PR19 draft determinations:
Severn Trent Water draft determination

About this document

This appendix sets out for consultation the details of the draft determination of price controls, service and incentive package for Severn Trent Water for 2020 to 2025. All figures in this document are in 2017-18 prices except where otherwise stated.

The draft determination sets out:

- the outcomes for Severn Trent Water to deliver;
- the allowed revenue that Severn Trent Water can recover from its customers; and
- how we have determined allowed revenues based on our calculation of efficient costs and the allowed return on capital.

The draft determination covers all five price controls for the 2019 price review (PR19):

- water resources;
- water network plus;
- wastewater network plus;
- bioresources; and
- residential retail.

We have developed this draft determination in accordance with our methodology, our statutory duties and the UK Government's statement of strategic priorities and objectives for Ofwat. We have also had regard to the principles of best regulatory practice to be transparent, accountable, proportionate, consistent and targeted.

The appendices to this document provide more detail and form part of the draft price control determination:

- PR19 draft determinations: Severn Trent Water - Cost efficiency draft determination appendix
- PR19 draft determinations: Severn Trent Water - Outcomes performance commitment appendix
- PR19 draft determinations: Severn Trent Water - Accounting for past delivery appendix
- PR19 draft determinations: Severn Trent Water - Allowed revenue appendix

For all other documents related to the Severn Trent Water's draft determination, please see the draft determinations webpage.

Written representations on this draft determination should be provided to us by 24 May 2019. Final determinations for all companies will be issued in December 2019.

Contents

1. Summary

We set high expectations for water companies at PR19. We pushed them to go further than ever before, improving efficiency, customer service and resilience. We asked them to share financing gains with customers and to ensure that their dividend and executive pay policy is aligned to delivering for customers. We asked them to look well beyond the five-year price review period to meet needs of future customers and protect and improve the natural environment.

Our initial assessment of Severn Trent Water's business plan showed it to be one of the best plans in the sector. It put forward an innovative suite of bespoke performance commitments, high quality outcome delivery incentives for asset health performance commitments, with strong protection for customers against failure to deliver on its performance commitments. Severn Trent Water is supporting customers who struggle to pay their bills by committing to almost doubling the number of customers on social tariffs. As part of its new community dividend, Severn Trent Water will donate 1% of its profits to help fund community projects. It will also build a new technical academy. Severn Trent Water also has many examples of best practice in innovation culture, including a range of initiatives to make sure that its employees address business challenges now and in the future.

We identified limited interventions to the plan to make sure customers' interests are protected, which Severn Trent Water formally accepted. On 31 January 2019, we awarded Severn Trent Water's plan fast-track status. The company confirmed its agreement to our interventions and resubmitted relevant data tables on 11 February 2019. These agreed interventions, along with some minor intervention amendments following the review of additional information provided by Severn Trent Water, are reflected in this draft determination.

This early draft determination means Severn Trent Water has the opportunity to accelerate the delivery of its plan so that customers and the environment get more of what matters sooner.

What the draft determination means for customer bills

Our draft determination for Severn Trent Water will cut average bills by 4.7% in real terms in the 2020-25 period. Table 1.1 below sets out the difference in bill profile between the company's business plan submission in September 2018 and our amended draft determination profile. Average bills are lower than originally proposed by Severn Trent Water, reflecting that the company accepted our view of efficient costs.

Table 1.1: Bill profile for 2020-25 before inflation

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Company plan	£343	£326	£331	£333	£331	£325
Draft determination	£343	£327	£327	£327	£327	£327

What the draft determination will deliver

Our draft determination package includes a full set of performance commitments, specifying the level of service that Severn Trent Water commits to deliver for customers and the environment. Each performance commitment also has a financial or reputational incentive to hold the company to account for delivery of these commitments. Table 1.2 below sets out some of the key performance commitments for 2020-2025 and the overall outcome delivery incentive (ODI) package, further details are in section 2.

Table 1.2: Key commitments for Severn Trent Water

Area	Measure
Overall incentive package	Overall outcome delivery incentive (ODI) package in our draft determination equates to a return on regulatory equity range of -3.9% (P10) to +1.7% (P90).
Common performance commitments	• 15% reduction in annual level of leakage by 2025 from the 2020 level[1]. • 3.5% reduction in per capita consumption by 2024-25 • 29% reduction in pollution incidents by 2024-25 • 21% reduction in internal sewer flooding incidents by 2024-25
Bespoke performance commitments	• 8% reduction in external sewer flooding incidents by 2024-25 • 7% reduction in public sewer blockages by 2024-25 • 5% reduction in sewer blockages by 2024-25 • 5% reduction in Water Quality complaints by 2024-25 • 64.5% customer satisfaction for value for money by 2024-25 • 43% customers get help to pay when they need it by 2024-25 • 96% customers with an enhanced level of resilient supplies by 2024-25

Note: Where the information provided in this table is an estimate of change over time, it may be calculated using reductions from the forecasts of performance that the company has made for 2019-20, which we are not publishing as part of the draft determination, compared against the 2024-25 performance commitment level. Consequently, it may not be possible to calculate the percentage change from the information we provide.

Severn Trent Water has committed to applying the principles set out in our July 2018 position statement 'Putting the sector in balance' to encourage companies to take the interests of customers into account when determining financial structure. This means it commits to:

- apply the default gearing outperformance sharing mechanism we set out, although Severn Trent Water proposes to maintain gearing levels below the 70% trigger threshold in 2020-25;
- dividend and performance related executive pay policies that are linked to delivery for customers; and
- donate 1% of its profits to a community fund for local schemes. It commits to fund hardship payments and to build a new technical academy.

[1] The company has committed to reduce its average annual leakage level by 15.2% from its 2019-20 level to its 2024-25 level. This is a different figure from the values in 'Severn Trent Water - Outcomes performance commitment appendix' because there the performance commitment is measured on a three-year average basis to smooth annual variations due to weather.

We identified areas of Severn Trent Water's proposals on dividend policy and executive pay which we required the company to address. The company has committed to meet our expectations in these areas and is taking steps to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers.

Allowed revenues

Our draft determination sets out allowed revenue or average revenue for each of the price controls. Table 1.3 sets out the allowed revenues in the draft determination across each price control.

Table 1.3: Allowed revenue, 2020-25 (£ million)

	Water Resources	Network plus - water	Network plus - wastewater	Bioresources	Wholesale Total	Residential retail
Final allowed revenues (£ million)	393.6	3,211.5	3,350.4	457.9	7,413.4	502.8

Note: retail revenue is the sum of the margin, retail costs, and adjustments. The bioresources and residential retail controls are average revenue controls. We have included forecast revenue (in real terms) for these controls to illustrate the total revenue across all controls.

The draft determination includes the early view cost of capital for the wholesale price controls of 3.3% (CPIH deflated) set out in our PR19 methodology. Severn Trent Water's business plan incorporated the early view cost of capital. We will update our view of the cost of capital when we publish the draft determinations for the slow-track and significant scrutiny companies in July 2019, and again for the final determinations for all companies in December 2019.

Consistent with our financing duty, we consider that Severn Trent Water's draft determination is sufficient for an efficient company, with the notional capital structure, to access funds necessary to finance its activities on reasonable terms.

Summary of interventions

This draft determination includes limited interventions to Severn Trent Water's business plans and agreed actions. The key interventions were to:

- adjust its enhancement and unmodelled costs to our view of efficient costs;

- rebalance the outcomes package towards its underperforming water business and reduce the scope for outperformance on sewer flooding;
- reduce the scope of the RCV run-off adjustment; correct the interest rate for index linked debt in the financial model; remove the uncertainty mechanism proposed for climate change; and
- confirm that it is committed to adopt the expectations on dividends and performance related pay for 2020-25 as set out in ‘Putting the sector in balance’.

We expect the company to ensure its performance related executive pay policy for 2020-25 is stretching. We expect the company to ensure the explanation and application of its dividend and performance related executive pay policies are transparent to customers.

Next steps

The procedural benefit of an early draft determination for fast-track companies is strengthened by early certainty on specified components of the draft determination related to outcomes and the cost allowance. Severn Trent Water has chosen to opt out of the early certainty principle for three specific performance commitments: supply interruptions, Water Quality Compliance (CRI), and unplanned outages. The company has also chosen to opt out of the early certainty principle as it applies to deadbands on common performance commitments.

We will publish Severn Trent Water’s final determination in December 2019 after considering representations on the draft determination.

2. Outcomes

The outcomes framework is a key component in driving companies to focus on delivering the objectives that matter to today's customers, future customers and the environment in the 2020-25 period and beyond. Outcomes define the service package that companies should deliver for their customers and their incentives to do this.

We have two key tools to ensure that companies deliver the right outcomes for customers, performance commitments and outcome delivery incentives. Performance commitments specify the services that customers should receive and set out in detail the levels of performance that the companies commit to achieve within the five year period from April 2020 to March 2025. Outcome delivery incentives specify the financial or reputational consequences for companies of outperformance or underperformance against each of these commitments. The framework gives companies the freedom to innovate and explore to find the most cost-effective way of meeting these outcomes.

Companies have engaged directly with their customers to develop a package of performance commitments and outcome delivery incentives in line with the guidance we set out in the PR19 methodology. Customer challenge groups (CCGs) provide challenge on the quality of each company's engagement with their customers. The Water Forum, Severn Trent Water's CCG, considers that there has been a step change in the quality of customer engagement by the company and that Severn Trent Water has proposed an appropriate suite of performance commitments which reflect the areas that are most important to customers.

Severn Trent Water's performance commitments and outcome delivery incentives for the 2020-25 period are summarised in Table 2.1 (common performance commitments) and Table 2.2 (bespoke performance commitments) below. These reflect the common performance commitments required by the PR19 methodology and the bespoke performance commitments proposed by the company in its business plan after consultation with its customers. They include the revisions accepted by the company in response to our 31 January 2019 initial assessment of business plans (IAP) publication (including the actions we placed on the company with respect to its performance commitments and outcomes delivery incentives).

