

April 2019

Trust in water

PR19 draft determinations: United Utilities draft determination

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About this document

This appendix sets out for consultation the details of the draft determination of price controls, service and incentive package for United Utilities 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 United Utilities to deliver;
- the allowed revenue that United Utilities 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: United Utilities - Cost efficiency draft determination appendix
- PR19 draft determinations: United Utilities - Outcomes performance commitment appendix
- PR19 draft determinations: United Utilities - Accounting for past delivery appendix
- PR19 draft determinations: United Utilities - Allowed revenue appendix

For all other documents related to the United Utilities 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.

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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 United Utilities' business plan showed it to be one of the best plans in the sector. Its plan included ambitious, innovative and sector-leading proposals to make customers' bills affordable and on providing support for vulnerable customers. It proposed sector-leading flexible payment plans for customers who are struggling to pay. It showed the most embedded innovation culture across all water companies. With innovation a core value linked to every employee's annual appraisal and bonus process.

We identified limited interventions to the plan to ensure customers' interests are protected, which United Utilities formally accepted. On 31 January 2019, we awarded United Utilities' 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 United Utilities, are reflected in this draft determination.

This early draft determination gives United Utilities the opportunity to accelerate the delivery of its plans so that customers and the environment get more of what matters sooner.

What the draft determination means for customer bills

Our draft determination for United Utilities will cut average bills by 11.1% in real terms in the 2020-25 period. Table 1.1 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 United Utilities, reflecting that the company has 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 | £427 | £394 | £392 | £386 | £383 | £382 |
| Draft determination | £427 | £378 | £378 | £378 | £378 | £378 |

What the draft determination will deliver

Our draft determination package includes a full set of performance commitments, specifying the level of service that United Utilities 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 sets out some of the key performance commitments for 2020-2025 and the overall incentive package; further details are in section 2.

Table 1.2: Key commitments for United Utilities

| Area | Measure |
|------------------------------------|--|
| Overall incentive package | Overall Outcome Delivery Incentive (ODI) package in our draft determination equates to a return on regulatory equity (RoRE) range of -2.3% (P10) to +1.0% (P90). |
| Key common performance commitments | <ul style="list-style-type: none"> • 20% reduction in annual level of leakage by 2025 from the 2020 level¹ • 5% reduction in per capita consumption by 2024-25 • 20% reduction in pollution incidents by 2024-25 • 73% reduction in internal sewer flooding incidents by 2024-25 • 75% reduction in supply interruptions by 2024-25 |
| Bespoke performance commitments | <ul style="list-style-type: none"> • 23% reduction in customer contacts about the taste, smell and appearance of their water by 2024-25 • 20% reduction in customers receiving low pressure by 2024-25 • 11% reduction in sewer blockages by 2024-25 • 22% reduction in external sewer flooding incidents by 2024-25 • 20% increase in the number of customers lifted out of water poverty through the company's financial assistance programmes by 2024-25 • 90% customer satisfaction for value for money 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.

United Utilities 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:

- applying the default gearing outperformance sharing mechanism we set out, although United Utilities proposes to maintain gearing levels below the 70% trigger threshold in 2020-25;
- spend £71 million of its own money on financial assistance schemes over 2020-25. It has committed that dividend distributions to shareholders which exceed the base dividend plus 2% of Return on Regulatory Equity (RoRE) will be matched

¹The company has committed to reduce its average annual leakage level by 20.3% from its 2019-20 level to its 2024-25 level. This is a different figure from the values in the 'United Utilities - Outcomes performance commitment appendix' because there the performance commitment is measured on a three-year average basis to smooth annual variations due to weather.

- by contributions to its CommUnity Share scheme which provides matching financial benefits for customers and communities in the North West; and
- dividend and performance related executive pay policies that are linked to delivery for customers.

We identified areas of United Utilities' 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) | 599.7 | 2,860.9 | 3,714.0 | 496.6 | 7,671.1 | 520.6 |

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. United Utilities' 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 United Utilities' draft determination is sufficient for an efficient company, with the notional capital structure, to access funds necessary to finance their activities on reasonable terms.

Summary of interventions

This draft determination includes limited interventions to United Utilities' business plans and agreed actions. The key interventions were to:

- increase the stretch on some key performance commitments and ensure financial incentives are aligned to customer interest;
- accept our view of efficient costs; and
- align the dividend policy for the notional structure to the allowed return and make an associated adjustment to pay as you go rates.

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. United Utilities has chosen to opt out of the early certainty principle.

We will publish United Utilities 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 (ODIs). 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. ODIs 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. Your Voice, United Utilities' CCG, considers that the company has developed a genuine understanding of its customers' priorities, needs and requirements, with their view on service improvement proposals for 2020-25 genuinely driving the development of the business plan. Customers broadly supported the proposed ODI framework.

United Utilities' performance commitments and outcome delivery incentives for the 2020-25 period are summarised in tables 2.1 (Common performance commitments) and 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 engagement 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 United Utilities agreed to a series of actions on its performance commitments and ODI package. These resulted in increases in the stretch on some key performance commitment targets (Reducing interruptions to water supply, Leakage, Per capita consumption, Mains repairs, Internal sewer flooding, Pollution incidents, External flooding incidents), a reduction of the potential outperformance payments or an increase of the potential underperformance payments on a number of material ODIs (including Reducing interruptions to water

supply, Leakage, Per capita consumption, Pollution incidents, Internal flooding incidents) and the removal of financial incentives from performance commitments that were not sufficiently well-justified (such as Keeping reservoirs resilient, Improving the water environment, Improving river water quality, and Streetworks performance).

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

- reducing the company's outperformance rates to the values proposed in its September business plan for Leakage, Mains repairs, Reducing interruptions to water supply, Per capita consumption, Internal flooding incidents, and External flooding incidents;
- increasing the company's standard and enhanced underperformance rates to the values proposed in its September business plan for Pollution incidents; and
- requiring the company to put in place a detailed process for assurance ahead of final determination in relation to the measurement of performance for the Enhancing natural capital value for customer's performance commitment.

We are also confirming a number of proposed interventions following our assessment of the further evidence provided by the company in February:

- amending the Per capita consumption performance commitment levels to deliver a 5% reduction by 2024-2025;
- amending the Mains repairs performance commitment levels to deliver a more stretching level of performance; and
- removing financial incentives from the Systems thinking capability performance commitment.

