

April 2019

Trust in water

**PR19 draft determinations:
Severn Trent Water – Cost efficiency
draft determination appendix**

PR19 draft determinations: Severn Trent Water - Cost efficiency draft determination appendix

1. Wholesale water activities

1.1 Enhancement

The tables below summarises the adjustments we made to the level of enhancement capex for the water resources and network plus water price controls. Specific areas of material disallowance, including investment considered to be within our base allowance, are shown. Table 1 does not include the £25.7m allowed to develop strategic water resource schemes.

Table 1: Material disallowances of enhancement costs for the water resources price control 2020-25 (£ million of 2017-18)

| Area of enhancement | Company requested capex | Our allowance |
|--|-------------------------|---------------|
| Total for all enhancement capex | 54.3 | 41.0 |
| Material areas of disallowance in enhancement capex (£ million) | | |
| Security and Emergency Measures Direction (SEMD) | | -10.0 |
| Supply-Demand schemes | | -1.4 |
| Resilience | | -0.4 |

Table 2: Material disallowances of enhancement costs for the water network plus price control 2020-25 (£ million of 2017-18)

| Area of enhancement | Company requested capex | Our allowance |
|--|-------------------------|---------------|
| Total for all enhancement capex | 758.5 | 470.7 |
| Material areas of disallowance in enhancement capex (£ million) | | |
| New developments and new connections | | -126.7 |
| Security and Emergency Measures Direction (SEMD) | | -55.3 |
| Supply-Demand schemes | | -43.6 |
| Resilience | | -27.8 |

2. Wholesale wastewater activities

2.1 Enhancement

The tables below summarise the adjustments we made to the level of enhancement capex for the network plus wastewater and bioresources price controls. Specific areas of material disallowance, including investment considered to be within our base allowance, are shown.

Table 3: Material disallowances of enhancement costs for the wastewater network plus price control 2020-25 (£ million of 2017-18)

| Area of enhancement | Company requested capex | Our allowance |
|--|-------------------------|---------------|
| Total for all enhancement capex | 748.6 | 709.6 |
| Material areas of disallowance in enhancement capex (£ million) | | |
| NEP Discharge relocation | | -18.1 |
| Non-WINEP Investigations into CSOs to inform AMP 8 WFD | | -10.0 |
| Reservoirs Act (1975) legislative requirements | | -8.0 |

Table 4: Material disallowances of enhancement costs for the bioresources price control 2020-25 (£ million of 2017-18)

| Area of enhancement | Company requested capex | Our allowance |
|--|-------------------------|---------------|
| Total for all enhancement capex | 23.9 | 0.0 |
| Material areas of disallowance in enhancement capex (£ million) | | |
| Sludge enhancement (quality) | | -4.4 |
| Sludge enhancement (growth) | | -19.5 |

3. Cost adjustment claims

Table 5 summaries our consideration and allowances for the cost adjustment claims submitted by the company. These claims cover both base and enhancement expenditure for the wholesale water and wholesale wastewater services.

Table 5: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million of 2017-18)

| Description of Claim | Value of company claim | Our allowed adjustment | Rationale for decision |
|--|------------------------|------------------------|--|
| Wastewater - Quality enhancement | 398.6 | - | We have made an allowance for this under our assessment of enhancement. No further adjustment is made as a cost adjustment claim as the company does not evidence any unique factors to support their claim. |
| Water Supply Demand - WFD environmental investigations and mitigations | 84.1 | - | We have made an allowance for this under our assessment of enhancement. No further adjustment is made as a cost adjustment claim as the company does not evidence any unique factors to support their claim. |
| Energy price increases | 185.0 | - | The claim fails to provide evidence that the CPIH indexation is not sufficient to cover for future energy inflation or that Severn Trent is uniquely impacted by such inflation. |
| Water Supply Demand Balance - New supply schemes | 218.2 | - | We have made an allowance for this under our assessment of enhancement. No further adjustment is made as a cost adjustment claim as the company does not evidence any unique factors to support their claim. |
| Water - Resilience | 135.4 | - | We have made an allowance for this under our assessment of enhancement. No further adjustment is made as a cost adjustment claim as the company does not evidence any unique factors to support their claim. |
| Water - Security | 67.0 | - | The company does not evidence any unique factors to support an |

