and the proposals set out within its PR19 plans. Companies who set themselves ambitious plans at PR14 and do so again at PR19 should be recognised relative to companies who only propose ambitious plans at PR19. Any assessment of past performance should take into account cross company performance and the level of stretch in business plans.	ANH, AFW	Companies who were ambitious at PR14 will thereby have created the opportunity to gain rewards through delivery. In the 'Accounting for Past Delivery' test area we included that "The company has a robust approach to delivering its business plan taking into account its performance over the 2015-20 period." While we are adopting an in-the-round approach, this means that the level of ambition at PR14, and the extent to which this ambition has been delivered on, will be taken into consideration when we assess business plans. This approach also means we do not disincentive less ambitious companies at PR14 from putting forward their most ambitious plans at PR19.	Clarification
Tests relating to outcomes and securing resilience should look specifically at whether companies have taken account of the expectations in WISER, in addition to the tests	EA	The extent to which has a company taken account of the WISER expectations should come through in the independent CCG report on the ability of the business plan to meet statutory obligations and the coverage of the environment in companies' proposed performance commitments.	No change

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
relating to Board assurance. High quality and fast-track business plans should include robust evidence that companies have engaged customers and partners on non-statutory environment expectations. High quality plans should also include evidence that companies have worked closely with partners and stakeholders to design and agree joint solutions that deliver wider benefits for customers and the environment, for example catchment approaches and integrated drainage solutions. We expect business plans that do not demonstrate that companies will meet their statutory and statutory plus expectations to be categorised as slow track.		We consider the balance between customers and the environment in the resilience principles is appropriate. We indicate that we might expect a high-quality plan to mean that a company has assessed long-term resilience in the round in accordance with each of the resilience planning principles. The resilience in the round document also provides examples of good practice in dealing with environmental issues and responding to future challenges and provides the context for environmental delivery, including co-creation of solutions and the use of ecosystem services. The delivery of environmental obligations and commitments will be an important consideration within the IAP process.	
Clarity and detail of the methodology			
Ofwat should provide further clarity or detail on the mechanics of the methodology, including in terms of proportionality, that is, how individual test scores are aggregated, the relative weightings of the tests, or if any tests are 'gates' in terms of the final categories. Ofwat should focus on material issues and not place undue weight on some tests vs. others (esp. given the one-shot approach). One	ANH, SVT, SWB, UU, WSH, WSX, BRL, PRT,	Our assessment covers nine key test areas which reflect the strategic policy statements of the UK and Welsh Governments and will help us best deliver the PR19 themes. We are taking an in-the-round approach to our assessment. This is consistent with our view that companies should own their business plans, and that these plans should reflect strong customer engagement. We have set out a clear framework through the nine test areas, and have set out test questions and potential features	No change

Q1. Do you agree with our proposed approach to the initial assessment of business plans? **a. In terms of the nine test areas?** **b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.)** **c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.)** **d. In terms of the financial, procedural and reputational incentives we propose to put in place?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
suggestion that past performance should be given the highest weight if tests are weighted. Another suggestion that engaging customers, addressing affordability and vulnerability, and delivering outcomes for customers, are the most important of the nine test areas. For a company to be stretching in all areas (on every common and bespoke ODI, and on retail and wholesale costs for each price control) is almost certainly not going to be feasible (or makes it unlikely to perform well on the IAP). For the overall assessment of plans, Ofwat should consider what a stretching plan should look like in the round, and accept that it doesn't necessarily need to be a plan that is pushing at industry leading performance in every area. Ofwat could give some examples of what an 'exceptional' plan looks like. Ofwat should recognise the inevitable and natural differences between companies when assessing company business plans, and not rely solely on models and other comparative assessments.	SEW, Waterwise	on high quality, ambition and innovation. Our assessment of ambition and innovation will take both absolute and relative aspects into account. This level of detail exceeds what we provided at an equivalent stage for PR14. We do not want the initial assessment of business plans methodology to become overly prescriptive, which risks the drafting of the plans becoming a 'tick-box' exercise; this too would take ownership of the business plans away from companies. This is discussed further in chapter 14 and appendix 13.	
Ofwat should be under no obligation to use all their categories in practice. If, for example, no companies meet the criteria for 'exceptional',	CCWater	We have no fixed limits, but exceptional status will be achievable only by a small number of the most ambitious and innovative companies. We do not consider it necessary to	Clarification