Table 2.1: Summary of performance commitments: common PCs

| Name of common performance commitment | Type of Outcome Delivery Incentive (ODI) | Price controls which ODIs will apply to |
|---|---|--|
| Water quality compliance (CRI) [PR19 U UW_A01-CF] | Financial – Under; In-period | Water resources; Water network plus |
| Water supply interruptions [PR19 U UW_B03-WN] | Financial - Out & under; In-period | Water network plus |
| Leakage [PR19 U UW_B01-WN] | Financial - Out & under; In-period | Water network plus |
| Per capita consumption [PR19 U UW_B05-WN] | Financial - Out & under; In-period | Water network plus |
| Mains repairs [PR19 U UW_B02-WN] | Financial - Out & under; In-period | Water network plus |
| Unplanned outage [PR19 U UW_B04-CF] | Financial – Under; In-period | Water resources; Water network plus |
| Risk of severe restrictions in a drought [PR19 U UW_B06-CF] | Reputational | NA |
| Priority services for customers in vulnerable circumstances [PR19 U UW_D03-HH] | Reputational | NA |
| Internal sewer flooding [PR19 U UW_G02-WWN] | Financial - Out & under; In-period | Wastewater network plus |
| Pollution incidents [PR19 U UW_C01-WWN] | Financial – Out & under; In-period | Wastewater network plus |
| Risk of sewer flooding in a storm [PR19 U UW_G01-WWN] | Reputational | NA |
| Sewer collapses [PR19 U UW_F01-WWN] | Financial - Under; In-period | Wastewater network plus |
| Treatment works compliance [PR19 U UW_C02-CF] | Financial – Under; In-period | Wastewater network plus |
| C-MeX: Customer measure of experience [PR19 U UW_D01-HH] | Financial - Out & under; In-period | Residential retail |
| D-Mex: Developer services measure of experience [PR19 U UW_D02-CF] | 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 water quality contacts due to taste, smell and appearance [PR19 U UW_A02-WN] | Financial – Out & under; In-period | Water network plus |
| Number of properties with lead risk reduced [PR19 U UW_A03-WN] | Financial - Out & under; In-period | Water network plus |
| Helping customers look after water in their home [PR19 U UW_A04-WN] | Financial - Out & under; In-period | Water network plus |
| Reducing discolouration from the Vyrnwy treated water aqueduct [PR19 U UW_A05-WN] | Financial – Out; In-period | Water network plus |
| Reducing areas of low water pressure [PR19 U UW_B07-WN] | Financial - Out & under; In-period | Water network plus |
| Water service resilience [PR19 U UW_B08-WN] | Financial - Out & under; In-period | Water network plus |
| Manchester and Pennine resilience [PR19 U UW_B09-DP] | TBC | TBC |
| Keeping reservoirs resilient [PR19 U UW_B10-WR] | Reputational | NA |
| Thirlmere transfer into West Cumbria (AMP7) [PR19 U UW_B11-WN] | Financial - Out & under; In-period | Water network plus |
| Abstraction incentive mechanism [PR19 U UW_C03-WR] | Financial - Out & under; In-period | Water resources |
| Improving the water environment [PR19 U UW_C04-WR] | Reputational | NA |
| Improving river water quality [PR19 U UW_C05-WWN] | Reputational | NA |
| Protecting the environment from the impact of growth and new development [PR19 U UW_C06-WWN] | Financial - Out & under; end of period | Wastewater network plus |
| Enhancing natural capital value for customers [PR19 U UW_C08-CF] | Financial - Out & under; In-period | Water resources, water network plus, wastewater network plus, bioresources |
| Recycling biosolids [PR19 U UW_C09-BR] | Financial - Out & under; In-period | Bioresources |

| Name of bespoke performance commitment | Type of Outcome Delivery Incentive (ODI) | Price controls ODIs will apply to |
|--|---|---|
| Better air quality [PR19 U UW_C10-BR] | Financial - Out & under; In-period | Bioresources |
| Street works performance [PR19 U UW_D04-CF] | Reputational | NA |
| Priority Services- BSI accreditation [PR19 U UW_D05-HH] | Reputational | NA |
| Number of customers lifted out of water poverty [PR19 U UW_E01-HH] | Financial - Out & under; In-period | Residential retail |
| Household occupancy verification [PR19 U UW_E02-HH] | Financial - Out & under; In-period | Residential retail |
| Non-household vacancy incentive scheme [PR19 U UW_E03-CF] | Financial – Out; In-period | Water network plus, wastewater network plus |
| Gap sites (Wholesale) [PR19 U UW_E04-CF] | Financial – Out; In-period | Water network plus, wastewater network plus |
| Gap sites (Retail) [PR19 U UW_E05-HH] | Financial – Out; In-period | Residential retail |
| Systems thinking capability [PR19 U UW_E06-CF] | Reputational | NA |
| Successful delivery of direct procurement of Manchester and Pennine resilience [PR19 U UW_E07-DP] | TBC | TBC |
| Strategic regional solution development (Severn Thames transfer) [PR19 U UW_E08-WR] | TBC | TBC |
| Customers say that we offer value for money [PR19 U UW_E09-HH] | Reputational | NA |
| Sewer blockages [PR19 U UW_F02-WWN] | Financial - Out & under; In-period | Wastewater network plus |
| External flooding Incidents [PR19 U UW_G03-WWN] | Financial - Out & under; In-period | Wastewater network plus |
| Raising customer awareness to reduce the risk of flooding [PR19 U UW_G04-WWN] | Financial - Out & under; In-period | Wastewater network plus |
| Hydraulic internal flood risk resilience [PR19 U UW_G05-WWN] | Financial - Out & under; In-period | Wastewater network plus |
| Hydraulic external flood risk resilience [PR19 U UW_G06-WWN] | Financial - Out & under; In-period | Wastewater network plus |

The 'United Utilities - 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 2.2 below provide an indication of the financial value of each of United Utilities' 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 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)