To achieve fast-track status Severn Trent Water agreed to a series of actions on its performance commitments and outcome delivery incentives package. These resulted in increases in the stretch on some key performance commitment targets (Duration of interruptions to supply, Internal sewer flooding and Pollution incidents (Cat 1–3)), a reduction of the potential outperformance payments and an increase of the potential underperformance payments on a number of material outcome delivery incentives (e.g. internal and external sewer flooding, sewer collapses, sewer blockages, mains repairs, treatment works compliance, pollution incidents (Cat 1–

3)), an application of the potential underperformance payments (per capita consumption (PCC), unplanned outage, water quality compliance (CRI)) and a reduction in the overall size of the outcome delivery incentives package in absolute terms.

The further material interventions we are making in the draft determination include:

- setting more demanding performance commitment levels for mains repairs; and
- setting numerical performance commitment levels for sewer collapses and unplanned outage

Table 2.1: Summary of performance commitments: common PCs

Name of common performance commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Water quality compliance (CRI) [PR19 SVE_H01]	Financial – Under; In-period	Water resources; Water network plus
Water supply interruptions [PR19 SVE_G01]	Financial - Out & under; In-period	Water network plus
Leakage [PR19 SVE_G02]	Financial – Out & under; In-period	Water network plus
Per capita consumption [PR19 SVE_G03]	Financial - Under; In-period	Water resources
Mains repairs [PR19 SVE_G04]	Financial - Out & under; In-period	Water network plus
Unplanned outage [PR19 SVE_G05]	Financial – Under; In-period	Water resources; Water network plus
Risk of severe restrictions in a drought [PR19 SVE_G06]	Reputational	N/A
Priority services for customers in vulnerable circumstances [PR19 SVE_E02]	Reputational	N/A
Internal sewer flooding [PR19 SVE_F01]	Financial - Out & under; In-period	Wastewater network plus
Pollution incidents [PR19 SVE_F02]	Financial – Out & under; In-period	Wastewater network plus
Risk of sewer flooding in a storm [PR19 SVE_F04]	Reputational	N/A
Sewer collapses [PR19 SVE_F03]	Financial – Out & under; In-period	Wastewater network plus
Treatment works compliance [PR19 SVE_C01]	Financial – Under; In-period	Water network plus; Wastewater network plus
C-MeX: Customer measure of experience [PR19 SVE_D01]	Financial - Out & under; In-period	Residential retail
D-Mex: Developer services measure of experience [PR19 SVE_D02]	Financial - Out & under; In-period	Water network plus; Wastewater network plus

Table 2.2: Summary of Performance Commitments: Bespoke PCs

Name of bespoke performance commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Reducing residential void properties [PR19 SVE_A01]	Financial – Out; In-period	Residential retail
Reducing residential gap sites [PR19 SVE_A02]	Reputational	N/A
Reducing business void and gap site supply points [PR19 SVE_A03]	Financial – Out; In-period	Business retail
Value for Money [PR19 SVE_A04]	Reputational	N/A
Inspiring our customers to use water wisely [PR19 SVE_B01]	Financial – Out & under; In-period	Water network plus, wastewater network plus
Improvements in WFD criteria [PR19 SVE_C02]	Financial - Out & under; end of period	Wastewater network plus, water resources
Biodiversity (Water) [PR19 SVE_C03]	Financial – Out & under; In-period	Water resources
Biodiversity (Waste) [PR19 SVE_C04]	Financial - Out & under; In-period	Wastewater network plus
Satisfactory sludge use and disposal [PR19 SVE_C05]	Financial – Under; In-period	Bioresources
Help to pay when you need it [PR19 SVE_E01]	Reputational	N/A
External sewer flooding [PR19 SVE_F05]	Financial - Out & under; In-period	Wastewater network plus
Sewer blockages [PR19 SVE_F06]	Financial - Out & under; In-period	Wastewater network plus
Public sewer flooding [PR19 SVE_F07]	Financial - Out & under; In-period	Wastewater network plus
Green communities [PR19 SVE_F08]	Financial - Out & under; In-period	Wastewater network plus
Collaborative flood resilience [PR19 SVE_F09]	Financial - Out & under; end of period	Wastewater network plus
Speed of response to visible leaks [PR19 SVE_G07]	Financial - Out & under; In-period	Water network plus
Persistent low pressure [PR19 SVE_G08]	Financial - Out & under; In-period	Water network plus
Abstraction Incentive Mechanism (AIM) [PR19 SVE_G09]	Financial - Out & under; In-period	Water resources

Name of bespoke performance commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Resilient supplies [PR19 SVE_G10]	Financial - Out & under; end of period	Water network plus
Resolution of low pressure complaints [PR19 SVE_G11]	Financial - Out & under; In-period	Water network plus, residential retail
Increasing water supply capacity [PR19 SVE_G12]	Financial – Under; end of period	Water resources
Number of water meters installed [PR19 SVE_G13]	Financial - Out & under; In-period	Water resources
Water quality complaints [PR19 SVE_H02]	Financial - Out & under; In-period	Water resources, water network plus
Farming for Water [PR19 SVE_H03]	Financial - Out & under; end of period	Water network plus
Protecting our schools from lead [PR19 SVE_H04]	Financial - Out & under; end of period	Water network plus

The 'Severn Trent Water - Outcomes performance commitment appendix' sets out in detail our draft determination of each of the performance commitments and outcome delivery incentives proposed by the company, and further detail on each of our interventions in the company's performance commitments and outcome delivery incentives following our 31 January 2019 initial assessment of plans publication.

Figure 2.1 and Figure 2.2 below provide an indication of the financial value of each of Severn Trent Water's outcome delivery incentives (taking into account the impact of our draft determination interventions) showing how much they would have to pay out to customers if they underperformed to the P10 level and how much they would gain if they over performed to the P90 level. The figures cover common and bespoke commitments respectively. Table 2.3 below provides an indication of the financial value of the overall package at the upper and lower extreme levels of performance (expressed as a percentage point impacts on Return on Regulated Equity (RoRE)) and the overall impact of our draft determination interventions. The estimates are based on the company's own view of the plausible bounds of performance. The P90 is the performance threshold at which there is only a 10% chance of outturn performance being better. The P10 is the performance threshold at which there is only a 10% chance of outturn performance being worse.

Figure 2.1: Projected P10 penalties and P90 payments for Common Performance Commitments over 2020-25 (£ million)

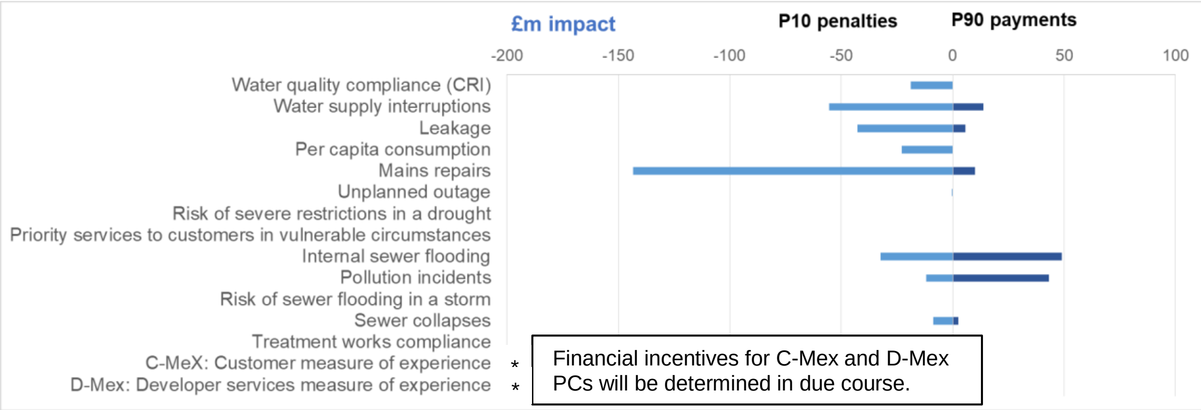


Figure 2.2: Projected P10 penalties and P90 payments for Bespoke Performance Commitments over 2020-25 (£ million)

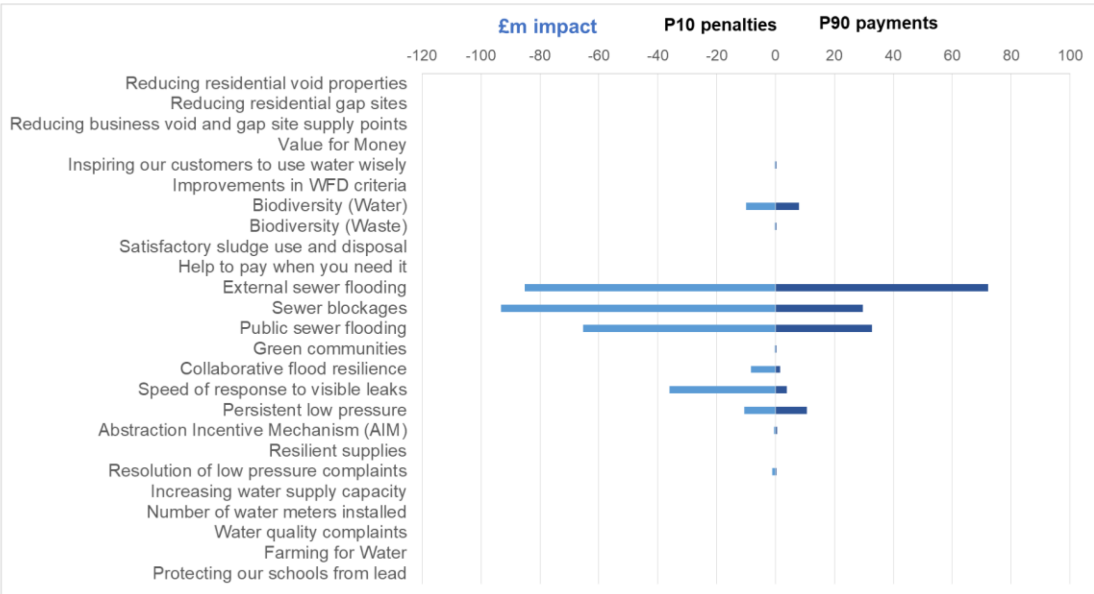


Table 2.3: Impact of Draft Determination Interventions on RoRE range

	Sep 2018 business plan		Draft determination	
	% 5 year regulatory equity		% 5 year regulatory equity	
	p10	p90	p10	p90
Severn Trent Water	-4.6%	3.6%	-3.9%	1.7%

We said in the PR19 methodology that we expect companies to propose approaches to protecting customers in case their outcome delivery incentive payments turn out to be much higher than expected. We explained in our IAP Technical Appendix Delivering Outcomes for Customers published on 31st January that we are asking all companies to commit to put in place additional protections for customers, where we consider protections are not adequate to protect customers from high outperformance payments.

