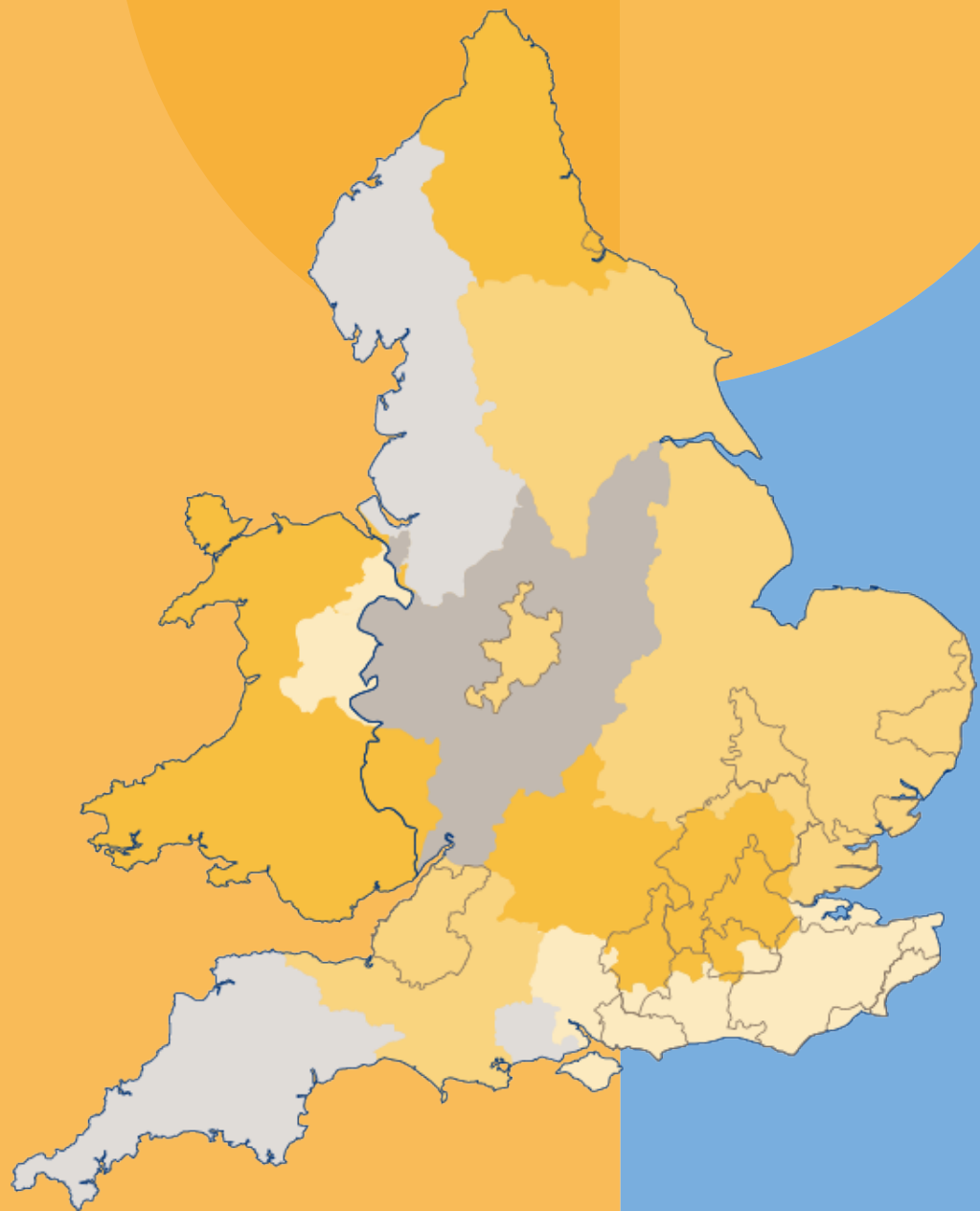


PR19 draft determinations

Notification of the PR19 draft determination of Price Controls for Bristol Water



1 Notification of the draft determination of price controls for Bristol Water plc

1.1 About this document

Every five years we set the price, service and incentive package for monopoly water companies. This document sets out for consultation the draft determination of the formal price controls for Bristol Water plc (**Bristol Water**) which will apply over the 2020 to 2025 period.