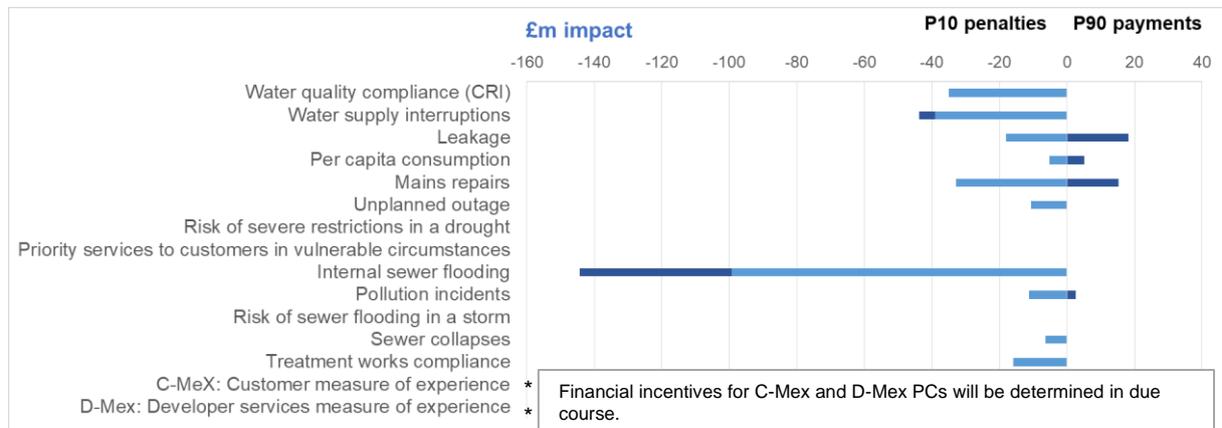


Figure 2.2: Projected P10 penalties and P90 payments for bespoke performance commitments over 2020-25 (£ million)

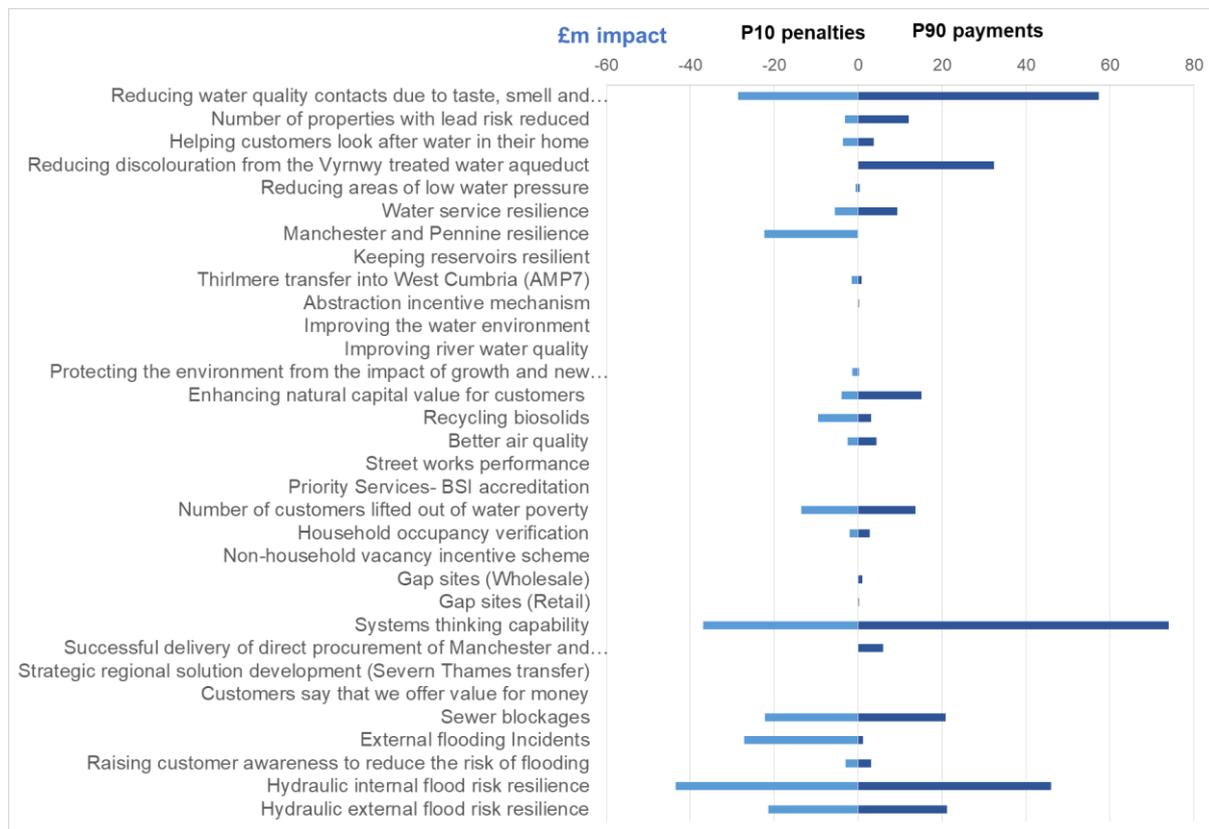


Table 2.3: Impact of draft determination Interventions on RoRE range

| | Sep 2018 business plan | | Draft determination | |
|------------------|-------------------------------|------------|-------------------------------|------------|
| | % of 5 year regulatory equity | | % of 5 year regulatory equity | |
| United Utilities | p10 | p90 | p10 | P90 |
| | -1.9% | 2.0% | -2.3% | 1.0% |

We said in the PR19 methodology that we expect companies to propose approaches to protecting customers in case their ODI 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 ODI payment caps and collars across a number of its material common and bespoke performance commitments, including wastewater

(pollution incidents, sewer blockages, hydraulic internal flood risk resilience) and water (mains repairs, water service resilience, reducing water quality contacts due to taste, smell and appearance).

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.

As part of our IAP assessment, we asked United Utilities to provide a revised proposal by 1 April on their Manchester direct procurement (DPC) resilience scheme. We also asked the company to propose ODI mechanisms to allow allocated funding to be recovered by customers in the event of its strategic regional solution development (Severn Thames transfer) scheme not progressing and for the non or late delivery of outputs.

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. United Utilities submitted a plan for 2020-25 that is broadly efficient in water resources, network plus water, bioresources and residential retail. However, its proposed expenditure in network plus wastewater was over 7% less efficient than our view of costs. We challenged United Utilities' 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 controls. 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 Totex¹ (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 | 72.2 | 74.6 | 74.9 | 83.6 | 100.9 | 406.0 |
| Water network plus | 460.3 | 430.3 | 422.5 | 391.5 | 372.3 | 2,076.9 |
| Wastewater network plus | 440.2 | 467.0 | 427.3 | 600.8 | 532.4 | 2,467.6 |
| Bioresources ² | 77.9 | 80.3 | 75.6 | 70.7 | 72.9 | 377.5 |
| Total | 1,050.5 | 1,052.2 | 1,000.3 | 1,146.5 | 1,078.5 | 5,328.0 |

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 is driven by factors such as population growth, new statutory obligations and improvements in areas important to customers. In addition, we allow costs for the development of a regional strategic solutions to address long-term water resource provision. For United Utilities the allowance relates specifically to schemes to transfer water from the River Severn to the River Thames, in collaboration with both Severn Trent Water and Thames Water. This investment will be linked to gated project deliverables and ODIs to ensure that customers are protected if the project does not progress through every gate.