The company has applied outcome delivery incentives payment caps and collars across a number of its material common and bespoke performance commitments, including wastewater (internal/external/public sewer flooding and pollution incidents) and water (water supply interruptions, mains bursts, water quality complaints).

The company has accepted our mechanism for sharing with customers through bill reductions 50% of their incremental outperformance payments once the outperformance payments in any year reach 3% of their wastewater or water RoRE for that year. We will be undertaking further work on the detail of the mechanism and the process for annual reconciliation which we plan to publish for stakeholder views alongside the slow-track and significant scrutiny draft determinations in July. We will publish our final decisions on these aspects of the mechanism (and including its incorporation into the company's price controls) as part of the final determinations in December.

In our PR19 methodology, we set out that we would replace the current Service Incentive Mechanism (SIM) with the C-Mex for customers and introduce a new service incentive for developers, D-Mex. We have worked with stakeholders including companies, CCWater and developer customers to develop both mechanisms and would like to acknowledge and thank those who have contributed to the working groups. We have piloted the C-Mex and D Mex mechanisms in 2018 and will run both mechanisms in a shadow year in 2019. We published our guidance for the C-Mex and D-Mex shadow year in early March. We will finalise our detailed approach to C-Mex and D-Mex taking account of the learnings from the shadow year. As part of the slow-track and significant scrutiny draft determinations process we will publish our minded to positions on detailed working of C-Mex and D-Mex, and will seek stakeholder views and further input. We will publish our decision on final C-Mex and D-Mex incentive design for 2020-2025 as part of the final determinations in December.

We will finalise the company's performance commitments and outcome delivery incentives in the light of representations on this draft determination and our draft determinations for slow-track and significant scrutiny companies, to be published in July, so that these can be reflected as appropriate in the company's final determination to be published in December. Any changes that we make will be subject to the provisions of the "early certainty" principle agreed with the company.

The outcomes framework sits in the broader context of the company's statutory and licence requirements for service delivery. Independently of the outcomes framework, each company also has to ensure that it complies with its statutory obligations, or risk enforcement action. If a company's performance falls below the level set for a performance commitment, we will consider whether this is indicative of wider compliance issues to the detriment of consumers and whether enforcement action, with the potential for remedial and fining measures, is warranted.

3. Cost allowances

We set out in our PR19 methodology that we expect company business plans to show a step change in efficiency. Severn Trent Water's plan for 2020-25 is broadly efficient overall in water resources, network plus wastewater, bioresources and residential retail. It proposes expenditure in network plus water that is over 10% less efficient than our view of costs. We challenged Severn Trent Water's proposed costs to ensure customers pay only for efficient costs. Where appropriate, we also made interventions to protect customers if the proposed investment is not delivered.

3.1. Wholesale total expenditure

Our approach to setting total expenditure (totex) allowances is detailed in our initial assessment of business plans '[Technical Appendix 2: Securing cost efficiency'](). In this section we set out our totex allowance for 2020-25 for the water resources; network plus water; bioresources and network plus wastewater. In the appendix we provide more detailed information on our cost challenge for enhancement expenditure, our allowance for cost adjustment claims and transitional expenditure and how we will deal with the uncertainty in WINEP.

Table 3.1 shows the totex allowances by year and by price control for the period 2020-25. We have phased our allowed totex over 2020-25 using the company business plan totex profile.

Table 3.1 Totex[1] (excluding pension deficit recovery) by year for wholesale controls, 2020-25 (£ million, 2017-18 CPIH deflated prices)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Water Resources	68.6	70.3	73.4	78.9	82.9	374.1
Water network plus	485.6	521.1	514.6	503.7	498.6	2,523.7
Wastewater network plus	506.7	547.1	554.6	546.6	490.9	2,645.9
Bioresources[2]	88.9	89.3	88.0	84.9	76.2	427.3
Total	**1,149.8**	**1,227.8**	**1,230.7**	**1,214.1**	**1,148.6**	**5,970.9**

[1] Totex includes all costs except pension deficit recovery costs. Totex includes third party costs (ie costs that are offset by revenues from third parties, such as bulk supply of non-potable water) and it is stated here before removing any grants and contributions we expect the company to receive. These are shown in the table below.

[2] The bioresources control is an average revenue control. The totex allowance in our draft determination is based on a forecast level of tonnes of dry solids.

Table 3.2 sets out the build-up of our totex allowance from base and enhancement costs. Base expenditure refers to routine, year on year costs, which companies incur in the normal running of their business. Enhancement expenditure refers to investment for the purpose of enhancing the capacity or quality of service beyond current levels. Enhancement expenditure may be driven by factors, including population growth, new statutory obligations and improvements in areas important to customers. In addition we allow costs for the development of a regional strategic solution to address long-term water resource provision. For Severn Trent Water the allowance relates specifically to schemes to transfer water from the River Severn to River Thames, in collaboration with both United Utilities and Thames Water. This investment will be associated to gated project deliverables and linked ODIs to ensure that customers are protected in the event of the project not progressing through every gate. The following sections provide more information on base and enhancement expenditure.

Our cost assessment framework allows companies to submit cost adjustment claims to allow for unique operating circumstances, legal requirements or atypical expenditure. The claims can relate to both base and enhancement costs. Our totex allowance includes all adjustments made and the ‘Severn Trent Water - Cost efficiency draft determination appendix’ sets out the rationale for our decisions.

Table 3.2: Totex by wholesale price control and type of cost, 2020-25 (£ million, 2017-18 CPIH deflated prices)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
Base expenditure	295.9	2,025.1	1,932.7	427.3	4,680.9
Enhancement expenditure	41.1	470.5	709.6	0.0	1,221.3
Water resources strategic scheme development expenditure	25.7	0.0	0.0	0.0	0.0.
Third party costs	11.4	28.1	3.5	0.0	43.0
Total – excluding pension deficit recovery	**374.1**	**2,523.7**	**2,645.9**	**427.3**	**5,970.9**
Pensions deficit recovery costs	2.7	20.9	13.8	4.1	41.5
Total	**376.8**	**2,544.6**	**2,659.7**	**431.3**	**6,012.4**

Note: We are displaying pension deficit recovery costs separately as they are not included in the calculation for PAYG (see section 4.2).

3.2. Base expenditure

For our draft determinations, we apply an efficiency challenge to base expenditure proposed by companies. Our efficiency challenge is based on cost performance within the sector as well as on wider factors.

To come to our view of efficient base costs our initial benchmark is "upper quartile" performance within the sector. Such a benchmark provides an efficiency challenge to 75% of the water companies to catch up with the top 25% of companies in the sector. We look beyond the water sector as well. We apply further stretch to our view of costs based on evidence of ongoing productivity improvement in the wider economy as well as evidence of the efficiency gains from the totex and outcomes framework. Our efficiency challenge is based on comparative assessment.

We use econometric models to derive this challenge. Our challenge to company business plans should be considered 'in the round'. Therefore companies receive our modelled allowance even if their proposed costs are below our allowance within a given service area. There are, however, cost factors that do not lend themselves to this approach. These are termed unmodelled base costs and include business rates, third party costs, abstraction charges and typically costs relating to the Traffic Management Act and occasionally the Industrial Emissions Directive. For Severn Trent Water no allowance was necessary for costs relating to the Industrial Emissions Directive.

Our approach to setting an efficiency challenge to modelled base costs is set out in in our initial assessment of business plans '[Technical Appendix 2: Securing cost efficiency'.]

Table 3.3: Base expenditure, 2020-25 (£ million, 2017-18 CPIH deflated prices)

Service	Company business plan - base cost	Modelled base costs efficiency adjustment	Unmodelled base costs challenge	Base cost allowance
Wholesale water	2,360.9	22.7	-62.7	2,320.9
Wholesale wastewater	2,193.3	207.4	-40.7	2,359.9
Total	4,554.2	230.1	-103.4	4,680.9

3.3. Enhancement expenditure

Our draft determinations also apply a challenge to the company's proposed enhancement expenditure based on benchmarking models and an assessment of the evidence it has provided. Our approach to enhancement is set out in in our initial assessment of business plans '[Technical Appendix 2: Securing cost efficiency'.] Table 3.4 summarises our allowances. The 'Severn Trent Water – Cost efficiency draft determination appendix' gives the most significant areas of disallowance, however, our allowance should be considered 'in the round' rather than focus solely on a particular area.

Table 3.4: Enhancement expenditure, 2020-25 (£ million, 2017-18 CPIH deflated prices)

Service	Company requested capex	Cost efficiency adjustment	Our allowance
Wholesale water	812.8	-301.1	511.7
Wholesale wastewater	772.4	-62.8	709.6
Total	1585.2	-363.9	1221.3

3.4. Cost sharing

Our totex allowance is a baseline reference for the application of cost sharing. When a company overruns its totex allowance, the additional cost incurred above the baseline will be shared between its investors and customers. When a company spends less than its totex allowance, it will share the benefits with customers.

Cost sharing rates are the proportion of cost savings that investors get to keep, or the proportion of any cost overrun that investors will have to bear. Cost sharing ensures that customers get a share of the benefits when companies outperform their cost allowance, and that customers and companies are protected when companies overrun their allowance. Cost sharing performance will be taken into account in the PR19 reconciliation for the next price control period.

The cost sharing mechanism applies to total revenue controls only, namely for water resources, water network plus and wastewater network plus. For the water resources and water network plus controls, we set the same cost sharing rates. We do not apply cost sharing in average revenue controls, namely in the retail and bioresources controls. In the average revenue controls, any deviation from our allowed expenditure will be incurred fully by the company.

The sharing rates are determined from the ratio of the company's view of totex to our view of totex. As a fast-track company that accepted the outcome of our view of efficient costs at the initial assessment stage the company's outperformance and underperformance cost saving rates are both 50%.

