

April 2019

Trust in water

PR19 draft determinations: Severn Trent Water – Securing cost efficiency actions and interventions

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Following our initial assessment of plans, we categorised two types of actions for fast-track companies:

- agreed actions that fast-track companies committed to implement to ensure that their plans meet the threshold for fast-track status; and
- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery).

Table 1 below sets out the agreed and required actions, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix 'SVE' denotes the company Severn Trent Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key of these acronyms. Actions whose numbers are preceded with an 'A' denote agreed or required actions.

Table 2 below sets out any further interventions that are not resulting from an action, which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix 'SVE' denotes the company Severn Trent Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key of these acronyms. Intervention numbers are preceded with a 'C'.

For all other documents related to the Severn Trent Water draft determination, please see the [draft determinations webpage](#).

Table 1: Severn Trent Water's response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing cost efficiency	SVE.CE.A1	Agreed	Company should remove proposed outcome delivery incentive 'Water trading interconnector'. This outcome delivery incentive proposal now overlaps with the strategic regional solution development allocation which requires its own set of outcome delivery incentives.	10am, 11 February 2019	SVE is proposing to remove this performance commitment as set out in SVE.OC.A34 - Delivering Outcomes for Customers.	No intervention required.	N/A
	SVE.CE.A2	Agreed	Strategic regional solution development - we have identified from the plans that at least one strategic supply solution is required over the next 5-15 years to secure drought resilience in the south-east. The strategic regional solution development allocation is	N/A	The company accepts the action.	No intervention required at this stage. The company has committed to provide the information for review by 1 April, and due to the collaborative element of	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			<p>to allow the delivery of consistent and transparent investigations, planning and development of strategic options with the overall aim of optimum solutions being construction ready by 2025. The company's allocation is made on the basis of having clear deliverables and customer protection for the gated delivery of the development of the River Severn-River Thames transfer scheme. The following actions are required to ensure the efficient delivery of this programme:</p> <ul style="list-style-type: none"> • In conjunction with the other companies involved, jointly propose methods for collaborative working including setting up the joint working group for individual schemes, and how consistent assumptions and decisions will be made within these groups and between them. • Provide more detail on the gated process, the deliverables, timings and expenditure allocations at each gate <p>Propose ODI-type mechanisms to allow allocated funding to be recovered by customers in the event of the scheme not progressing through each gate and for the non-delivery or late delivery of outputs.</p>			this action will align to the slow track determination deadlines.	
	SVE.CE.A3	Agreed	For actions on cost efficiency thresholds, see data table below.	10am, 11 February 2019	SVE accepts the outcome of our view of efficient costs at the initial assessment stage.	No intervention required.	N/A
	SVE.CE.A4	Agreed	Real Options as applied to uncertain WINEP schemes - In principle we consider your Real Options mechanism proposals for excluded WFD schemes, based on a cost per 'benefit point' to be acceptable. However, we require	10am, 11 February 2019	Clarity on which of the 389 Amber schemes listed in the company's WINEP and on the other points raised was provided in the response received on 11	The information provided in the various responses and the further understanding gained in a meeting on 22 March 2019 will enable us	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			clarity on exactly which of the 389 Amber schemes listed in your company's WINEP3 have been excluded from your business plan and how your proposals apply to non-WFD exclusions (if any), in respect of which 'benefit points' would not seem to be relevant (eg schemes with UWWTD drivers). In order to form a view on the reasonableness of the proposed unit cost of £1.42m per benefit point (and whether a different rate should be adopted for included Amber schemes for which the need is not eventually confirmed), we also need to know: i) how much expenditure on Amber schemes has been included in tables WS2 and WWS2 (and to which capex and opex lines it has been allocated), ii) the benefit points associated with the expenditure allocated to each line, and iii) to which lines in tables WS2 and WWS2 the £121m of excluded expenditure would have been allocated had it not been excluded from your plan.		February 2019 and, in response to a follow-up query, in a corrigendum dated 18 February 2019. A related further query on the company's proposed cost adjustment mechanism and the methodology for the calculation of benefit points was responded to on 28 March 2019.	to operate the unit cost adjustment mechanism for uncertain WINEP schemes, if required. No intervention required.	

Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
SVE.CE.C1	<p>We consider that the proportion of developer services expenditure that is assumed recoverable from developers should be the same across all companies unless there is specific evidence in the company business plans to the contrary.</p> <p>Water</p> <p>New developments: Company business plan forecasts suggest an industry average recovery rate for new developments of 48%. Six companies (including all 3 fast track companies) are forecasting a negative infrastructure charge as the income offset is greater in absolute terms than the infrastructure charge. In 2020 new charging rules for developer services (England only) mean that the income offset is now applied to the infrastructure charge. We said in Charging Rules for New Connection Services (December 2018) that in the transition to the new charges regime, that companies should take reasonable steps to ensure that the existing balance of charges between</p>	<p>We propose to intervene to use our forecast of the proportion of developer services expenditure that is assumed recoverable from developers:</p> <p>Water</p> <p>New developments: 66%</p> <p>New connections: 75%</p> <p>Diversions: 100%</p> <p>Wastewater</p> <p>New developments: 100%</p>

	<p>developers and other customers prior to the implementation of the new rules should be broadly maintained.</p> <p>For the purposes of determining an appropriate industry position, we have capped the amount of income offset such that it cannot exceed the infrastructure charge for the 6 companies referred to above. This is because we do not recognise this as being consistent with the balance of charges under the pre-2020 regime. This gives a revised average rate of 66% which we have applied.</p> <p>New connections: We expect recovery rates for new connections to be close to 100%. SVE state that they will offer a discount to developers install water efficient fittings. We agree this is a sound argument for applying a recovery rate of less than 100% and for them we will allow their forecast 75%.</p> <p>Diversions:</p> <p>Our expectation is that diversion activities are fully recoverable by companies. We will apply a 100% assumption for diversions recovery rates.</p> <p>Wastewater</p> <p>New developments: Our expectation, based on previous price reviews, is that recovery rates for wastewater should be close to 100%. Of the 11 WaSCs, 8 state that they will recover 100%, including Severn Trent. We therefore assume a recovery rate of 100%.</p> <p>Diversions: Our expectation is that diversion activities are fully recoverable by companies. We will apply a 100% assumption for diversions recovery rates.</p>	Diversions: 100%
SVE.CE.C2	<p>Our adjustments to base and enhancement expenditure will impact operating and capital expenditure differently. We therefore propose to adjust the opex and capex split in each control to reflect the adjustments agreed with the company to base and enhancement expenditure in each control. In base expenditure, we retain the opex and capex expenditure splits provided by the company in its submission. We assume all enhancement expenditure we allow is capex expenditure.</p>	We are intervening to adjust the opex/capex split in each control to reflect the adjustments we have agreed with companies to base and enhancement expenditure.
SVE.CE.C3	<p>Our adjustments will impact different programmes within totex differently. The five-year profile of expenditure provided in the company submission by Severn Trent Water is reasonable and therefore we propose to profile our totex allowance over the five-year period based on this profile.</p>	We are intervening to apply Severn Trent Water's five-year totex profile to our totex allowance.

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

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