Q1. Do you agree with our proposed approach to the initial assessment of business plans? **a. In terms of the nine test areas?** **b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.)** **c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.)** **d. In terms of the financial, procedural and reputational incentives we propose to put in place?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
then no companies should be allocated this status;		give any companies exceptional status, if none is deemed to have submitted a plan sufficiently ambitious and innovative. We expect companies to submit plans of such quality that we do not need to assign any to the significant scrutiny category at the end of our initial assessment of business plans. However, we will use this category if we see a plan that does not meet the quality necessary to achieve a higher category.	
The assessment of the potential RoRE for companies over estimates the potential rewards under the ODI's as it assumes that a company is able to outperform to the maximum on all of its ODI's. This is unlikely as Ofwat proposes caps on the number of companies that can gain a reward even if they meet their business plan targets, in contrast to the downside scenario where no such downside limits have been proposed. We are concerned that this proposal creates significant regulatory risk that is not in the long term interests of customers.	BRL	Our assessment of RoRE assesses the impact of performance between P10 and P90 – the range of likely outcomes where 10% of the time performance is worse than the range, and 10% of the time performance is better than the range. This RoRE impact therefore does not assume that all ODIs would be at maximum over or out performance. We are not putting a cap on the number of companies that can gain a reward even if they meet their business plan targets. Only for companies whose business plans are assessed into the significant scrutiny category will get reduced cost-sharing rates and may get a cap on their ODIs.	Clarification
Ofwat should provide further clarity or detail on the mechanics of the methodology, including in terms of the level at which the assessment will apply (appointee or price control level)	ANH	We are taking an in-the-round approach to the assessment. Our in-the-round approach applies equally to the question of control versus appointee-level assessments. We will assess at the level of controls where appropriate, but as an input into the overall business plan categorisation at the level of the appointee. This is discussed further in appendix 13.	Clarification

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Ofwat should provide further clarity or detail on the mechanics of the methodology, including in terms of how 'material interventions' are defined	ANH	In our draft and final methodology we provide examples of where material interventions may be required. For example, we have stated that in plans with significant scrutiny status "the quality of data, customer engagement and assurance may be so poor that it does not provide sufficient basis for making a draft determination, without significant further work. For example a plan with weak evidence and justification for its performance commitments, including weak evidence of customer support, and with performance commitment levels well below stretching levels, would require significant scrutiny. Another example would be a plan which falls outside the cost thresholds for most or all price controls or well outside the cost threshold for at least one control, with no robust explanation and poorly evidenced special cost factor claims." In addition we have set out a framework in terms of the nine test areas, and have set out test questions and potential features on high quality, ambition and innovation. This level of detail exceeds what we provided at an equivalent stage for PR14. We do not want the initial assessment of business plans methodology to become overly prescriptive, which risks the drafting of the plans becoming a 'tick-box' exercise; this too would take ownership of the business plans away from companies.	No change
The approach overall places significant tension on balancing affordability, resilience, innovation and ambition which will be one of	AFW	Maintaining the stability of existing assets is recognised and reflected in a number of the test areas, such as 'securing long term resilience' and 'delivering outcomes for customers.' For	Clarification

Q1. Do you agree with our proposed approach to the initial assessment of business plans? **a. In terms of the nine test areas?** **b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.)** **c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.)** **d. In terms of the financial, procedural and reputational incentives we propose to put in place?**			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
the key challenges for companies in developing their business plan proposals. The approach follows on strongly from the move to totex at PR14 looking for non-fixed asset solutions. Maintaining the stability of existing assets is essential to continue to supply and provide service to customers and this is not explicitly reflected in the initial assessment.		example, four of the 14 common performance commitments in our PR19 final methodology relate to asset health (see chapter 4).	
Format of submissions			
Ofwat should require companies to provide a short Board level summary of their plan that is then shared directly with the Ofwat Board.	WSX	We expect companies to structure their business plans in a way which allows Ofwat to effectively assess it. In early 2018 we will publish a pro forma for companies to complete, which draws together high level information and key metrics from the business plan and which explains the drivers behind the business plan, the key benefits for customers and the impact on customer bills. This information will also be made available to all Ofwat Board members ahead of the company presentations We also invite companies to present their business plans after submitting them. These presentations will offer an opportunity for the company to set out its business plan. We would expect at least one company Non-Executive Director to be present as well. Ofwat, including Ofwat Board members, would be	Minor change