This first section provides an introduction to how the price controls will operate. The rest of the document is structured as follows:

- our proposed approach to the designation of activities to be included in the water resources and retail controls;
- the draft price control for network plus water activities;
- the draft price control for water resources activities;
- the draft price control for residential retail activities;
- the proposed assumptions on notified items and land sales;
- the proposed performance commitments that could lead to changes in the price controls during the 2020 to 2025 period to reflect the water company's performance; and
- the proposed revenue forecasting incentive (RFI) formula that we intend to apply, subject to a proposed licence modification.

This document has been published on our website. We are also publishing information on our general approach and the reasons for our draft decisions. For all other documents relating to the Bristol Water draft determination please see the [draft determinations webpage](#).

1.2 Background

The 2019 price review (PR19) will set out the price, service and incentive package that will apply to monopoly water companies for the 2020 to 2025 period. In the PR19 methodology we consulted on our approach to setting price controls, building on the work that we had undertaken as part of the Water2020 programme. Our approach to setting price controls as part of PR19 reflects a number of changes from the approach taken at the 2014 price review (PR14). These include:

- determining separate wholesale controls for water resources and network plus water activities;

- the change in the measure of inflation used to index controls, replacing the retail price index (RPI) with the consumer price index including owner occupiers' housing costs (CPIH);
- a move to more in-period rather than end of period outcome delivery incentives (ODIs); and
- replacing the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) with the RFI.

We summarise our general approach to the key elements below.

1.2.1 Designation of activities

We need to designate the activities that are included in the new water resources price control. Our designation of activities follows the approach we set out in the PR19 Methodology. Where appropriate, we cross-refer to updated definitions in our Regulatory Accounting Guidelines (RAGs) that we provide to companies.

We are not proposing any change to the designation of retail activities. The definition of these activities would therefore remain the same as it was for PR14.

1.2.2 Form of control

In our PR19 methodology we set out the form that each control would take. In the formal price controls below we have included in-period adjustments¹ which would apply automatically. We have excluded in-period adjustments made through in-period determinations i.e. in-period ODIs.

Below, we set out the some of the specific considerations for each control.

Network plus activities: For network plus activities the form of control is determined in licence condition B (Charges). Allowed revenue changes each year in line with inflation, CPIH, and a factor we determine, 'K'. Due to the constraints of the condition, further potential adjustments to the level of these controls (e.g. to accommodate the RFI and blind year adjustments) are addressed separately.

Water resources: We have structured the control in the same way as for network plus activities. In our PR19 methodology we set out the adjustment mechanism for changes to water companies' allowed revenue once the bilateral market opens. Adjustments will be based on the difference between forecast and actual bilateral market entry, but will only be made if a company invests in new water resource

¹ End-of-period adjustments are not included because, by definition, allowed revenues would be adjusted at the end of the price control period.

capacity after 1 April 2020. For Bristol Water we have not included this adjustment mechanism as there is no relevant new water resources capacity.

Residential retail: The residential retail control is an average revenue control. Allowed revenue is adjusted to reflect the difference between actual and forecast customer numbers. Our control does not distinguish between classes of customer, reflecting our assessment of companies' costs.

Revenue forecasting incentive: In our PR19 methodology document we said that we would introduce the RFI to apply a revenue correction adjustment and a financial incentive to each charging year's recovered revenue for the network plus and water resources controls. The draft RFI formula is set out in Appendix 3. We are proposing a licence modification to make sure that such in-period adjustments are allowed during the 2020 to 2025 period and future price control periods. This will be equivalent to the licence modification we made for most companies in 2016 to implement the WRFIM in the current price control period.

Notified Items: Our draft determination includes a proposed notified item stating that we have not allowed for a change (whether an increase or decrease) to the charges for water supplied to it from the Gloucester and Sharpness Canal under the agreement between Bristol Water and Canal & River Trust. This would allow price controls to be changed during the 2020 to 2025 period through an interim determination if any changes were material for the purposes of Condition B (either alone or together with other relevant items). Additional information on the proposed notified item is set out in the draft determination summary document for Bristol Water.