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 'United Utilities - 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 | 356.7 | 1,786.3 | 1,633.2 | 368.8 | 4,145.1 |
| Enhancement expenditure | 23.6 | 284.1 | 832.9 | 0.0 | 1,140.6 |
| Water resources regional strategic solution development expenditure | 25.7 | | | | |
| Third party costs | 0.0 | 6.4 | 1.5 | 8.7 | 16.7 |
| Total – excluding pension deficit recovery | 406.0 | 2,076.9 | 2,467.6 | 377.5 | 5,328.0 |
| Pensions deficit recovery costs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | 406.0 | 2,076.9 | 2,467.6 | 377.5 | 5,328.0 |

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

The following sections provide more information on base and enhancement expenditure.

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, costs relating to the Traffic Management Act and the Industrial Emissions Directive.

Our approach to setting an efficiency challenge to modelled base costs is set out 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 | 2,078.6 | 71.7 | -7.3 | 2,143.0 |
| Wholesale wastewater | 2,205.5 | -177.4 | -26.1 | 2,002.0 |
| Total | 4,284.1 | -105.7 | -33.4 | 4,145.1 |

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 our initial

assessment of business plans '[Technical Appendix 2: Securing cost efficiency](#)'. Table 3.4 summarises our allowances. The 'United Utilities – Cost efficiency draft determination appendix' gives the most significant areas of disallowance, however, our allowance should be considered 'in the round' rather than focusing solely on a particular area.

United Utilities propose a large 'direct procurement for customers' scheme to deliver significant improvement to resilience of Manchester water supplies. We welcome the direct procurement for customer proposals, however, ongoing work is required on the scheme before approval. We will continue to progress our assessment of the scheme outside of the fast-track process, given the significance of the issues.

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

| Service | Company requested capex | Cost efficiency adjustment | Our allowance |
|----------------------|-------------------------|----------------------------|---------------|
| Wholesale water | 382.6 | -74.9 | 307.7 |
| Wholesale wastewater | 864.6 | -31.7 | 832.9 |
| Total | 1,247.2 | -106.6 | 1,140.6 |

3.4. Cost sharing

Our totex allowance is a reference for the application of cost sharing. When a company overruns its totex allowance, the additional cost 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 costs.

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) | 406.0 | 2,084.8 | 2,466.1 |
| Grants and contributions | 0.0 | 178.2 | 94.2 |
| Net totex (subject to cost sharing) | 406.0 | 1,906.6 | 2,371.9 |

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

Table 3.7 sets out expenditure allowed under the transition programme. 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 costs 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.

Table 3.7: Summary of wholesale water and wastewater requested and allowed transitional capex expenditure 2019-20, (£ million, out-turn nominal).

| | Company requested expenditure | Our allowed expenditure | Rationale |
|----------------------|--------------------------------------|--------------------------------|--|
| Wholesale water | 19.579 | 19.579 | We allow the expenditure to progress the development of the Manchester & Pennines Resilience scheme to support the management of the associated risks. |
| Wholesale wastewater | 10.184 | 9.409 | We allow the expenditure for an early start on WINEP schemes. We do not allow the investment under the line 'Maintaining the long term capability of the assets ~ non-infra' as the need for it was not clearly evidenced. |

3.6. Residential retail

We determine the residential retail control from the expenditure set out in Table 3.8.

Table 3.8 Expenditure, residential retail, 2020-25 (£ million, nominal)

| | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 | Total |
|--------------------|----------------|----------------|----------------|----------------|----------------|--------------|
| Residential retail | 102.7 | 102.7 | 102.7 | 102.7 | 102.7 | 513.4 |

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.

- Grants and contributions – this is an allowance for the income from connection and infrastructure charges.
- Other price control income – this is an allowance for revenue that is included in the price control but is not covered by wholesale 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 United Utilities' 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 for wholesale controls (£ million)

| | Water resources | Water network plus | Wastewater network plus | Bioresources | Total |
|--|------------------------|---------------------------|--------------------------------|---------------------|----------------|
| Pay as you go | 349.8 | 1,445.5 | 1,119.4 | 214.3 | 3,129.0 |
| RCV run-off | 125.4 | 794.9 | 1,487.9 | 201.7 | 2,609.9 |
| Return on capital | 107.2 | 437.1 | 957.3 | 62.4 | 1,564.0 |
| Revenue adjustments for PR14 reconciliations | 0.8 | -7.1 | -2.4 | 0.0 | -8.8 |
| Fast-track reward | 0.0 | 14.3 | 0.0 | 0.0 | 14.3 |
| Tax | 17.0 | 60.8 | 95.6 | 18.0 | 191.4 |
| Grants and contributions (price control) | 0.0 | 114.0 | 56.0 | 0.0 | 170.0 |
| Other income (price control) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Deduct other income (non-price control) | -0.8 | -9.5 | -1.5 | 0.0 | -11.8 |
| Revenue re-profiling | 0.3 | 10.8 | 1.7 | 0.2 | 13.0 |
| Final allowed revenues | 599.7 | 2,860.9 | 3,714.0 | 496.6 | 7,671.1 |

We set out the calculation of allowed revenue for each wholesale control on an annual basis in the 'United Utilities: 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 United Utilities 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) | 8,322.7 |
| Proportion of wholesale revenue allocated to residential (%) | 69.09% |
| Residential retail costs (£ million) | 513.4 |
| Total retail costs (£ million) | 6,263.3 |
| Residential retail net margin (%) | 1.00% |
| Residential retail net margin (£ million) | 63.3 |
| Residential retail adjustments (£ million) | 0.7 |
| Residential retail revenue (£ million) | 577.4 |

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 'United Utilities: Allowed revenue appendix' in tables 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.

United Utilities 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 |
|---|-----------------|--------------------|-------------------------|--------------|
| Totex allowance (£ million) | 406.0 | 1898.7 | 2373.4 | 377.5 |
| Pay as you go totex (£ million) | 86% | 76% | 47% | 57% |
| Pension deficit recovery cost (£ million) | 0.0 | 0.0 | 0.0 | 0.0 |
| Total pay as you go (£ million) | 349.8 | 1,445.5 | 1,119.4 | 214.3 |

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 'United Utilities: Allowed revenue appendix' in tables 2.1 to 2.4.