Q1. Do you agree with our proposed approach to the initial assessment of business plans? a. In terms of the nine test areas? b. In terms of the business plan characteristics we want to see? (High quality, ambition and innovation.) c. In terms of the business plan categories we propose to assign companies to? (Significant scrutiny, slow track, fast track, exceptional.) d. In terms of the financial, procedural and reputational incentives we propose to put in place?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		represented at a senior level in every meeting. This is discussed further in chapter 14 and appendix 13.	
Ofwat should allow companies some freedom to consider innovative and more creative presentations of business plans using digital technology. This would allow more scope for co-creation with customers and presentation of material in accessible and customer friendly formats.	NES	For Ofwat to effectively analyse, assess and compare business plans, we continue to require plans to be submitted in line with the more traditional requirements set out in chapter 13 (confidence and assurance). We very much encourage companies to set out their business plans in formats which can be shared with their customers and other stakeholders, using technology platforms which are most accessible to all customers. Especially as these plans will reflect the extensive engagement companies have had with their customers. This should be focused on the customers, not Ofwat, but we will not take this into account as part of the initial assessment of business plans.	No change

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?

The draft methodology set out our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation. We proposed assessing companies' capacity and readiness to innovate as part of the initial

assessment of business plans, and set out a specific test question under the test area for 'Targeted controls, markets and innovation'.

There was broad agreement from respondents, with some suggesting that it will be challenging for Ofwat to assess, or for companies to demonstrate, the capacity and readiness to innovate. One company considered that innovation should not be promoted through the initial assessment of business plans at all.

The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.2 Summary of issues raised in response to the initial assessment of business plans, question 2

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
How we will assess innovation			
In this context of incentives too heavily weighted on penalties, focusing on a companies' capacity and process to innovate is the wrong approach. If the incentives don't work, then companies will not innovate – even if they have great processes. This is because the downside from taking a risk is too great compared to the potential reward. Asking companies to set out these processes is also inconsistent with an incentive based approach to regulation; it runs the risk of creating a culture of "regulator focus" sector. Instead Ofwat should be focused on incentivising the outcome.	SVT	See above under Q1 – Overarching comments (first point). We do not consider that this drives a regulator focus.	No change

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
It will be challenging for Ofwat to assess (and for companies to demonstrate) companies' capacity and readiness to innovate. Ofwat should provide greater clarity on how it will assess innovation. Reservations about how Ofwat can assess innovation [this point was repeated under several of the IAP consultation questions].	ANH, WSH, AFW, Thames Tideway	Assessing companies' capacity and readiness to innovate will bring a level of challenge, but we consider this can be addressed. Existing theory, frameworks and good practice will allow us to robustly assess this important capability perspective, which complements the focus on delivery. This is discussed further in appendix 13.	No change
The test is valid, but it should be an assessment on the level of confidence rather than a level of detail test.	SEW	We agree that this test should be aimed at providing Ofwat with confidence that the level of innovation set out in a company's business plan can be delivered. This should be supported by evidence that also gives a degree of assurance around this.	Clarification
The best way of assessing whether a company has the management capability, culture and motivation to innovate for its customers is by the track record of innovation which has moved the frontier for the sector. It should not just come down to how well written a section of the business plan is.	WSX	A company which is already innovative will also be able – within its business plans – to point to the capabilities which enable this innovation. In the context of setting out that – as part of our initial assessment of business plans – we will assess companies' capacity and readiness to innovate, we have noted that we can also consider how well the companies have developed and delivered innovations in the past, where they demonstrate that its proposals take account of and build on this experience (both where innovations have been successful and less successful). This approach also means we do not disincentivise less innovative companies at PR14 or during the current control period from putting forward their most ambitious and innovative plans at PR19.	Clarification
Environment			