1.2.3 Outcomes

We can change the level of price controls during the 2020 to 2025 period to reflect performance commitments, provided those performance commitments are notified to the company by 31 December 2019.

The PR19 methodology encourages companies to make more of their performance commitments subject to in-period assessment of ODIs rather than end-of-period. In Appendix 2 we set out for consultation the company's performance commitments which have in-period financial ODIs along with the price controls to which they apply.

In relation to common performance commitments with financial ODIs, companies have put forward a variety of proposed allocations across price controls. We accept that there may be good reasons for these differences and at this stage we have accepted the proposed allocations. We will consider further whether this is an appropriate approach for slow track and significant scrutiny draft determinations in July and for final determinations for all companies in December.

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 the initial assessment of business plans [Technical appendix 1: Delivering outcomes for customers \(January 2019\)](#) 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 accepted our standard sharing mechanism, where 50% of outperformance payments that exceed 3% of return on regulatory equity (RoRE) in any year are shared with customers through bill reductions in the following year. It also proposes to limit customer bill changes from outcome delivery incentives to £4 per year to manage bill volatility. We accept this proposal. We are undertaking further work on the detail of the mechanism and the process for annual reconciliation. We will publish our final decisions on these aspects of the mechanism (including how it will affect the in-period assessment of ODIs) as part of the final determinations in December 2019.

As well as the performance commitments set out in Appendix 2, we also propose to include in our final notification the company's existing performance commitments that cover 2019-20 and have financial ODIs. This will allow us to adjust price controls during the 2020 to 2025 period (instead of waiting until the 2024 price review) to reflect any differences between the assumptions about 2019-20 performance we use when setting the 2020 to 2025 price controls and actual 2019-20 performance. We are not publishing these performance commitments at the draft determination stage because they have already been published as part of the PR14 final determinations and will not be changing. Because any such adjustments would relate to performance in the current (2015 to 2020) price control period, they will not be covered by the above mechanism to protect customers from higher than expected outperformance payments in relation to the 2020 to 2025 period.

2 Notification by the Water Services Regulation Authority of the draft determination of Price Controls for Bristol Water plc

This document sets out for consultation the draft determination by the Water Services Regulation Authority (“Ofwat”) of the Price Controls for Retail Activities, Network Plus Water Activities and Water Resources Activities.

The final determination of the Price Controls will be made by Ofwat in December 2019 in accordance with Part III of Condition B (Charges) of your Appointment as a water undertaker:

- after having had regard to all the circumstances which are relevant in the light of the principles which apply by virtue of Part I of the Water Industry Act 1991 in relation to Ofwat’s determinations, including, without limitation, any change in circumstance which has occurred since the last Periodic Review or which is to occur; and
- in accordance with the statement setting out strategic priorities and objectives for Ofwat published by the Secretary of State for Environment, Food and Rural Affairs.

The Price Controls, when they take effect, will all apply for the five consecutive Charging Years starting on 1 April 2020.

Unless the contrary intention appears, words and expressions used in this document shall have the same meaning as in the Conditions of the Appointment. Common terms used in the formulae in this document are defined in the Glossary set out in Appendix 4.

2.1 Designation of activities

The sets of activities that Ofwat proposes will be covered by the relevant Price Controls are set out below.

2.1.1 Network Plus Water Activities

All activities carried out by the Appointee in performance of its functions as a water undertaker that are not designated as Water Resources Activities or Retail Activities will be Network Plus Water Activities.

2.1.2 Water Resources Activities

Ofwat proposes to designate as Water Resources Activities under sub-paragraph 8.9 of Condition B the activities carried out as part of the Appointed Business that fall within the definitions of the following services in [RAG 4.08 – Guideline for the table definitions in the annual performance report](#) (March 2019)²:

- Water resources – Abstraction licences; and
- Water resources – Raw water abstraction.

2.1.3 Retail Activities

Ofwat does not propose to change the activities that are currently designated as Retail Activities.