United Utilities' approach to PAYG rates is to recover in each year an amount equivalent to operating costs. We accept the approach taken by the company and have intervened to amend the PAYG rates proposed in the business plan to reflect our view of the mix of operating and capital expenditure compared with the business plan.

United Utilities proposed an adjustment in its September 2018 business plan to increase PAYG rates for all years for all controls to address a financeability constraint for the notional company. In response to our required action, United Utilities amended the dividend yield for the notional company and has identified that a smaller adjustment is required to PAYG rates to address the financeability constraint. We have accepted the evidence supporting the adjustment and have applied the smaller uplift to our draft determination.

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 (%) | 86.6% | 71.0% | 49.3% | 57.3% |
| Draft determination (%) | 86.2% | 76.1% | 47.2% | 56.8% |

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

Opening RCV adjustments

As part of the business plan United Utilities proposed allocations of the RCV for both Water Resources and Bioresources price controls.

United Utilities has maintained that a 14% allocation is appropriate for Water Resources. We remain concerned about the implications of a low RCV allocation to the potential for Water Resources trading. To promote confidence in the development of a Water Resources market we are making an intervention. We are proposing to intervene to increase United Utilities' RCV allocation for water resources to 20%. The allocation is similar to other companies operating in the north of England with similar characteristics (that is, significant long life, high value

reservoir assets and aqueducts). No interventions have been for Bioresource allocation.

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 | 3,957.4 | | 7,273.2 | |
| % of RCV allocated by control | 20.00% | 80.00% | 93.94% | 6.06% |
| RCV – 31 March 2020 | 791.5 | 3,165.9 | 6,832.5 | 440.7 |
| Midnight adjustments to RCV | 3.6 | 14.9 | 21.2 | 0.0 |
| Opening RCV – 1 April 2020 | 795.0 | 3,180.7 | 6,853.7 | 440.7 |

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. United Utilities’ 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. Tables 4.6 and 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 | 397.5 | 1,590.4 | 3,426.8 | 220.3 | 5,635.1 |
| CPIH inflated RCV | 397.5 | 1,590.4 | 3,426.8 | 220.3 | 5635.1 |
| Other adjustments | | - | - | | |
| Total RCV | 795.0 | 3,180.7 | 6,853.7 | 440.7 | 11,270.2 |

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 | 352.6 | 1,284.7 | 2,874.3 | 144.5 | 4,656.1 |
| CPIH inflated RCV | 337.3 | 1,228.8 | 2,749.3 | 138.2 | 4,453.5 |
| Post 2020 investment | 52.8 | 390.4 | 1,137.7 | 127.9 | 1,708.8 |
| Other adjustments | | - | - | | - |
| Total RCV | 742.7 | 2,903.9 | 6,761.3 | 410.5 | 10,818.4 |

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 | 43.2 | 165.5 | 362.0 | 20.9 | 591.6 |
| CPIH inflated RCV | 60.6 | 232.0 | 507.4 | 29.4 | 829.4 |
| Post 2020 investment | 3.4 | 39.6 | 87.9 | 12.0 | 143.0 |
| Other adjustments | | - | - | | - |
| Total return on capital | 107.2 | 437.1 | 957.3 | 62.4 | 1,564.0 |

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 RCV balances and the return on capital for each year of the price control for each wholesale control are shown in the 'United Utilities: 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 | 60.2 | 361.6 | 677.6 | 82.2 | 1,181.6 |
| CPIH inflated RCV | 61.7 | 370.6 | 694.0 | 84.2 | 1,210.5 |
| Post 2020 investment | 3.4 | 62.8 | 116.3 | 35.3 | 217.8 |
| Total RCV run off | 125.4 | 794.9 | 1,487.9 | 201.7 | 2,609.9 |

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).

United Utilities' RCV run-off rates are set to be consistent with the economic utilisation of assets for each wholesale control based on the company's forecast of current cost depreciation. We have accepted United Utilities' RCV run-off rates for the draft determination. 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 (%) | 3.23% | 5.02% | 4.31% | 8.90% |
| Draft determination (%) | 3.23% | 5.02% | 4.31% | 8.90% |

Note: RCV run off (%) reflects the unweighted 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 'United Utilities: 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 2010-15 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. ‘United Utilities - 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. ‘United Utilities - 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 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.

Table 4.11: Reconciliation of PR14 incentives, interventions

| Incentive | Intervention(s) |
|---|--|
| Outcome delivery incentives (ODIs) | <p>We are intervening as the company does not follow the stated definition for the A2 customer experience programme outcome delivery incentive. We are including an adjustment of - £1.029 million (2012-13 prices) which results in an overall penalty of - £4.738 million in 2019-20 for 'Net performance payment / (penalty) applied to revenue for end of period ODI adjustments ~ Retail (household) in 2012-13 prices.' This replaces the figure of - £3.709 million (2012-13 prices) contained in the company's business plan in September 2018.</p> <p>We are intervening because we are unable to reconcile the company's outcome delivery incentive calculation for B6: Thirlmere transfer into West Cumbria due to how company performance is rounded. We are including an adjustment of £0.408 million (2012-13 prices) which results in an overall payment of £19.792 million in 2019-20 for 'Net performance payment / (penalty) applied to revenue for end of period ODI adjustments ~ Wholesale water in 2012-13 prices.' This replaces the figure of £19.384 million (2012-13 prices) contained in the company's business plan in September 2018.</p> |
| Residential retail revenue | We are intervening to round the company's modification factor figures to two decimal places to ensure consistency with the PR14 Reconciliation Rulebook. |
| Wholesale revenue forecasting incentive mechanism | No intervention required. |
| Totex | No intervention 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. |
| Service Incentive Mechanism (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 (ODIs) | 35.2 | 35.2 | -27.8 | -28.5 |
| Residential retail revenue | N/A | N/A | 6.0 | 6.0 |
| Wholesale revenue forecasting incentive mechanism | N/A | N/A | 0.0 | 0.0 |
| Totex | 83.4 | 83.4 | 46.3 | 46.3 |
| Land sales | -6.6 | -6.7 | N/A | N/A |
| Service Incentive Mechanism (SIM) | N/A | N/A | 11.4 | N/A |
| PR09 blind year adjustments | -126.8 | 126.8 | -23.6 | -23.6 |
| Water trading | N/A | N/A | N/A | N/A |
| Total | -14.8 | -14.9 | 12.4 | 0.2 |
| Total post profiling | N/A | N/A | 13.2 | 0.3 |

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); 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 | 0.0 | 14.3 | 0.0 | 0.0 | 14.3 |
| Tax | 17.0 | 60.8 | 95.6 | 18.0 | 191.4 |
| Grants and contributions (price control) | 0.0 | 114.0 | 56.0 | 0.0 | 170.0 |
| Other income (price control) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Deduct other income (non-price control) | -0.8 | -9.5 | -1.5 | 0.0 | -11.8 |

Fast-track reward

We are allowing United Utilities 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. United Utilities requested that this reward is attributed as an additional revenue adjustment to the water network plus control.