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Environmental challenges are alluded to as threats to the delivery of services to customers, rather than as pressures upon the environment that need to be attended to in their own right.	WWF-UK, CIWEM	We continue to consider the balance between customers and the environment in the resilience principles is appropriate. The environment is an important aspect of resilience and we expect companies to account for environmental obligations and impacts as part of their engagement with customers. However customers pay bills and to maintain trust and confidence it is important that they understand and support proposals that go beyond a water companies obligations. We will expect water companies to have regard to the EA's/NE's WISER strategic steer (found on our website) which sets out their obligations and expectations; and the NRW and UK Government's and Welsh Government requirements, including the requirements of the Water Industry National Environment Programme (WINEP) in England, and the National Environment Programme (NEP) in Wales, due to be issued in March 2018. The resilience in the round document provides examples of good practice in dealing with environmental issues and responding to future challenges. We have amended the final methodology to more clearly set out our expectations on water companies with respect to the environment. For example, we are asking companies to achieve good coverage of the environment with their bespoke performance commitments; and our 15% leakage reduction challenge, and challenge for companies to set a	Clarification

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		stretching commitment on reducing per capital consumption, will help the environment by reducing the need for companies to build additional water resource infrastructure.	
The approach taken assumes that the environment benefits indirectly from innovation through "better services and benefits", and that "high levels of innovation…would result in benefits for customers, companies and the environment". Delivering for the environment through innovation must be considered as a direct, rather than indirect outcome, and be factored in from the start to optimise the outcomes. Innovation should be directed towards relieving pressures upon, and enhancing, the environment in its own right.	Blueprint for Water	We have set out in resilience in the round that the environment underpins water and wastewater services both directly and indirectly. Likewise some innovations will provide direct benefits for the environment while others will provide indirect benefits.	Clarification

Appendix Q1. Do you agree with the key questions under each of the test areas?

The draft methodology set out the key questions we propose to assess under each of the nine test areas.

There was broad agreement from respondents. Several put forward suggestions for additional points to consider within the test questions. The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.3 Summary of issues raised in response to the initial assessment of business plans, appendix question 1

Appendix Q1. Do you agree with the key questions under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Overarching comments			
The questions all seem reasonable individually. There is the potential conflict between how well has the company incorporated engagement with customers into its business plan proposals, against the regulatory expectation that company performance levels need to be stretching. Clarity is needed here on which test takes precedence if and when a conflict exists.	SEW	See answer above under Q1 - "clarity and detail of the methodology". We will look at the evidence and justification for a company's performance commitment levels including evidence from customer engagement, comparative assessment, historical information and other sources. We want to change the starting point for the conversation with customers from the status quo to why companies cannot achieve more stretching performance commitments.	No change
The environment should be more clearly included under 6 of the test areas (engaging customers; delivering outcomes for customers; securing long-term resilience; targeted controls, markets and innovation; securing cost efficiency; aligning risk and return) Suggestion to rename the 'Delivering outcomes for customers' test area to 'Delivering outcomes for customers and the environment'	Blueprint for Water, EA	The environment is covered in the outcomes IAP question and additional context is provided through the resilience in the round document. The critical role of the environment in underpinning resilience in the round is clearly expected to be reflected in companies' outcomes commitments. We have been more explicit about the environment throughout the methodology. We do not consider it would be appropriate to rename one of the test areas and not others.	Clarification
Addressing affordability and vulnerability			
The emphasis on a cost-benefit analysis on companies' social tariffs is too narrow at determining the efficacy of companies' approaches and we favour a	ANH	We have worked with companies and others since our draft methodology proposals on the best metrics to use. We will make it clearer that our assessment of affordability and vulnerability looks at the common	Minor change - no change to policy of common metrics, but significant