Table 3.5: Totex cost sharing for cost performance for 2020-25, £ million

	Water resources	Network plus – water	Network plus - wastewater
Cost sharing rate – outperformance	50%	50%	50%
Cost sharing rate – underperformance	50%	50%	50%

Table 3.6 sets out the costs that are subject to cost sharing. Cost sharing will be applied to net totex less third party costs. Net totex excludes grants and contributions and pension deficit recovery cost.

Table 3.6: Totex subject to cost sharing rates – 2020-25, £ million

	Water resources	Network plus – water	Network plus – wastewater
Gross totex (excluding third party costs	362.7	2,495.6	2,642.3
Grants and contributions	0.0	180.0	97.8
Net totex (subject to cost sharing)	362.7	2,315.6	2,544.5

Note: Table 3.6 does not include third party costs or pension deficit repair expenditure, as these are not included in cost sharing.

3.5. Transition expenditure

The transition programme allows companies to bring forward planned investment from 2020-25 to 2019-20, where it is efficient to do so. Although the expenditure would be incurred in 2019-20, for the purpose of cost performance incentives it is considered as expenditure incurred in the following regulatory period (2020-25).

We allow cost when reasonably justified in order to make efficient use of resources to minimise whole life costs, where it is efficient to bring forward an investment, or to enable companies to meet early statutory deadlines.

Severn Trent Water did not propose any transitional expenditure.

Residential retail

We determine the residential retail control from the expenditure set out in Table 3.7. The table, and the rest of this draft determination, does not include a proportion of our allowed pension deficit recovery costs of £10.9 million in relation to the residential retail control. These costs will be added at final determinations.

Table 3.7 Expenditure, residential retail, 2020-25 (£ million, nominal)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Residential retail	98.1	98.1	98.1	98.1	98.1	490.5

Note: The residential retail control is an average revenue control. Allowed cost and the associated allowed revenue is based on a forecast of the number of customers.

4. Calculation of allowed revenue

This section sets out the calculation of allowed revenue for each of the price controls, based on our assessment of efficient costs. We set out in section 4.1 the components of allowed revenue for each of the price controls. We then set out information relevant to the calculation of the components of that allowed revenue in sections 4.2 and 4.5.

4.1. Allowed revenue

We calculate revenue separately for each of the wholesale controls and for the residential retail control. We set out the calculation of five year revenues for each of these controls in this section.

Wholesale controls

For the wholesale controls (that is water resources, water network plus, wastewater network plus and bioresources), allowed revenue is calculated based on the following elements, not all elements are applicable to all wholesale controls as set out in Table 4.1.

- Pay as you go (PAYG) – this reflects the allocation of our efficient totex baseline to costs that are recovered from revenue in 2020-25 (PAYG). The proportion of totex not recovered from PAYG is added to the regulatory capital value (RCV) which is recovered over a longer period of time.
- Allowed return on capital – this is calculated based on our assessment of the cost of capital multiplied by the average RCV for each year.
- RCV run-off – this reflects the amount of RCV that is amortised from the RCV in the period of the price control.
- PR14 reconciliations – this reflects the application of out/underperformance incentives or penalties from PR14 through revenue adjustments in 2020-25.
- Fast-track reward – fast-track companies are awarded a financial reward for achieving fast-track status equivalent to 0.1% of return on regulatory equity. Companies are able to decide how they receive this reward either through an adjustment to revenue or to opening RCV.
- Corporation tax allowance – this is estimated from projected corporation tax rates, profit forecasts and assumed levels of tax relief contained in our financial model for the draft determination.
- Income from other sources – this is revenue that companies charge but is not part of the regulated water and wastewater bills that customers pay.

- Other price control income – this is an allowance for revenue that is included in the price control but is not covered by wholesale charges.
- Grants and contributions – this is an allowance for the income from connection and infrastructure charges.
- Revenue re-profiling – this reflects the change in revenue in 2017-18 prices as a result of adjustments made to annual revenues to smooth the final bill profile consistent with customer preferences. The financial model calculates revenue adjustments on a net present value (NPV) neutral basis.

We set out the calculation of the allowed revenue for Severn Trent Water's wholesale controls in Table 4.1. We summarise the total of the build-up of allowed revenue as five year totals, however our financial model calculates the allowed revenue on an annual basis for the purposes of our draft determination. We state the allowed revenue for each price control on an annual basis in section 5.

We explain how we calculate PAYG, RCV run off and the cost capital in section 4.2, the revenue adjustments for PR14 reconciliations in section 4.3, and other elements of allowed revenue in section 4.4.

Table 4.1: Calculation of allowed revenue (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresource s	Total
Pay as you go	268.7	1,454.2	1,461.0	169.6	**3,353.6**
RCV run-off	94.4	992.9	1,056.8	189.2	**2,333.3**
Return on capital	55.3	590.6	582.7	81.9	**1,310.6**
Revenue adjustments for PR14 reconciliations	-	6.8	86.1	-	**92.9**
Fast-track reward	0.8	8.9	8.6	-	**18.4**
Tax	6.8	36.0	84.6	17.0	**144.4**
Grants and contributions (price control)	-	171.5	97.8	-	**269.3**
Other income (price control)	-	-	-	-	**-**
Deduct other income (non-price control)	-32.4	-50.2	-28.0	-	**-110.6**
Revenue re-profiling	0.1	0.6	0.7	0.1	**1.5**
Final allowed revenues	**393.6**	**3,211.5**	**3,350.4**	**457.9**	**7,413.4**

We set out the calculation of allowed revenue for each wholesale control on an annual basis in the ‘Severn Trent Water: Allowed revenue appendix’ in Tables 1.1 to 1.4.

Residential retail control

For the residential retail control, allowed revenue is calculated as:

- Retail cost to serve – this reflects our efficient view of costs per customer for the retail business; plus,

- Net margin on wholesale and retail activities – this is calculated based on the wholesale and retail revenue applicable to retail customers multiplied by our allowed retail margin. Our methodology set out an early view of the retail margin that applies for the retail price controls, which was used by Severn Trent Water in its business plan.

Allowed revenue for the residential retail control is set on a nominal basis and therefore we present the make-up of the revenue in the nominal price base in Table 4.2.

Table 4.2: Retail margins (nominal price base)

	2020-25
Total wholesale revenue - nominal (£ million)	7,927.3
Proportion of wholesale revenue allocated to residential (%)	75.90%
Residential retail costs (£ million)	490.5
Total retail costs (£ million)	**6,507.3**
Residential retail net margin (%)	1.00%
Residential retail net margin (£ million)	**65.7**
Residential retail adjustments (£ million)	1.4
Residential retail revenue (£ million)	**557.6**

Note: retail revenue is the sum of the margin, retail costs, and adjustments.

We set out the calculation of residential retail revenue on an annual basis in the ‘Severn Trent Water: Allowed revenue appendix’ in Table 1.5.

The proportion of wholesale revenue allocated to residential customers is provided by the company in the business plan tables. We have accepted the company’s view of the allocation of wholesale revenue between residential and business customers.

Severn Trent Water based its business plan on the residential retail margin set out in our early view cost of capital. We have set the draft determination on this basis.

4.2. Cost recovery now and in the long term for the wholesale controls

Our totex cost allowances are sufficient to meet a company's operating and capital expenditure. Companies recover this expenditure either in period from current customers using pay-as-you-go (PAYG) or add it to the regulatory capital value (RCV) and recover from future generations of customers using the RCV) run-off rates. Consistent with our methodology, we have assessed how each company's choice of PAYG and RCV run off rates reflects the levels of proposed expenditure, bill profiles, affordability and customer views relevant to the short and the long term.

To determine the allowed revenue, the PAYG rate is applied to totex allowance for each wholesale control for each year of the price control. The proportion of the totex allowance that is not recovered in PAYG is added to the RCV and recovered from customers in future periods.

In this section we set out our approach to calculating the PAYG rates, the RCV to which the cost of capital is applied and the RCV run off rates.

PAYG

The average PAYG rates and the associated totex recovery for 2020-25 for each wholesale control is set out in Table 4.3.

To PAYG we add the allowed costs for pension deficit recovery set out in Table 3.2 to derive total amount to be recovered in 2020-25 for each price control.

Table 4.3: PAYG allowances for each wholesale control (5 year)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
Totex allowance (£ million)	374.1	2,343.6	2,548.1	427.3	**5,693.1**
PAYG (%)	71%	61%	57%	39%	
Pay as you go totex (£ million)	265.9	1,433.4	1,447.2	165.6	**3,312.1**
Pension deficit recovery cost (£ million)	2.7	20.9	13.8	4.1	**41.5**
Total pay as you go (£ million)	268.7	1,454.2	1,461.0	169.6	**3,353.6**

The PAYG revenue for each year of the price control is based on totex allowance multiplied by PAYG rate for that year plus an allowance for pension deficit recovery costs. The annual PAYG revenue and PAYG rates for each wholesale control are shown in the ‘Severn Trent Water: Allowed revenue appendix’ in Tables 2.1 to 2.4.

Severn Trent Water’s approach to PAYG rates is reflective of, but not mechanistically linked to, measures of the structure of costs over time (in particular operating costs and infrastructure renewal expenses). The company set out these should remain relatively stable over time and adjusted only in response to relatively clear and significant changes to that structure. We have accepted the approach taken by the company and have applied the PAYG rates proposed in the business plan for our draft determination. We are not intervening on the company’s PAYG rates on the basis of financeability.

Table 4.4 sets out the average PAYG rates across 2020-25 for each wholesale control proposed in the company’s business plan and for our draft determination.

Table 4.4: PAYG rates for each wholesale control (5 year)

	Water resources	Water network plus	Wastewater network plus	Bioresources
Company plan (%)	71.1%	61.2%	56.8%	38.7%
Draft determination (%)	71.1%	61.2%	56.8%	38.7%

PAYG (%) reflects the weighted average rate applied across the 5 years 2020-25.

Opening RCV adjustments

As part of the business plan Severn Trent Water proposed allocations of the RCV for both Water Resources and Bioresources price controls based on Ofwat guidance. We are allocating the company's RCV between the existing wholesale controls and these new controls in accordance with the proportions proposed by Severn Trent Water.

We make reconciliation adjustments ("midnight adjustments") related to the company's performance against incentive mechanisms from previous price reviews and for land sales in order to determine the opening RCV for the period of the PR19 controls. We also adjust the RCV upwards to reflect a change in the accounting treatment of leases, which causes some assets formerly recognised as operating leases to be recognised on the company's Balance sheet. In doing so, we have followed the approach set out in IN 18/09 Guidance for reporting operating leases in PR19 business plans. We have used the adjustment proposed in the company business plan.