2.1.4 Wholesale activities not covered by wholesale price controls

The Price Controls in respect of Water Resources Activities and Network Plus Water Activities will not apply to those activities for which there are Excluded Charges. Excluded Charges (as defined in Condition B) include:

- charges for a supply of water in bulk to another water undertaker;
- amounts payable in respect of an unmeasured supply of water by means of stand-pipes or water tanks and in respect of the erection or maintenance of stand-pipes or water tanks;
- charges for a supply of water provided by the Appointee under section 59 (Supplies for other public purposes) of the Water Industry Act 1991;
- charges for unmeasured supplies of water to cattle troughs;
- charges for unmeasured building water supplies;
- amounts payable in respect of an unmeasured supply of water by means of bowsers or water tankers;
- charges for unmeasured supplies of water to farm taps and other agricultural water points; and
- amounts payable under any such agreement as is described in section 20(1)(b) of the Water Resources Act 1991; and
- charges payable under any agreement for any unmeasured supply of water which are calculated by reference to the rateable value of hereditaments, occupied by the person to whom the supply or services are provided, fixed in

² Condition B sets the envelope of what activities can be designated as Water Resources Activities by reference to RAG 4.06, but Ofwat intends to actually designate Water Resources Activities in December 2019 by reference to the most recent version.

accordance with section 32, 33 or, as the case may be, 34 of the General Rate Act 1967 or, as the case may be, fixed in accordance with section 54 of the Local Government Finance Act 1988.

As part of the draft determination we are also consulting on whether the list of Excluded Charges for the purposes of Condition B should include amounts payable in relation to diversions other than those required by section 185 of the Water Industry Act 1991. This change would require agreement between Ofwat and the Appointee for the purposes of the definition of “Excluded Charges” in paragraph 2 of Condition B. In its response to the draft determination, the Appointee should therefore indicate whether or not it would be prepared to agree to this and whether it has any comments on the following proposed definition:

“In relation to the period from 1 April 2020 to 31 March 2025, amounts payable in relation to the alteration or removal of any relevant pipe (as defined in section 158 of the Water Industry Act 1991) or other apparatus that the Appointee is required to carry out under the New Roads and Streets Works Act 1991 or any other statutory provision except section 185 of the Water Industry Act 1991.”

2.2 Price Controls for Network Plus Water Activities

In respect of the Appointed Business’s Network Plus Water Activities, except those activities for which there are Excluded Charges, there will be one single Price Control in respect of the Appointed Business’s Network Plus Water Activities.

Such Price Control will consist of in each Charging Year:

- the percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for the immediately preceding November; and
- a number, “**K**”, which may be a positive number or a negative number or zero

which together shall be expressed as a percentage, and which shall limit the change in the revenue allowed to the Appointed Business in each Charging Year in respect of the Network Plus Water Activities concerned.

For each Charging Year starting on or after 1 April 2021 the revenue allowed to the Appointed Business in respect of the Network Plus Water Activities concerned will be the product of the following formula:

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

For the Charging Year starting on 1 April 2020 the revenue allowed to the Appointed Business in respect of the Network Plus Water Activities concerned is the product of the same formula except that R_{t-1} = the relevant revenue allowance (as set out below). This is because (as the form of Price Controls has since changed) at the last Periodic Review no revenue allowance in respect of Network Plus Water Activities was set for the Charging Year that started on 1 April 2019.

In respect of the Appointed Business's Network Plus Water Activities, the starting point for the calculation of the change in the revenue allowed to the Appointed Business in the Charging Year starting on 1 April 2020 (the revenue allowance for Network Plus Water Activities) is **£80.023** million, which shall constitute the value of R_{t-1} in respect of that Charging Year.

The "K" numbers for each Charging Year are set out in Table 1.

Table 1: Price Control for Network Plus Water Activities "K" numbers

Charging Year beginning 1 April	2020-21	2021-22	2022-23	2023-24	2024-25
K number	0.00	1.30	1.03	1.41	1.19

2.3 Price Control for Water Resources Activities

The Price Control shall consist of, in each Charging Year:

- the percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for the immediately preceding November; and
- a number, "K", which may be a positive number or a negative number or zero

which together shall be expressed as a percentage, and which shall limit the change in the revenue allowed to the Appointed Business in each Charging Year.