Appendix Q1. Do you agree with the key questions under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
broader assessment of companies' approaches to affordability The data requested on metrics is too prescriptive to capture the breadth of approaches taken by companies; for example working with other third party agencies.		metrics, other quantitative and qualitative information provided in the round. The measures that companies use should be effective and maximise customer benefits. We will expect to see strong evidence that customers are supportive of social tariffs that go beyond revenue neutral levels of assistance and that the assistance is provided in the most efficient way. This is discussed further in chapter 3 and appendix 1 (addressing affordability and vulnerability).	changes to our list of common metrics. See appendix 1(addressing affordability and vulnerability) and table App4 of the business plan tables.
Delivering outcomes for customers			
There is a presumption that "appropriate" refers to how well a company's ODIs capture the specific preferences of each company and how they are reflected in the plans. If so, should be explicit. The assessment of how stretching a company's performance commitments and services levels are will need to be assessed in the context of previous plans and delivery so that companies who have previously set and delivered high levels of performance are not penalised in the assessment.	ANH	We do not consider that it is necessary to provide further clarity of 'appropriate' as this comprehensively and effectively covers all the different aspects and requirements of our approach in relation to performance commitments and ODIs. We will look at past performance when considering companies' proposals for performance commitments. It is up to companies to make the case for why it is appropriate for them not to achieve the challenges in relation to performance commitment levels we set out in the methodology.	No change
Securing long-term resilience			
Companies should engage with their customers on their resilience in the round, but we question a company's ability to provide comparative data on the risks faced by other companies.	ANH	We do expect companies to look beyond their own boundaries to understand wider data and information which will help them understand the risk exposure of their own systems and network. This wider information, suitably represented, will provide value to customers in	No change

Appendix Q1. Do you agree with the key questions under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		terms of understanding the relative nature of the risks which they may face.	
It is important that customer views on short-term and long-term trade-offs are taken into account in this assessment, and that it should cover current and long-term risks to services.	CCWater	We agree and the resilience in the round document makes clear our expectations that companies should consider risks over the full range of time frames but that resilience options should provide best value in the long term.	
Non-household retailers			
Wholesale performance assessment should be included within 'Accounting for past delivery'	South East Water Choice	We note that the business retail market only opened in April 2017 and the market is still early in its development. We consider that there will not be sufficient wholesale market comparative data available at the time of business plan submission to allow for this inclusion.	No change
Tests should include specifically requesting evidence of retailer engagement.	NWG Business	We say in chapter 2 and the 2016 policy statement that we want wholesalers to continue to engage with business end-customers on the wholesale services they provide to them. We do not want wholesalers to lose this link with their end customers. We will expect companies to provide evidence of engagement with business end-customers on the wholesale services they provide to them.	No change
A specific mechanism should be included which engages retailers in the process of assessing business plans and input to the final determination.	MOSL	Ofwat is responsible for assessing the companies' business plans. We encourage retailers to feed their views into the business plan through engagement with the water company directly or through its CCG.	No change

Appendix Q1. Do you agree with the key questions under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		All stakeholders are invited to provide views on company draft determinations. Within the retail market review, we will continue to explore the case for financial incentives for wholesalers in the retail business market, which we could introduce later in the PR19 process.	

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?

The draft methodology set out what we will look for in terms of high quality, ambition and innovation under each of the test areas. There was broad agreement from respondents. A number of specific issues or suggestions were raised. The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.4 Summary of issues raised in response to the initial assessment of business plans, appendix question 2