| Description of Claim | Value of company claim | Our allowed adjustment | Rationale for decision |
|--|------------------------|------------------------|--|
| | | | adjustment to our assessment of enhancement. They are bound by the same legislation as all companies. |
| Water treatment works (WTWs) economies of scale | 0 | - | The cost of this claim in the business plan tables is zero. |
| Developer services costs | 258.0 | - | We did not accept this claim as the company did not sufficiently evidence that their costs were different from other companies. |
| Sewage treatment works (STWs) economies of scale | 72.0 | - | We account for economies of scale in our assessment of this area. The claim did not present cost drivers that were more robust than those currently used. |
| Waste water treatment complexity | 55.0 | - | We account for wastewater treatment complexity in our assessment of this area. The claim proposed alternative/additional cost drivers. We did not accept this claim as the alternative models prove to be as robust as our current models. |
| Total for all claims | 1,473.4 | - | |

4. WINEP uncertainty mechanism

Our totex allowance to companies includes an allowance for environmental obligations set out in the Water Industry National Environment Programme (WINEP). Some of the requirements in WINEP are not expected to be confirmed until December 2021 at the earliest, after we make our final determinations in December 2019. Unconfirmed requirements in WINEP are known as 'amber' schemes.

We will use a unit cost mechanism to make adjustments if schemes for which an allowance is made in our determination are confirmed as not required. Similarly, we will use a unit cost mechanism to make adjustments if other schemes in the WINEP but for which no allowance has been made in our determination are subsequently confirmed as being required.

The tables below set out the unit costs on which such adjustments will be made at the end of the control period for each type of scheme in SVE's WINEP programme. Our adjustments are based on the company's capex estimate.

Table 6a: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP wastewater schemes included in our draft determination (£ million of 2017-18)

| Scheme type | 'Amber' schemes included in business plan | Company's capex estimate | Benefit points | Company's proposed unit cost (capex / point) | Our allowed unit cost (capex / point) |
|--|---|--------------------------|----------------|--|---------------------------------------|
| Storage schemes in the network to reduce spill frequency at CSOs | 23 | 15.3 | 7 | n/a | 2.2 |
| Chemicals removal schemes | 2 | 4.0 | 2 | n/a | 1.7 |
| Nutrients (P removal at activated sludge STWs) | 78 | 74.0 | 28.3 | n/a | 1.4 |
| Nutrients (P removal at filter bed STWs) | | 77.6 | 80.8 | n/a | |
| Reduction of sanitary parameters | 18 | 32.5 | 17 | n/a | 1.9 |

Table 6b: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP wastewater schemes included in our draft determination (£ million of 2017-18)

| Scheme type | 'Amber' schemes included in business plan | Company's capex estimate | Benefit points | Company's proposed unit cost (capex / point) | Our allowed unit cost (capex / point) |
|--|---|--------------------------|----------------|--|---------------------------------------|
| Making ecological improvements at abstractions | 1 | 0.9 | 0 | - | 1.6 |
| WFD measures | 53 | 14.3 | 0 | - | |
| Improvements to river flows | 87 | 14.2 | 17 | 0.8 | |

Table 6c: WINEP uncertainty mechanism – unit cost adjustments for unconfirmed WINEP schemes excluded from our draft determination (£ million of 2017-18)

| Scheme type | 'Amber' schemes excluded from business plan | Company's capex estimate | Benefit points | Company's proposed unit cost (capex / point) | Our allowed unit cost (capex / point) |
|--|---|--------------------------|----------------|--|---------------------------------------|
| Storage schemes in the network to reduce spill frequency at CSOs | 18 | 13.3 | 3 | 1.4 | 4.4 |
| Chemicals removal schemes | 2 | 0.4 | 2 | | 0.2 |
| Nutrients (P removal at activated sludge STWs) | 57 | 43.4 | 19 | | 1.3 |
| Nutrients (P removal at filter bed STWs) | | 58.0 | 60 | | |
| Reduction of sanitary parameters | 3 | 6.0 | 1 | | 6.0 |

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

April 2019

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gsi.gov.uk.