Table 4.5: Opening RCV, 1 April 2020 (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources
RCV – 31 March 2020	4,489.1		4,784.6	
% of RCV allocated by control	8.40%	91.60%	89.28%	10.72%
RCV – 31 March 2020	376.9	4,112.2	4,271.8	512.8
Midnight adjustments to RCV	2.0	18.1	-290.7	0.0
Opening RCV – 1 April 2020	**378.8**	**4,130.3**	**3,981.2**	**512.8**

Return on capital

Companies are allowed a return on the RCV, equal to the Weighted Average Cost of Capital (WACC).

Our PR19 methodology set out an ‘early view’ cost of capital for all wholesale controls. Severn Trent Water’s business plan incorporates the early view cost of capital for the wholesale price controls of 3.3% - CPIH deflated (2.3% - RPI deflated). We have used the early view cost of capital in this draft determination; we will update our view of the cost of capital when we publish the draft determinations for the slow-track and significant scrutiny companies in July 2019, and again for the final determinations for all companies in December 2019. The fast-track companies will have the opportunity to respond to our updated view of the cost of capital in response to the draft determinations for the slow-track and significant scrutiny companies in July 2019.

The PR19 methodology confirmed we will transition to CPIH as the primary inflation rate from 2020. At 1 April 2020, we will index 50% of RCV to RPI; the rest, including new RCV, will be indexed to CPIH. Table 4.6 and Table 4.7 set out the opening and closing balance for each component of RCV.

The PR19 methodology confirmed our protection of the value of the RCV as at 31 March 2020 across each of the wholesale price controls. New investment that is allocated to the RCV from 1 April 2020 is stated as ‘post 2020 investment’.

In determining the 'return on capital' revenue building block, we apply the relevant deflated cost of capital to the average RCV for the year for each component (RPI inflated, CPIH inflated and post 2020 investment) and results in a return on capital for each wholesale control over the period 2015-20 as set out in Table 4.8.

Table 4.6 Opening RCV by wholesale control for each component of RCV, 1 April 2020 (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
RPI inflated RCV	189.4	2,065.2	1,990.6	256.4	**4,501.6**
CPIH inflated RCV	189.4	2,065.2	1,990.6	256.4	**4,501.6**
Other adjustments		-	-		**-**
Total RCV	**378.8**	**4,130.3**	**3,981.2**	**512.8**	**9,003.2**

Table 4.7 Closing RCV by wholesale control for each component of RCV, 31 March 2025 (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
RPI inflated RCV	155.7	1,688.5	1,585.0	186.4	**3,615.6**
CPIH inflated RCV	154.1	1,659.5	1,573.1	184.8	**3,571.5**
Post 2020 investment	93.8	819.0	980.8	228.2	**2,121.8**
Other adjustments		-	-		**-**
Total RCV	**403.6**	**4,167.0**	**4,139.0**	**599.4**	**9,308.9**

Table 4.8 Return on capital by wholesale control for each component of RCV, 2020-25 (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
RPI inflated RCV	19.9	216.0	205.6	25.4	**466.8**
CPIH inflated RCV	28.3	306.8	292.8	36.1	**664.0**
Post 2020 investment	7.2	67.9	84.3	20.5	**179.8**
Other adjustments		-	-		**-**
Total return on capital	**55.3**	**590.6**	**582.7**	**81.9**	**1,310.6**

Note: Total return on capital is calculated by multiplying the annual average RCV for each element of RCV (RPI inflated, CPIH inflated and post 2020 investment) by the wholesale WACC for each control. The return on capital for each year of the price control for each wholesale control are shown in the 'Severn Trent Water: Allowed revenue appendix' in Tables 3.1 to 3.16 and 4.1 to 4.4.

RCV run off

RCV run off is the proportion of the RCV which is recovered in the 2020-25 period. Companies are able to propose different run-off rates for RPI inflated and CPIH inflated RCV and also, for the water resources and bioresources controls, for post 1 April 2020 investment. Table 4.9 sets out the resultant RCV run-off revenue for each component of RCV for each wholesale control.

Table 4.9: RCV run off on the RCV (5 year) (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
RPI inflated RCV	35.3	405.7	417.5	71.6	**930.1**
CPIH inflated RCV	44.7	496.0	519.3	84.1	**1,144.1**
Post 2020 investment	14.3	91.2	120.0	33.5	**259.1**
Total RCV run off	**94.4**	**992.9**	**1,056.8**	**189.2**	**2,333.3**

Note: Total RCV run off is calculated by multiplying the opening RCV for each element of RCV (RPI inflated, CPIH inflated and post 2020 investment) by the RCV run off rate for each control (50% of run off is applied to post 2020 investment in the year of additions).

Severn Trent Water's RCV run-off rates for RCV existing at 31 March 2020 for the water network plus and wastewater network plus controls are based on an assessment of current cost depreciation of the assets within each control over the long term. The RCV run off rates for RCV existing at 31 March 2020 for the water resources and bioresources controls and for post 1 April 2020 investment are set to recover a value equivalent to the forecast current cost depreciation. We have accepted this approach to setting RCV run off rates. These rates have been adjusted for the following.

- In its business plan, Severn Trent Water proposed an adjustment to RCV run off rates for RCV inflated by RPI to deliver the effect of a full transition to CPIH. The company's proposal was supported by evidence of customer support for the adjustment and the resulting bill profile. Following our intervention, Severn Trent Water reduced the adjustment to be consistent with the CPIH:RPI wedge in the early view cost of capital.
- In addition, Severn Trent Water identified a financeability constraint for the notional company and applied an uplift to all wholesale controls to address the constraint.

Following the application of the agreed actions, certain financial ratios were weak. We intervened to apply a further adjustment to the RCV run off rates for the water network plus control, but these run off rates are no higher than the company proposed in its business plan.

Table 4.10 sets out the average RCV run off rates across 2020-25 for each wholesale control proposed in the company's business plan and for our draft determination.

Table 4.10: RCV run off rates for each wholesale control (5 year)

	Water resources	Water network plus	Wastewater network plus	Bioresources
Original company plan (%)	4.94%	4.67%	5.24%	6.66%
Draft determination (%)	4.75%	4.67%	5.06%	6.50%

Note: RCV run off (%) reflects the average of the rates applied to the CPIH and RPI inflated RCV components across the 5 years 2020-25.

The annual rates for each wholesale control are set out in the 'Severn Trent Water: Allowed revenue appendix' in Tables 5.1 to 5.4.

4.3. PR14 reconciliations

In PR14, we set mechanisms to incentivise companies to do the right thing for their customers. These financial incentives cover cost efficiency, outcomes performance, revenue forecasting (wholesale and retail), customer service (the service incentive mechanism), water trading and land sales. It is important to reconcile the financial impacts of these mechanisms in PR19 to ensure that customers only pay for the service the company delivers.

We are also applying adjustments to reflect performance in the final year of the 2010 to 2015 period, which could not be fully taken into account in PR14. These adjustments apply to the RCV (the "midnight adjustment") and revenue for the 2020-25 period. These adjustments are made in line with the PR14 reconciliation rulebook.

We are publishing models for each of these reconciliations, and for the overall RCV and revenue adjustments on our website. 'Severn Trent Water - Accounting for past delivery actions and interventions' provides a detailed explanation of all policy interventions we are making in the models. Table 4.11 summarises our interventions. Table 4.12 sets out the resulting adjustments to revenue and the RCV. The 'Severn Trent Water - Accounting for past delivery appendix' sets out how these adjustments are allocated across controls and explains how the RCV adjustment feeds into the midnight adjustments to RCV set out in Table 4.5.

The reconciliation for the service incentive mechanism is relative and requires information for all companies. We will complete the reconciliation based on latest information. For the slow track and significant scrutiny companies this information was provided on 1 April 2019. We will publish the reconciliation for all companies alongside draft determinations for slow track and significant scrutiny companies in July.

For outcome delivery incentives, the information we have used to reflect performance in the final year of the 2015 to 2020 period is the latest expectation. Final figures for 2019-20 will not be able to be take into account in PR19. We set out in the PR14 Reconciliation Rulebook that we planned to complete the reconciliation for 2019-20 outcome delivery incentives at PR24 for the 2025 to 2030 period so that we could use correct information.

For outcome delivery incentives, the information we have used to reflect performance in 2019-20 is based on the company's latest expectations. Final figures for 2019-20 will not be able to be taken into account in PR19. We set out in the 'PR14 reconciliation rulebook' that we planned to complete the reconciliation for 2019-20 outcome delivery incentives at PR24 for 2025-30 so that we could use correct information.

However, most outcome delivery incentives for the 2020-25 period are in period and will have been reconciled before this date. In light of this we consider it would be more appropriate to complete this reconciliation in the autumn of 2021 and apply any change to bills for 2021-22 as part of the new in-period process. We will designate all of the financial PR14 performance commitments as being in-period for this purpose. Any adjustment between the 2019-20 forecast and actual figures should be modest and we would not expect a significant impact on bills. If, contrary to expectations the bill impact was more significant, we would expect companies to take measures to smooth the impact for their customers. The new PR19 mechanism to share unexpected high bill increases in a year will not apply in this case. Instead the PR14 protection that caps the impact across the five years 2015-20 should apply.

The above applies equally to the company's 2015-20 in period outcome delivery incentives and we have used forecast information for 2018-19 and 2019-20 to reconcile these outcome delivery incentives. For the avoidance of doubt, no application is required in 2019 for in period determinations.

Table 4.11: Reconciliation of PR14 incentives, interventions

Incentive	Intervention(s)
Outcome delivery incentives	We are making interventions to the latest submission from Severn Trent Water. However, we expect the underlying data on ODIs to be updated as part of the 15 July submissions. We have met with the company to discuss the information required to report performance and outcome delivery incentives for 2018-19 following the change in the company area on 1 July 2018. We will review any additional evidence the company provides for the final determination. We are unable to understand the reasons for differences in the App27 figures for water network plus in-period ODI adjustments and are asking the company to provide further explanation. We are intervening to ensure net performance payments applied to revenue reconcile to the outcome of the 2018 in-period determination.