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Overarching comments			

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
The tests seem subjective. There should be greater use of objective measures.	SVT	We have considered the objectivity of all our test questions and the indicative criteria in terms of high quality, ambition and innovation. We consider these allow us to objectively assess companies' business plans in the round. In this context it is also important to note that our assessment of ambition and innovation will take both absolute and relative aspects into account.	No change
Agreement with the 3 characteristics (high quality, ambition and innovation) in principle, but question how independent Ofwat will judge these characteristics to be – that is, will it be possible (in practice) for a company's plan to be considered to be high quality and innovative if it is not judged by Ofwat also to be ambitious?	UU	We recognise there will be a degree of dependency between ambition and innovation. We have set out that for a company to have an ambitious plan, it must be innovative – the two must go hand-in-hand.	No change
A company's 'ambition' should be to deliver the best value for customers, given customers' preferences, expectations, priorities and willingness-to-pay. "Ambition" and "innovation" as defined in the document should not be objectives in themselves, but should be evaluated on the basis of how well the companies are delivering against customers' expectations and priorities. Ofwat should ensure that the views of customers are taken into account in all of the test areas.	WSH, SWB, SEW, CCWater	Ambition and innovation are not ends in themselves, but are means to delivering for customers and the environment. We recognise this in setting out that innovation, as one of the PR19 themes, underpins the other three themes. We will look at the evidence and justification for a company's performance commitment levels including evidence from customer engagement, comparative assessment, historical information and other sources.	No change
It is unclear how the overall plan will be assessed from a collection of individual tests as we find it implausible that any one company will reach the ambitious or innovative category in but a few test areas	SEW	See above under 'Clarity and detail of the methodology' (Q1). (This addresses an analogous comment that Ofwat should consider what a stretching plan should look like in the round, and accept that it doesn't necessarily	No change

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		need to be a plan that is pushing at industry leading performance in every area.)	
Would like to see additional evidence in the assessment criteria covering business retailers	NWG Business	We say in chapter 2 and the 2016 policy statement that we want wholesalers to continue to engage with business end-customers on the wholesale services they provide to them. We do not want wholesalers to lose this link with their end customers. We will expect companies to provide evidence of engagement with business end-customers on the wholesale services they provide to them.	No change
The current approach does not adequately assess environmental commitments under the majority of the test areas	Blueprint for Water, WWF-UK	See our response (in the table above) to similar issues raised in appendix Q1 under 'Overarching comments'.	
Delivering outcomes			
Ofwat should define 'sector leading' so that multiple companies could propose.	SVT	We want to learn from companies' proposals what sector leading performance could look like and maintain an element of competition between companies to deliver more for their customers.	No change
Securing cost efficiency			
Sector leading cost efficiency – not clear what additional insights is sought under the IAP test	SVT	The more efficient a company, the higher it will score on cost assessment. Sector leading doesn't automatically mean that it is exceptional. It needs to look very efficient relative to our cost baselines, which will include sector and non-sector information, past and future.	No change
Targeted controls, markets and innovation			

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Targeted controls, markets and innovation should reflect how well a company uses its supply chain and alliance partners to deliver innovation and cost efficiency to customers.	ANH	In chapter 14 we note that innovation "will not be limited to the use of new technology or new services. It could involve, for example, new ways of encouraging customer participation in service design and provision; and new and more collaborative ways of working with customers, communities, the supply chain and other stakeholders. In terms of the companies' capacity and readiness to innovate, we have revised our test question as follows: "How well does the company's business plan demonstrate that it has the right culture for innovation which enables it, through its systems, processes and people, to deliver results for customers and the environment from innovation?" It is up to companies to demonstrate how they are set up to deliver innovation.	Clarification
The tests relating to "targeted controls, markets and innovations" appear to duplicate the outcomes that the incentives and markets are being used to deliver. This runs counter to the concept of targeted and proportionate regulation. (For example the bioresources price control has been designed to incentivise both imports and exports as all parties benefit. It is therefore not apparent what additional use bioresources trading strategies would provide when setting cost allowances.) We agree with the tests relating to RCV allocation. We appreciate that companies many not have the right incentives to do these activities in the manner desired by Ofwat and hence this additional requirement will help guide the right behaviour.	SVT	In terms of the initial assessment of business plans, our tests will be applied so that this does not translate into inappropriate 'double-counting' across test areas. We do not intend the IAP to incentivise outcomes already incentivised by the bioresources price control, but rather to ensure that companies articulate their strategy regarding sludge. We need to know how they are going to treat sludge during the period – for example whether they plan to do it themselves (and potentially need to access new capacity), whether they will export sludge to another company, when they plan to invest in capacity themselves. We need to understand to what extent companies are building capability to also treat imported sludge (and potentially expose customers to stranded asset risks which need to be managed). This is discussed further in chapter 6.	Clarification