Taxation

We calculate a tax allowance reflecting the corporation tax that companies expect 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.

United Utilities 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. We have accepted the 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 United Utilities 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 United Utilities 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 and wastewater new developments 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, United Utilities forecast that, for water new developments, that the grants and contributions would be negative. This was due to the impact of the 'income offset' which was calculated as more than exceeding the infrastructure charges 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. For new connections the United Utilities forecast is lower than our view as they state that they are not allowed to recover certain overhead amounts in the charges. We do not agree that this is the case and so have applied the industry rate of 100%. On wastewater our assumed rate of 100% is slightly higher than United Utilities' forecast.

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

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.

United Utilities' approach to other income includes an element representing losses on the disposal of fixed assets. In our determinations, we ensure that assets are funded when they are purchased and so it is not appropriate to provide further additional funding on disposal. We are intervening to amend the forecast 'other income' to adjust the forecast to exclude the impact of losses on the disposal of fixed assets.

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. United Utilities has not proposed any uncertainty mechanisms in its business plan.

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 United Utilities' 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 United Utilities' proposals is in Table 5.1.

Table 5.1 Our assessment of United Utilities' proposals to balance the interests of customers

| Issue | Our assessment |
|--|--|
| Gearing outperformance benefit sharing | United Utilities' September 2018 business plan 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 | United Utilities has committed to spend £71 million of its own money on financial assistance schemes over 2020-25. It has committed that dividend distributions to shareholders which exceed the base dividend plus 2% of RoRE will be matched by contributions to its CommUnity Share scheme which provides matching financial benefits for customers and communities in the North West. Allocations from the CommUnity Share scheme will be made in consultation with customers and shareholders, overseen by the CCG. |

| Issue | Our assessment |
|--|---|
| Dividend policy for 2020-25 | <p>United Utilities' 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, assuming gearing in the range 60-70%. Further distributions of dividends up to 2% of RoRE may be made, reflecting past and current outperformance. For any payments beyond this level the company will match the payment with contributions to the CommUnity Share initiative. It has confirmed that when setting dividend payments, the company's Board will apply ten core principles to ensure that dividend payments take account of the company's overall delivery for customers.</p> <p>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.</p> |
| Performance related executive pay policy for 2020-25 | <p>United Utilities has stated it is committed to meet the expectations set out in our 'putting the sector in balance' position statement:</p> <ul style="list-style-type: none"> • The company has confirmed it is carrying out a review of the annual bonus arrangements, with an expectation that there will continue to be at least a 60% weighting linked to delivery for customers. • The company is in consultation with shareholders to increase the weighting of customer focused performance in its long term incentive plan. It proposes a 50% weighting on customer measures including customer measures (CMeX/DMeX), resilience measures and performance against specific ODIs and a 50% weighting on RoRE (which focuses performance across a range of areas such as totex, customer ODIs and financing). Shareholder approval at an annual general meeting would be required to implement this change. • The United Utilities Remuneration Committee will oversee the policy and is constituted entirely of independent non-executive directors. In addition, the committee is required under its terms of reference to ensure that performance elements of executive pay are "transparent, stretching and rigorously applied". • Executive pay policies and practices will be disclosed in the annual report and financial statement and annual performance report. <p>We understand that there remain a number of details to be finalised, for example the exact structure and weightings of the metrics within the annual bonus scheme, approval of the long term incentive with shareholders and the basis on which targets will be set. The proposed policy if approved, demonstrates the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance'</p> <p>We expect United Utilities to demonstrate that its policy on performance related executive pay demonstrates a link to stretching performance delivery for customers through 2020-25. We expect the company to be transparent about further updates to the development of its policy that will apply in 2020-25.</p> |
| Financial resilience | <p>United Utilities' Board has provided assurance that the company's September 2018 business plan is financeable, having considered the</p> |

| Issue | Our assessment |
|-------|---|
| | <p>results of financial risk scenario analysis. The analysis included stress testing of key financial ratios and was supported by third party reviews. United Utilities is targeting gearing levels close to our notional level of 60% for 2020-25. In response to our required action, the company has committed to assess its financial resilience beyond 2025 in its next long term viability statement.</p> |

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 values².

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 United Utilities 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 United Utilities' PR19 business plan submission, and the values in our determination. The RoRE ranges for United Utilities are illustrated in Figure 5.1. The updated base RoRE value for our draft determination includes the 10 basis points reward for the company achieving fast-track status. United Utilities has requested that the reward be attributed as an additional revenue adjustment to the water network plus control.