Incentive	Intervention(s)
	We are unable to understand the reasons for differences in the App27 figures for wastewater network plus in-period ODI adjustments and are asking the company to provide further explanation. We are intervening to ensure net performance payments applied to revenue reconcile to the outcome of the 2018 in-period determination. We are unable to understand the reasons for differences in the App27 figures for water network plus end of period ODI adjustments and are asking the company to provide further explanation. We are intervening to ensure net performance payments applied to revenue reflect our view following our independent check of actual and forecast performance and reported ODI underperformance and outperformance payments. As part of this we are intervening to account for the underperformance payment in 2017-18 that the company included in table 3A of its annual performance report, but did not include in table App27 of the business plan.
Residential retail revenue	We are intervening to round the company's modification factor figures to 2 decimal places to ensure consistency with the PR14 Reconciliation Rulebook. We are intervening to include an updated weighted average modification factor for allowed retail service revenue per unmeasured water customer in 2018-19 and 2019-20. This is because the PR14 modification factors were different for Severn Trent Water and Dee Valley Water unmeasured water customers and it is appropriate to use a weighted average for the merged company. We are intervening to include an updated weighted average modification factor for allowed retail service revenue per measured water customer in 2018-19 and 2019-20. This is because the PR14 modification factors were different for Severn Trent Water and Dee Valley Water measured water customers and it is appropriate to use a weighted average for the merged company.
Wholesale revenue forecasting incentive mechanism	No interventions required.
Totex	No interventions required.
Land sales	We are intervening to revise the calculation of present value effect of 50% of proceeds from disposals of interest in land for the wholesale water and wastewater price controls. We are doing this so that the calculation aligns with the revised business plan table templates released on 31 January 2019.
SIM	No interventions required.
PR09 blind year adjustments	No interventions required.

Table 4.12: Reconciliation of PR14 incentives, 2020-25 (£ million)

Incentive	RCV adjustments		Revenue adjustments	
	Company view	Ofwat view	Company view	Ofwat view
Outcome delivery incentives	0.0	-0.5	120.4	118.4
Residential retail revenue	N/A	N/A	1.2	1.2
Wholesale revenue forecasting incentive mechanism	N/A	N/A	-35.1	-35.1
Totex	-111.4	-111.4	4.0	4.0
Land sales	-19.3	-20.9	N/A	N/A
Service Incentive Mechanism	N/A	N/A	-18.9	N/A
PR09 blind year adjustments	-141.1	-141.1	-5.6	-5.6
Water trading	N/A	N/A	N/A	N/A
Total	-271.9	-274.0	65.9	82.9
Total post profiling	N/A	N/A	69.0	88.5

4.4. Other allowed revenue

We also provide companies with a number of other sources of allowed revenue:

- the fast-track reward;
- an allowance for tax;
- an allowance for income from grants and contributions (which is not included in totex);
- an allowance for other price control forecast income; and
- deduction of non-price control forecast income.

Table 4.13: Calculation of other allowed revenue (£ million)

	Water resources	Water network plus	Wastewater network plus	Bioresources	Total
Fast-track reward	0.8	8.9	8.6	0.0	**18.4**
Tax	6.8	36.0	84.6	17.0	**144.4**
Grants and contributions (price control)	0.0	171.5	97.8	0.0	**269.3**
Other income (price control)	0.0	0.0	0.0	0.0	**0.0**
Deduct other income (non-price control)	-32.4	-50.2	-28.0	0.0	**-110.6**

Fast-track reward

We are allowing Severn Trent Water a financial reward equivalent to 10 basis points on the return on regulatory equity to recognise the quality of its business plan, as part of its fast-track status. Severn Trent Water requested that this reward is split evenly between the water network plus and wastewater network plus controls and is applied as an additional revenue allowance.

Other price control income

Other price control income covers income from the sale of non-potable water (not covered by bulk supplies) and rechargeable works. We include an allowance equal to the income that we expect companies to recover from other price control income. We have reviewed the company forecast of 'other price control income' and use this in the draft determination.

Taxation

We calculate a tax allowance reflecting the corporation tax that companies expects to pay during 2020-25. We calculate the tax allowance using the financial model based on the projected taxable profits of the appointed business and the current UK corporation tax rates and associated reliefs and allowances.

Severn Trent Water provided information in data tables relevant to the calculation of the expected tax charge. The information has been updated as part of the resubmission of various data tables to take account of the recent UK corporation tax legislation. Severn Trent Water provided further information about the adjustments to taxable profits which relates to asset backed funding arrangements entered into to support the pension scheme. It clarifies that these arrangements reflect deficit repair contributions over and above the level included in price limits (as set out in IN13/17). As these are not reflected in our financial model for the draft determination, the adjustment is not required. We have accepted all other information provided by the company and applied this to the draft determination.

Our interventions in other areas may impact on forecast levels of capital expenditure and in the area of new connections our assumed recovery rates may differ from what Severn Trent Water had assumed in the business plan. The resulting impact on allowances used for the calculation of taxation has not been reflected. Where these changes result in significantly different inputs for capital allowances or tax deductions, we expect Severn Trent Water to identify this as part of its representations on the draft determination.

Grants and contributions (price control)

Companies receive grants and contributions from developers towards the costs of ‘new developments’, expenditure to reinforce the network, and ‘new connections’, expenditure to connect a property, for example the meter and connection pipe. We calculate the grants and contributions by applying a recovery rate to our view of new developments and new connections expenditure. This ensures that developers pay a fair share towards costs to connect new properties rather than these costs being borne by customers in general. We provide companies with an allowance equal to the income that we expect companies to be able to recover from developers.

We use industry wide recovery rates for water and wastewater new developments and new connections.

- For water new developments we use a rate of 66% derived from industry data,
- For water new connections we accepted Severn Trent Water’s rate of 75%; and
- For wastewater we use a rate of 100% based on our understanding of historical practice in the industry and is broadly supported by company business plans.

In the business plan Severn Trent Water forecast that, for water new developments, that the infrastructure charges receivable would be negative. This was due to the impact of the ‘income offset’ which was calculated as more than the infrastructure charge made to developers. In 2020 there is a change in the way that the income offset rules apply, meaning that rather than being applied to requisitions they are applied to the infrastructure charge. In deriving our industry rate we have capped such discounts so that the infrastructure charge assumption cannot go below zero.

We observed that for new connections the Severn Trent Water forecast for the amount recovered from developers is lower than our view. However the business plan makes a clear case that a discount is being offered to developers where development properties have water efficient fittings to reduce consumption. We agree this is a valid reason for recovering less than 100% and so we have accepted the business plan view.

Our assumption of 100% for wastewater is slightly lower than the Severn Trent Water business plan which was slightly above 100%.

For diversions activities, where companies move their assets to make way for new infrastructure, we have used the company view of the associated income.

Non-price control income

Non-price control income is income from the excluded charges defined in licence condition B. It includes bulk supplies, standpipes and unmeasured cattle troughs. This is deducted from the total allowed revenues

We have reviewed the company forecast of ‘non-price control income’ and use this in the draft determination.

Uncertainty mechanisms

The PR19 methodology makes limited provision for companies to propose bespoke uncertainty mechanisms. In its business plan, Severn Trent Water proposed an uncertainty mechanism in relation to climate change. Following an agreed action, Severn Trent Water has removed this uncertainty mechanism from its business plan. There are no uncertainty mechanisms in our draft determination.

5. Returns, financeability and affordability

This section sets out company proposals for aligning the interests of company management and investors with its customers. We set out Severn Trent Water's proposals in response to our 'Putting the sector in balance' position statement. We comment on the expected range of returns for the notional financial structure. We comment also on the financeability and affordability of the draft determination and any adjustments that we have made to the bill profile.

5.1. Putting the sector in balance

In July 2018 we published our 'Putting the sector in balance' position statement. The position statement set out the steps we expect companies to take to demonstrate they strike the right balance between the interests of customers and their investors. We expect that:

- company dividend and performance related executive pay policies show appropriate alignment between returns to owners and executives and what is delivered for customers;
- companies with high levels of gearing will share financing gains from high gearing with customers; and
- companies will provide assurance that they are financially resilient.

We also encouraged companies to adopt voluntary sharing mechanisms, particularly where, for example, companies outperform our cost of debt assumptions.

Our assessment of Severn Trent Water's proposals is in Table 5.1.

Table 5.1: Our assessment of Severn Trent Water's proposals to balance the interests of customers

Issue	Our assessment
Gearing outperformance benefit sharing	Severn Trent Water projects gearing will remain below 70% in 2020-25. However, the company has provided a clear statement that it is committed to implementing the default gearing benefit mechanism should gearing exceed 70% in 2020-25.
Voluntary sharing mechanisms	Severn Trent Water has committed to donating 1% of its profits to a community fund for local schemes. It has committed to fund hardship payments and to building a new technical academy
Dividend policy for 2020-25	Severn Trent Water has committed to the proposals on dividend policy as set out in our putting the sector in balance position statement. In doing so it has indicated a base dividend yield of 5% for 2020-25. It has confirmed

Issue	Our assessment
	that when setting dividend payments, the company's Board will have regard to performance across its obligations and customer ODIs. The company has committed to reporting on its dividend policy annually, that the published information is clear and transparent and that it links to performance delivery for customers. It has also committed to signal changes to stakeholders. However no detail has been provided on which obligations or commitments to customers will be considered or how they will affect dividend payments. We expect the company to be transparent in this area, to demonstrate that in paying or declaring dividends that it has taken account of the factors we set out in our position statement.
Performance related executive pay policy for 2020-25	Severn Trent Water has stated it is committed to meet the expectations set out in our 'putting the sector in balance' position statement. It has proposed that for 2020-25: • The annual bonus will be based on (i) 51% weighting linked to customer and environmental based objectives (8% colleague safety, 8% complaints, 15% customer outcomes, 10% asset health and 10% environment and social outcomes), and (ii) 49% profit before interest and tax. • The long term incentive plan is based on achieving upper quartile performance of a single performance measure (RoRE). Having this single measure requires management to focus on performance across a range of areas such as Totex, customer ODI's and financing. • The Severn Trent Water Remuneration Committee determines the policy on the remuneration of all executive directors and the committee's terms of reference are reviewed annual and published on the company's website. • Full details of the targets, achievement against them and performance narrative, for both the LTIP and annual bonus scheme will continue to be published in the relevant Director's Remuneration report. In addition with a commitment to engaging with shareholders regarding any proposed changes to design or performance metrics. Severn Trent Water's policy demonstrates the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance' We expect Severn Trent Water to demonstrate that its policy on performance related executive pay demonstrates a substantial link to stretching performance delivery for customers through 2020-25. We expect the company and its remuneration committee to ensure executives have stretching targets linked to performance delivery for customers, and that any further updates to the policy for 2020-25 are transparently reported to stakeholders.
Financial resilience	Severn Trent Water's board has provided assurance that, in all of the financial risk scenarios considered in its business plan, mitigation measures mean that the company's business plan is financeable. This view is supported by its stress testing of key financial ratios for the period to 2025. Severn Trent Water expects its gearing to remain close to our notional level of 60% for 2020-25 and, in response to our challenge, the company has committed to assess its financial resilience beyond 2025 in its next long term viability statement.