Appendix Q2. Do you agree with what we will look for in terms of high quality, ambition and innovation under each of the test areas?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
These tests should reinforce the need for companies to demonstrate that the investment(s), or other actions proposed to deliver required outcomes offers value for money for customers	CCWater	The assessment of plans in the round means that the tests under the 'ensuring affordability and vulnerability' area will meet this requirement. This will include evidence that the company understands what affordability looks like for its customers and that this is reflected in its plan, alongside a high level of customer support for the affordability of the plan. The measures that companies use should be effective and maximise customer benefits.	No change
Accounting for past delivery			
We strongly disagree with the statements of a high quality plan and in particular the presentation of evidence that mechanistic adjustments agreed with customers at PR14 require another round of engagement to be implemented.	SVT	We expect high quality engagement around the outcomes of the PR14 reconciliations, informed by anticipated performance in the last two years, and around customer choices/preferences on using the flexibility to spread revenue adjustments across the 2020-25 period. But we are not expecting companies to engage with their customers on issues that have already been decided – the outcomes and performance payment and penalty regime set in PR14, for example, or the PR14 reconciliation rulebook methodology.	No change
Past performance and evidence relating to prosecution rates, non-compliance and incident self-reporting should be taken into account in the initial assessment of business plans.	EA	We agree that there are a number of areas beyond business plans which we should take into account such as statutory compliance and recovery from incidents and we have amended text in chapter 5.	Clarification

Appendix Q3. Do you agree with our high-level approach for scoring business plans into the four categories (significant scrutiny; slow track, fast track and exceptional)?

The draft methodology set out our proposed approach for scoring business plans into the four categories (significant scrutiny, slow track, fast track and exceptional). We proposed that our starting assumption will be that all plans require significant scrutiny until shown otherwise. It is up to companies to demonstrate through their business plan that they should move up to a higher category. Where company business plans score well against our tests, the plan will move up through our categories.

There was broad agreement from respondents. A number of specific issues or suggestions were raised. The issues raised (by both those in general support and those in opposition to our proposal) are considered in the table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.5 – Summary of issues raised in response to the initial assessment of business plans, appendix question 3

Appendix Q3. Do you agree with our high-level approach for scoring business plans into the four categories (significant scrutiny, slow track, fast track, exceptional)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Starting in Significant Scrutiny			
Companies should not start in 'significant scrutiny' by default. This could signal a lack of trust which is unmerited. The default should be 'slow track', which could be renamed 'standard'.	ANH, WSX, CCG	We will also maintain our starting assumption that all plans require significant scrutiny until shown otherwise. The companies are largely monopoly businesses. We face asymmetry of information when assessing business plans – we know less about companies' businesses than they do. This asymmetry underpins our starting assumption. It is up to companies to demonstrate, through their business plans that they should be in a higher category. This is a procedural point in our assessment process. It is not a reflection of	No change

Appendix Q3. Do you agree with our high-level approach for scoring business plans into the four categories (significant scrutiny, slow track, fast track, exceptional)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
		trust or lack of trust. We expect companies to submit plans of such quality that we do not need to assign any to the significant scrutiny category at the end of our initial assessment of business plans. This is discussed further in appendix 13.	
Relative importance of each of the tests			
Request for greater clarity on how performance on each test and any overlap between tests contributes to the overall IAP Particular request for detail on how performance in any specific tests potentially may act as "gated tests" against the four overall assessment categories.	ANH	See above under "Clarity and detail of the methodology" (Q1). There are clear conceptual relationships between the test areas. For example, both the 'addressing affordability and vulnerability' and 'securing cost efficiency' areas of companies' business plans will contribute to our PR19 theme of affordability. In terms of the initial assessment of business plans, our tests will be applied so that this does not translate into inappropriate 'double-counting' across test areas.	No change
It is reasonably clear what Ofwat's expectations are for a company that is judged to have an "exceptional" plan – however there is some substantial uncertainty regarding the boundary between the other categories. It appears that this reflects a measure of how much Ofwat has agreed with a particular company's business plan proposals, in the event that they are not proposing better than future upper quartile performance. The corollary of this is that the business plan assessment could be a reflection of the number of areas in which a company has to provide additional evidence.	UU	We have set out a comprehensive framework for the initial assessment of business plans, including the test area questions and potential features for high quality, ambition and innovation. This sets a level playing field for all companies. We expect companies to own their business plans. Our assessment of the business plans will be made based on the evidence made available to us at the time of the assessment, including evidence of customer support and preferences. This too is the same for all companies.	No change