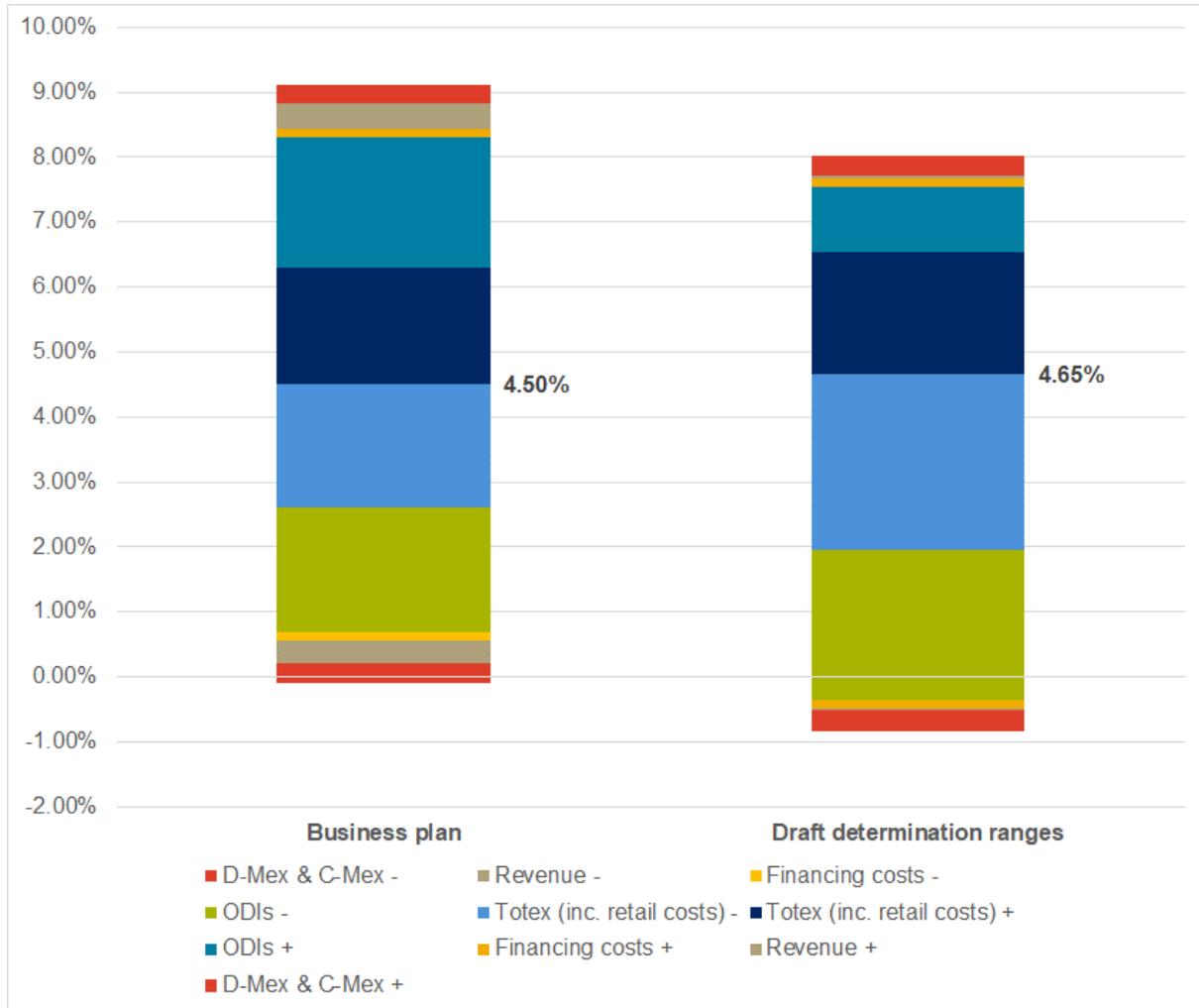
² Values that the company considers would not be exceeded 90% of the time.

Table 5.2: Annual average RoRE risk ranges

| | Business plan | | Draft determination ranges | |
|--------------------|----------------------|--------------------|-----------------------------------|--------------------|
| Base RoRE | 4.50 | | 4.65 ¹ | |
| Risk ranges | Lower bound | Upper bound | Lower bound | Upper bound |
| Totex | -1.56 | 1.46 | -2.38 | 1.51 |
| ODIs | -1.90 | 2.00 | -2.30 | 1.00 |
| Financing costs | -0.14 | 0.14 | -0.14 | 0.14 |
| Retail costs | -0.34 | 0.34 | -0.32 | 0.37 |
| D-Mex & C-Mex | -0.32 | 0.29 | -0.32 | 0.29 |
| Revenues | -0.34 | 0.38 | -0.02 | 0.05 |
| Total | -4.60 | 4.61 | 5.58 | 3.67 |

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. In response to our initial assessment of its plan, United Utilities revised its view of revenue risk, suggesting that revenue risk applies only to the biosresources and retail price controls. This is reflected in our draft determination RoRE range.

The totex RoRE range in our draft determination reflects United Utilities' revised view of out / under performance in its response to our required actions. In practice, the regulatory regime strongly incentivises United Utilities to seek cost efficiencies, and so the actual outturn performance of the company will be strongly influenced by factors that are within the company's control in 2020-25.

We expect that the company will provide an updated view of RoRE risk ranges at P10/P90 confidence levels in light of our draft determination³. For this purpose, the

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

company should take 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 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 their 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 United Utilities' 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 United Utilities' draft determination is financeable for the notional structure after the application of an adjustment to PAYG rates.

As set out in section 4, United Utilities identified a financeability constraint for the notional structure, primarily in relation to the funds from operations/net debt ratio and has proposed an uplift to PAYG rates across all wholesale controls to address this. In response to our required action for the company to amend its assumed dividend yield for the notional structure, United Utilities reduced its proposed PAYG adjustment. We have accepted this revised PAYG adjustment to address the constraint and have applied the same uplift in the draft determination.

The results for key financial ratios is set out below. The financial ratios for the notional company structure in our draft determination are broadly consistent with the ratios set out by United Utilities in its business plan.

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

| | Business plan | Draft determinations |
|---|---------------|----------------------|
| Gearing | 59.85% | 58.89% |
| Interest cover | 4.01 | 4.05 |
| Adjusted cash interest cover ratio (ACICR) | 1.55 | 1.54 |
| Funds from operations (FFO)/Net debt | 9.73% | 9.81% |
| Dividend cover | 0.96 | 1.00 |
| Retained cash flow (RCF)/Net debt | 6.30% | 6.66% |
| Return on capital employed (RoCE) | 4.62% | 4.34% |
| <p>The basis of the calculation of the ratios is set out in the PR19 methodology</p> <p>Net debt represents borrowings less cash and excludes any pension deficit liabilities.</p> <p>FFO is cash flow from operational activities and excludes movements in working capital.</p> <p>Cash interest excludes the indexation of index-linked debt.</p> | | |

As set out in section 4 we have amended PAYG rates to reflect our view of efficient total expenditure and therefore the mix of operating and capital expenditure. This has increased average PAYG rates compared to the company's September 2018 business plan. The increase is partially offset by the reduction in the PAYG uplift to address the financeability constraint.