5.2. Return on regulatory equity

The PR19 methodology set out that we expected companies to demonstrate a clear understanding of risk to the delivery of their business plans and to explain and demonstrate how they manage and mitigate risk. We expected companies to use Return on Regulatory Equity (RoRE) analysis to assess the impact of upside and downside risk on the basis of their notional capital structures based on a prescribed suite of scenarios using P90/P10 confidence limit values[2].

RoRE is calculated as the return on equity for the equity portion of the RCV based on our notional gearing assumption. A company's base RoRE is aligned with our assumed real post-tax cost of equity, but can differ between companies because the blended real cost of equity will vary according to the proportion of the RCV (and notional regulatory equity) that is indexed to RPI or CPIH. The proportion of RCV (and notional regulatory equity) that is linked to RPI or CPIH will vary between companies according to factors that include the size of the investment programme, the proportion of totex that is capitalised and RCV run-off rates.

We did not require Severn Trent Water to carry out any additional actions on its RoRE risk analysis for our fast-track determination. However, it reassessed risk range values for ODIs as a result of our required actions. Table 5.2 sets out the annual average RoRE ranges in Severn Trent Water's PR19 business plan submission, and the values in our determination. The RoRE ranges for Severn Trent Water are illustrated in Figure 5.1. The base RoRE value for our draft determination includes the full 10 basis points reward for the company achieving fast-track status, which Severn Trent Water has requested be applied as additional allowed revenue.

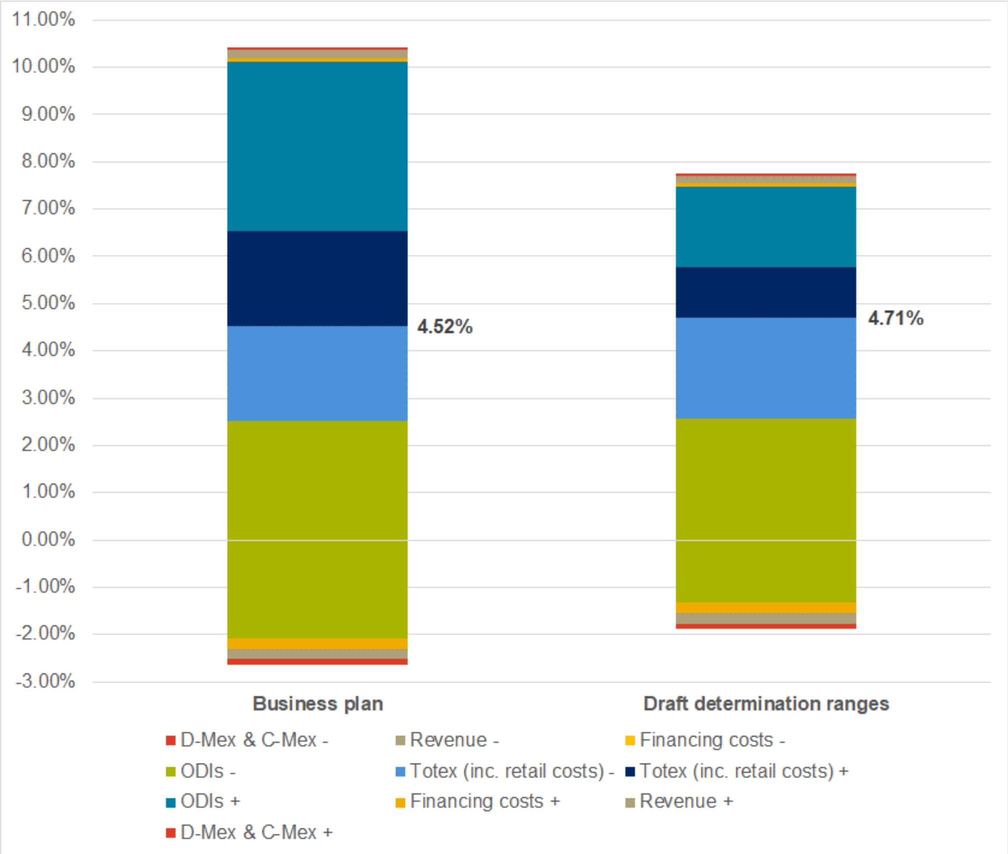
[2] Values that the company considers would not be exceed 90% of the time.

Table 5.2: Annual average RoRE risk ranges

	Business plan		Draft determination ranges	
Base RoRE	4.52		4.71[1]	
Risk ranges	**Lower bound**	**Upper bound**	**Lower bound**	**Upper bound**
Totex	-1.77	1.77	-1.91	0.83
ODIs	-4.60	3.60	-3.90	1.70
Financing costs	-0.22	0.07	-0.22	0.07
Retail costs	-0.23	0.23	-0.23	0.23
D-Mex & C-Mex	-0.11	0.05	-0.11	0.05
Revenues	-0.22	0.17	-0.22	0.17
Total	-7.15	5.89	-6.59	3.05

[1] The base RoRE in the draft determination takes account of the 10 basis point uplift for fast-track status and the effect of reconciliations for past delivery. We are reviewing this and may amend the approach for the slow track draft determinations and final determinations for all companies.

Figure 5.1: RoRE ranges



The draft determination risk ranges shown in Table 5.2 and Figure 5.1 reflect our interventions. In particular, we have included the RoRE risk ranges for ODIs that are shown in Table 2.3 in section 2. The values for ODIs represent the upper and lower extreme levels of performance.

We have included Severn Trent Water's view of revenue risk ranges in the table and chart above, but we expect the company to reconsider whether its exposure to revenue variation is as wide as it suggests, given the PR19 methodology.

We expect that the company will provide an updated view of RoRE risk ranges at P10/P90 confidence levels in light of our draft determination[3]. For this purpose, the company should apply its view on the interactions between individual ODI risks in arriving at an overall risk range for ODIs.

5.3. Financeability

We interpret our financing duty as a duty to secure that an efficient company can finance its functions, in particular by securing reasonable returns on its capital. In

[3] Calculated using the App26 rows on the F-Inputs tab of the draft determination financial model.

coming to our determinations we assess whether allowed revenues, relative to efficient costs, are sufficient for an efficient company to finance its investment on reasonable terms and to deliver activities in the long term, while protecting the interests of current and future customers.

Our final methodology required companies to provide Board assurance that the business plan was financeable on both the notional and the actual capital structures. Companies were required to provide evidence to support these statements, including evidence supporting the target credit rating and that this was supported by the financial ratios that underpin the plan. In our initial assessment of business plans, we assessed there was sufficient evidence to support the Severn Trent Water's Board assurance statement that the business plan is financeable.

We consider that companies and their shareholders should bear the risk of their capital structure and financing choices, not customers. Therefore, we have focused on whether our draft determination is financeable based on the notional capital structure that underpins our cost of capital using our own financial model. Our assessment uses a suite of financial metrics based on those used in the financial markets and by the credit rating agencies. Based on the financial ratios from the financial model alongside evidence in the business plan, we consider that Severn Trent Water's draft determination is financeable for the notional structure after the application of an adjustment to RCV run off rates.

In its plan, Severn Trent Water identified a financeability constraint for the notional structure, primarily in relation to the funds from operations/net debt (FFO/Net debt) ratio and proposed an uplift to RCV run off rates across all wholesale controls to address this. We have accepted this requirement to address the constraint.

In response to an action following the initial assessment of business plans, Severn Trent Water reduced the adjustment to RCV run off rates in relation to the wedge between CPIH and RPI. This resulted in a weaker FFO/Net debt ratio, to maintain financeability on a notional basis, we applied a further uplift to RCV run off rates for the water network plus in the draft determination as set out in section 4. The overall effect of these adjustments has been to reduce the amount of revenue related for RCV run off in the draft determination compared with the business plan.

The results for key financial ratios is set out below. Certain financial ratios for the notional company structure in our draft determination are lower than the ratios set out by Severn Trent Water in its business plan. However, we consider the ratios to be consistent with the draft determination being financeable for the notional structure.

Table 5.3: Financial ratios – notional structure before reconciliation adjustments (5 year average)

	Business plan	Draft determinations
Gearing	61.28%	60.04%
Interest cover	3.89	4.08
Adjusted cash interest cover ratio (ACICR)	1.56	1.48
Funds from operations (FFO)/Net debt	10.48%	10.02%
Dividend cover	1.40	1.42
Retained cash flow (RCF)/Net debt	7.84%	7.62%
Return on capital employed (RoCE)	5.49%	4.65%
The basis of the calculation of the ratios is set out in the PR19 methodology **Net debt** represents borrowings less cash and excludes any pension deficit liabilities. **FFO** is cash flow from operational activities and excludes movements in working capital. **Cash interest** excludes the indexation of index-linked debt.		

We have not amended PAYG rates. However, the application of our view of efficient costs has changed the weightings applied to the various wholesale controls resulting in a reduction in average PAYG rates. As set out in section 4 and above, Severn Trent Water amended RCV run off rates and we have intervened to reduce RCV run off rates overall compared with the proposals in the business plan. The reduction in expenditure means that the RCV will now increase slightly more than in the company's business plan.