Appendix Q3. Do you agree with our high-level approach for scoring business plans into the four categories (significant scrutiny, slow track, fast track, exceptional)?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Unless Ofwat's comparative assessments are sufficiently sophisticated to allow for all environmental differences between companies (that affect both cost and performance levels), this will lead to an uneven playing field whereby some companies will inevitably need to explain more differences from Ofwat's expectations more than other companies.		The comparative assessment will allow companies to raise cost adjustment claims to explain legitimate differences from our efficiency expectations, including environmental considerations. Inevitably, some companies may have to raise more claims than others. We will consider the claims. There will be no implication to IAP categorisation as long as the claims are legitimate and we consider that the company has taken a balanced approach to the cost adjustments process. We consider that there is a clear distinction between the categories, and have made some further points of clarification. For example, we set out that that extensive material intervention is required for business plans assigned to the significant scrutiny category. This is discussed further in appendix 13.	

Appendix Q4. Do you agree with our proposed schedule for the initial assessment of business plans?

The draft methodology set out our proposed timelines for the initial assessment of business plans, from receipt of business plans to the publication of our decision.

The majority of respondents agreed with the schedule, but some asked for greater detail on exact dates to facilitate their CCG and Board meetings. The issues raised (by both those in general support and those in opposition to our proposal) are considered in the

table below. For each issue, we explain our position, following consideration of the views expressed, and outline any subsequent adjustment to our draft methodology proposals.

Table 13.6 Summary of issues raised in response to the initial assessment of business plans, appendix question 4

Appendix Q4. Do you agree with our proposed schedule for the initial assessment of business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
Concerns with overall schedule and further detail requested			
It would be helpful if Ofwat could provide further detail of specific dates to facilitate companies' CCG and Board planning	SVT; SES	We are not able to provide exact dates on the publication of the initial assessment categorisation; or of the publication of the draft and final determinations. This will depend on the nature of the business plan submissions. We clarify that we expect to announce the outcome of our initial assessment of business plan in *late* January 2019. We also invite companies to present their business plans after these have been submitted. This is discussed further in chapter 14 and appendix 13.	Clarification
The proposed submission of September 2018 does not give sufficient time for companies to reflect on 2017-18 actual performance and potential impacts to their plans. We would therefore suggest a submission date which is later in 2018 which gives companies time to reflect and also update the Ofwat data tables and models accordingly.	SWB	We consider that there is sufficient time between the end of the 2017-18 financial year and the submission of business plans on 3 September 2018 to take into account the previous year's performance. We have also provided two extra weeks for companies to submit their proposed PR14 reconciliations for the 2015-20 to allow companies to more fully reflect on 2017-18 performance. We therefore do not consider that we should change the pre-established date for the submission date of business plans.	No change
We believe that it should be possible for the regulator to reach final determinations sooner than December	WSH	Based on our experience and feedback on the 2014 price review process, comparison with earlier price	No change

Appendix Q4. Do you agree with our proposed schedule for the initial assessment of business plans?			
Issue raised	**Who raised the issue?**	**Our consideration of the issue**	**Change to our proposals?**
2019, 15 months after business plans are submitted. The timing of final determinations also creates a problem in relation to the setting of tariffs for year 1 of the next period.		controls and other sectors, and the common suggestion that further time would have been helpful to complete that process more effectively, we initially proposed a 17 to 18 month period for the review process. The December 2015 consultation noted that there was broad support for our views but identified a risk that misalignment between the timetables for PR19, river basin management plans (RBMPs) and WRMPs could create uncertainty for the sector, resulting in higher costs for customers. To counter this risk, we worked with the UK and Welsh Governments to better align these timelines, including revising the timeline for review to 15 months. We do not therefore consider it would be appropriate to now shorten the review period.	