We have not amended RCV run off rates. However, the allocation of a higher proportion of opening RCV to water resources has resulted in a lower average RCV run off rate shown in Table 5.4. This is because the water resources control has a lower run off rate than the water network plus control. The reduction in expenditure means that the RCV will now decline 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 | 60.7% | 4.7% | -2.4% |
| Draft determinations | 61.9% | 4.6% | -4.0% |

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

United Utilities undertook acceptability testing for 2020 - 25 by providing customers with two bill options (Plan A and Plan B). Plan A proposals tested average household bills of £451 (£10 greater than final business plan proposals as a result of including the full bill impact of the Manchester and Pennines Resilience project in bills for the 2020 to 2025 period, which will now be realised in the 2025 to 2030 period). Plan B contained £20 lesser bill reductions and less ambitious service improvements. Plan B received overall customer acceptability of 76% (compared with 82% for Plan A). The bill profile in the September business plan was set between the two tested bill options.

In its business plan, the company states that most customers would like bills to be as stable and predictable as possible and that their preferred bill profile therefore drops at the start of the period and then stabilises. In line with this, the real terms bill profile in the business plan provides an immediate reduction at the start of the period, followed by small year-on-year reductions. United Utilities' CCG confirms that the company's bill profile reflects what customers want, stating 'research indicated that customers value stable, predictable bills, with a clear majority (86%) expressing a preference for bills with smaller year-on-year changes compared with bills that may be smaller in the short term but present greater volatility over the longer term'.

United Utilities' bill profile in its September business plan put forward a 11% bill cut for the 2020 to 2025 period. Our amended profile reduction 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 minor adjustments to make the nominal profile flat over the period.

Table 5.5: Bills in real terms

| | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 |
|------------------------------------|---------|---------|---------|---------|---------|---------|
| Company plan | £427 | £394 | £392 | £386 | £383 | £382 |
| Bill profile – before re-profiling | £427 | £384 | £382 | £380 | £373 | £372 |
| Draft determinations | £427 | £378 | £378 | £378 | £378 | £378 |

In its business plan, the company sets out that bills will increase by 3.8% in the 2025-30 period. The company undertook some qualitative research aimed at establishing how customers wanted bills to move over the long-term, which

established that customers preferred stable and predictable bills with small year-on-year changes.

Table 5.6: Long term bills

| | 2020-25 | 2025-30 |
|----------------------|---------|---------|
| Company view of plan | 387 | 394 |

5.5. Help for customers who are struggling to pay

Our draft determinations for United Utilities will cut average bills by 11.1% in real terms between 2020 and 2025.

In addition, United Utilities commits to:

- provide financial assistance to 152,000 customers by 2024-25 to alleviate affordability issues. To help it meet this goal United Utilities will increase its social tariff cross-subsidy to £1.60 per customer and it will also spend £71m of company funding on schemes to help customers who need financial support.
- increase the flexibility and accessibility of its payment break offer;
- continue its innovative Town Action Planning approach which engages hard-to-reach customers on its affordability schemes; and
- expand its 'Lowest Bill Guarantee' scheme, whereby customers who may experience affordability difficulties when switching to a water meter are guaranteed to be billed the lowest of their old unmetered charge or their new metered charge for two years after switching.

United Utilities has two performance commitments on affordability which will require it to:

- improve customer views on value for money; and
- increase the number of customers lifted out of water poverty every year.

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 | 113.1 | 114.6 | 116.6 | 123.9 | 131.5 | 599.7 |
| Water network plus | 567.6 | 578.0 | 580.8 | 570.1 | 564.4 | 2,860.9 |
| Wastewater network plus | 736.8 | 731.9 | 737.2 | 749.4 | 758.7 | 3,714.0 |
| Bioresources | 94.3 | 96.2 | 98.7 | 102.6 | 104.8 | 496.6 |
| Residential retail | 104.5 | 104.5 | 103.9 | 103.7 | 103.9 | 520.6 |
| Total | 1,616.3 | 1,625.2 | 1,637.2 | 1,649.8 | 1,663.2 | 8,191.7 |

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:

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

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 | 113.6 | 0.00% | 1.45% | 1.73% | 6.33% | 6.28% |
| Water network plus | 569.0 | 0.00% | 1.92% | 0.45% | -1.89% | -1.03% |
| Wastewater network plus | 734.0 | 0.00% | -0.65% | 0.71% | 1.66% | 1.26% |

In addition to these controls, we have set a modified average revenue control for biorevenues. We recognise that a proportion of biorevenues 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 biorevenues costs'. Further details of how we have applied the methodology to United Utilities is set out in the 'Biorevenues revenue to remunerate fixed costs - United Utilities' 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 | 62.1 | 62.4 |
| Total run off | N/A | 198.2 | 201.7 |
| Revenue to service RCV | N/A | 260.2 | 264.0 |
| Local authority and Cumulo rates for both treatment and disposal | N/A | 35.4 | 35.4 |
| Fixed share of other direct costs of treatment and disposal | N/A | 33.0 | 33.2 |
| Fixed share of other indirect cost of treatment and disposal | N/A | 19.6 | 19.7 |
| Fixed PAYG revenue | N/A | 88.0 | 88.2 |
| Fixed share of revenue to cover tax | N/A | 0.0 | 0.0 |
| Pension deficit repair contributions | N/A | 0.0 | 0.0 |
| Other fixed costs | N/A | 0.0 | 0.0 |
| Revenue to remunerate fixed costs | 239.9 | 348.2 | 352.3 |

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 United Utilities Water Limited' which includes some components set now in this determination and other 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) | - | - | - | - | - | 496.6 |
| Forecast volume of sludge (TDS) | 195,962 | 197,394 | 199,216 | 201,746 | 205,079 | 999,397 |
| Revenue to remunerate fixed costs (£ million) | | | | | | 352.3 |
| Baseline average revenue per unit of sludge (£/TDS) | | | | | | 496.9 |

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. United Utilities have chosen to opt out of the early certainty principle entirely.

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 commitments⁴.

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 United Utilities' final determination in December 2019 after considering representations on the draft determination and other relevant matters. The final determination may be different to the draft determination.

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.

Table 6.1: Timelines and next steps for all companies

| Company category | Next steps | Date |
|----------------------|---|-------------------------|
| Fast-track companies | Fast-track companies' representations on draft determinations | 10am on 24 May 2019 |
| Slow-track companies | Slow-track and significant-scrutiny draft determinations to be published | 7am on 18 July 2019 |
| | Slow-track and significant-scrutiny companies' representations on draft determinations | 10am on 30 August 2019 |
| All companies | Companies resubmit 2014 price review reconciliations to include 2018-19 actual data and updated forecasts for 2019-20 | 15 July 2019 |
| | Final determinations to be published | 7am on 11 December 2019 |

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