Table 5.4: PAYG rates, RCV run off and RCV growth

	PAYG	RCV run off	RCV growth
Company plan	58.7%	5.0%	0.7%
Draft determinations	58.2%	5.0%	3.4%

Note: PAYG and RCV run off rates are weighted averages across all wholesale controls across 2020-25, calculated in 2017-18 prices

5.4. Affordability and probable bill profile

Severn Trent Water undertook two pieces of customer acceptability research, testing a bill reduction of reduction of 3% and 5% (or £20 in the average bill). The company's research shows that 85% of customers found the 5% reduction in bills acceptable. The profiles tested were higher than those in the business plan and those resulting from our draft determinations. However, the percentage reduction it proposed over the 2020 to 2025 period remains constant with its testing.

In its business plan the company states that that 87% of those surveyed prefer for a smaller bill reduction between 2020 and 2025 and a more stable bill profile over time. The bill profile put forward in the company's business plan provides an immediate reduction at the start of the 2020 to 2025 period, followed by three years of bills slightly above this level, before it drops again at the end of this period. Severn Trent Water's CCG is satisfied that affordability considerations have been effectively integrated into customer engagement, stating 'We are pleased to see that, after robust acceptability testing research, 85% of customers find the bills implied by the plan acceptable'..

Severn Trent Water's bill profile in its original business plan put forward a 5% bill cut for the 2020 to 2025 period, our amended profile keeps this reduction around the same level. The table below sets out the difference in bill profile between the company's business plan submission in September 2018 and our amended draft determination profile. We have made amendments to the profile to ensure it remains constant throughout the 2020 to 2025 period.

Table 5.5: Bills in real terms

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Company plan	£343	£326	£331	£333	£331	£325
Bill profile – before re-profiling	£343	£328	£329	£327	£325	£323
Draft determinations	£343	£327	£327	£327	£327	£327

In its business plan, Severn Trent Water sets out its intention to keep bills broadly flat in the 2025-30 period. The company's research indicated this is in line with customers' preference, as they wanted smaller bill cuts in the short term in return for a more stable long-term profile.

Table 5.6: Long term bills

	2020-25	2025-30
Company view of plan	329	337

5.5. Help for customers who are struggling to pay

Our draft determinations for Severn Trent Water will cut average bills by 4.7% in real terms between 2020 and 2025.

In addition Severn Trent Water commits to:

- Nearly double the number of customers on its social tariff from 50,900 in 2019-20 to 97,750 by 2024-25. To help it meet this goal Severn Trent Water will increase its social tariff cross-subsidy from £3 to £8 per customer.
- Simplify the application process for its social tariff scheme and offer different levels of discount to customers in different circumstances to ensure that customers are receiving the right amount of support.
- Introduce two new initiatives: a debt write-off scheme for customers with large arrears and a payment breaks scheme.
- Through social tariffs, payment holidays and breaks and other schemes, the company aims to support 199,000 customers who struggle to pay in 2024-25, a 64,000 increase on the number it will support in 2019-20.

Severn Trent Water has two performance commitments on affordability which will require it to:

- improve customer views on value for money; and
- increase the proportion of customers who receive affordability support.

Companies will be reporting their performance against the Priority Services Register (PSR) common performance commitment (PC) and their bespoke affordability and vulnerability PCs to us and their customers on an annual basis during the price control period. In addition, companies put forward in their business plans further measures for addressing affordability and vulnerability issues. We expect companies to report periodically to their customers on their progress on addressing affordability and vulnerability concerns. We will also be considering how we will scrutinise and report on companies' progress in this important area, including working with other stakeholders in the water sector and beyond.

5.6. Total revenue allowances and k factors

Table 5.7 summarises the allowed revenue for each control. This is expressed in a 2017-18 CPIH price base so that this can be compared with the rest of this document.

Table 5.7: Allowed revenue by year (£ million, 2017-18 prices)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Water resources	74.9	77.5	77.9	79.7	83.5	**393.6**
Water network plus	643.1	645.1	634.7	638.1	650.4	**3,211.5**
Wastewater network plus	672.8	664.0	662.1	668.2	683.2	**3,350.4**
Bioresources	90.8	90.8	90.4	92.2	93.7	**457.9**
Residential retail	101.2	100.9	100.6	100.2	99.9	**502.8**
Total	**1,582.8**	**1,578.4**	**1,565.8**	**1,578.4**	**1,610.7**	**7,916.1**

The water resources, water network plus and wastewater network plus controls are in the form of a percentage limit (inflation plus or minus a number that we determine for each year of the control (the 'K' factor)) on the change in allowed revenue (R) from the previous charging year (t-1). This is based broadly on the formula:

$$R_t = R_{t-1} \times \left[1 + \frac{CPIH_t + K_t}{100}\right]$$

Table 5.8 sets out the K factors in each year for each of these three controls. For the first year, we have set a 'base' revenue which will be used as the starting revenue for calculating 2020-21 allowed revenues.

Table 5.8: Base Revenue and K factors by charging year (2017-18 prices)

	Base (£ million)	2020-21	2021-22	2022-23	2023-24	2024-25
Water resources	74.9	0.00%	3.55%	0.48%	2.28%	4.88%
Water network plus	643.1	0.00%	0.37%	-1.67%	0.52%	1.97%
Wastewater network plus	672.8	0.00%	-1.29%	-0.32%	0.91%	2.29%

In addition to these controls, we have set a modified average revenue control for bioresources. We recognise that a proportion of bioresources revenues are fixed, so it would be inappropriate to set an average revenue control which did not account for this. The revenue control ensures that where sludge production varies the incremental change in revenues that arises is aligned to incremental costs. Therefore, the 'modified average revenue' control includes a revenue adjustment factor, which applies if there are differences between the forecast and measured quantities of sludge.

Getting the alignment between incremental revenues and incremental costs right is key to ensuring that the company is correctly remunerated, if there is a difference between the sludge companies actually produce and what they had forecast. To ensure companies' allowed revenues reflect their costs, we are intervening to implement a standard approach across companies to this classification. We have set out our methodology and our reasons for intervening in the appendix 'Our methodology for the classification of bioresources costs'. Further details of how we have applied the methodology to Severn Trent Water is set out in the 'Bioresources revenue to remunerate fixed costs - Severn Trent Water' model.

Table 5.9 sets out our view of the share of revenue to remunerate fixed costs.

Table 5.9: Classification of proportion of revenue to remunerate fixed costs for bioresources

Bioresources revenue requirements to remunerate fixed costs in £ million 2017-18 FYA CPIH deflated prices (2020-2025)	Company view	Ofwat view based on company submitted data	Ofwat view based on draft determination
Total return on capital	N/A	76.2	81.9
Total run off	N/A	184.4	189.2
Revenue to service RCV	**N/A**	**260.5**	**271.2**
Local authority and Cumulo rates for both treatment and disposal	N/A	28.4	28.4
Fixed share of other direct costs of treatment and disposal	N/A	31.5	43.2
Fixed share of other indirect cost of treatment and disposal	N/A	14.0	19.2
Fixed PAYG revenue	**N/A**	**73.9**	**90.8**
Fixed share of revenue to cover tax	N/A	0.0	0.0
Pension deficit repair contributions	N/A	8.0	4.1
Other fixed costs	**N/A**	**8.0**	**4.1**
Revenue to remunerate fixed costs	**345.5**	**342.4**	**366.0**

The modified average revenue in each year is calculated by a formula that we set out in the 'Notification of the PR19 draft determination of Price Controls for Severn Trent Water Limited', which includes some components set now in this determination and some components which relate to out-turn performance (such as the actual volume of sludge in future years).

Table 5.10: Bioresources control

	2020-21	2021-22	2022-23	2023-24	2024-25	2020-25
Bioresources – total revenue (£ million)	90.8	90.8	90.4	92.2	93.7	**457.9**
Forecast volume of sludge (TDS)	237,477	238,240	239,273	239,925	240,978	**1,195,893**
Revenue to remunerate fixed costs (£ million)						**366.0**
Baseline average revenue per unit of sludge (£/TDS)						**382.9**

Note: baseline average revenue per unit of sludge assumes that the out-turn volume of sludge will be the same as the forecast.

6. Next steps

The procedural benefit of an early draft determination for fast-track companies is strengthened by early certainty on specified components of the draft determination related to outcomes and the cost allowance. These components are in the PR19 methodology and set out in Figure 6.1. Severn Trent Water has chosen to opt out of the early certainty principle for three specific performance commitments: supply interruptions, Water Quality Compliance (CRI), unplanned outages. The company has also chosen to opt out of the early certainty principle as it applies to deadbands on common performance commitments.

Early certainty does not apply to other components, including the cost of capital and retail margins. This allows us to make sure these are set at the efficient level for all companies in the final determinations.

Figure 6.1: Early certainty principle

We will not change our draft determination decision related to the company's own cost claims.

We will not change bespoke performance commitment levels.

We will not change financial incentives on performance commitments[4].

We will not change the number of financial ODIs.

We will not change the design of financial incentives in terms of deadbands, caps and collars. (Deadbands are levels of performance that do not lead to outperformance or underperformance payments. Caps and collars are limits on the maximum exposure by companies for their performance on one particular measure.)

We will publish Severn Trent Water's final determination in December 2019 after considering representations on the draft determination and other relevant matters.

[4] However, to protect customers, the early certainty principle will not apply if a company's outperformance payment or underperformance penalty rate was the highest or lowest, respectively, of all the companies. This is to protect customers against a company that has proposed ODI rates that are outliers compared to other companies.

Except where the early certainty principle applies the final determination may be different to the draft determination.

Table 6.1: Timelines and next steps for all companies

<table>
<tr><th>Company category</th><th>Next steps</th><th>Date</th></tr>
<tr><td>Fast-track companies</td><td>Fast-track companies’ representations on draft determinations.</td><td>10am on 24 May 2019</td></tr>
<tr><td rowspan="2">Slow-track companies</td><td>Slow-track and significant-scrutiny draft determinations to be published</td><td>7am on 18 July 2019</td></tr>
<tr><td>Slow-track and significant-scrutiny companies’ representations on draft determinations.</td><td>10am on 30 August 2019</td></tr>
<tr><td rowspan="2">All companies</td><td>Companies resubmit 2014 price review reconciliations to include 2018-19 actual data and updated forecasts for 2019-20</td><td>15 July 2019</td></tr>
<tr><td>Final determinations to be published.</td><td>7am on 11 December 2019</td></tr>
</table>