For each Charging Year starting on or after 1 April 2021 the revenue allowed to the Appointed Business in respect of the Water Resources Activities concerned will be the product of the following formula:

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

For the Charging Year starting on 1 April 2020 the revenue allowed to the Appointed Business in respect of Water Resources Activities is the product of the same formula except that R_{t-1} = the relevant revenue allowance (as set out below). This is because (as the form of Price Controls has since changed) at the last Periodic Review no revenue allowance in respect of Water Resources Activities was set for the Charging Year that started on 1 April 2019.

In respect of the Appointed Business’s Water Resources Activities, the starting point for the calculation of the change in the revenue allowed to the Appointed Business in the Charging Year starting on 1 April 2020 (the revenue allowance for Water Resources Activities) is **£16.910** million, which shall constitute the value of R_{t-1} in respect of that Charging Year.

The “**K**” numbers for each Charging Year are set out in Table 3.

Table 3: Price Control for Water Resources Activities “K” numbers

Charging Year beginning 1 April	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025
K number	0.00	1.82	2.54	2.32	1.59

Note:

There is no Table 2 in this draft determination. This is a deliberate omission that is intended to ensure consistency in Table numbers between different companies.

2.4 Price Control for Residential Retail Activities

In respect of the Appointed Businesses' Retail Activities, Ofwat proposes to set one single Price Control for the Appointed Business's Retail Activities relating to the supply of water to household premises (as defined in section 17C of the Water Industry Act 1991) ("**Residential Retail Activities**").

The Price Control for Residential Retail Activities:

- shall consist of a limit on the total revenue allowed to the Appointed Business in each Charging Year in respect of the Retail Activities concerned; and
- is set for a period of five consecutive Charging Years starting on 1 April 2020.

The total unadjusted revenue, **TR**, allowed to the Appointed Business in each Charging Year in respect of Residential Retail Activities shall be the relevant amount set out in Table 6 as modified in accordance with the following formula:

$$R_t = TR_t + (AC_t - FC_t) \times M_t \times 1000$$

Where:

TR_t Total Revenue The total unadjusted allowed revenue expressed in outturn prices as set out in table 6;

AC_t Actual Customers Actual customer numbers (meaning the average number of individual household premises (as defined in section 17C of the Water Industry Act 1991) supplied or served by the Appointed Business in a Charging Year) expressed in thousands;

FC_t Forecast Customers. Forecast customer numbers set out in table 6;

M_t Modification Factor. The modification factors expressed in outturn prices set out in table 6.

Table 6: Price Control for Residential Retail Activities numbers

Charging year beginning 1 April	2020-21	2021-22	2022-23	2023-24	2024-25	2020-25
TR (£million, outturn)	10.993	11.024	11.056	11.089	11.122	-
M (£, outturn)	21.636	21.447	21.282	21.127	20.980	-
FC (thousands)	508.069	514.020	519.486	524.860	530.110	-

Note:

There is no Table 4 and no Table 5 in this draft determination. This is a deliberate omission that is intended to ensure consistency in Table numbers between different companies.

2.5 Demonstrating Compliance with the Price Controls

The Appointee shall provide such information as Ofwat may reasonably require in relation to annual regulatory reporting to demonstrate how the Appointee is complying, or has complied, with its obligation to levy charges in a way best calculated to comply with each Price Control applicable to it.

Appendix 1: Notified Items and Land Sales

Notified Items

Ofwat proposes to give notice that the following item has not been allowed for at all when making the final determination of Price Controls:

Charges for water abstracted from the Gloucester and Sharpness Canal

Any change (whether an increase or decrease) to the Annual Charge and the Volumetric Charge for a supply of water from the Gloucester and Sharpness Canal under the Agreement that is payable by the Appointee to Canal & River Trust (“**CRT**”):

- (a) in relation to Charging Years beginning on or after 1 April 2020; and
- (b) as a result of the Review of CRT Charges.

Definitions

Words and expressions used in this Notified Item have the same meaning as in the Conditions of the Appointment, unless the contrary intention appears. In addition, the following words have the following meaning for the purposes of this Notified Item:

“**Agreement**” means the agreement dated 10 July 2000 between CRT and the Appointee for the supply of untreated water from the Gloucester and Sharpness Canal together with the associated agreement between CRT and the company dated 28 November 2007;

“**Annual Charge**” means the annual charge in pounds referred to in clause 5.1 of the Agreement;

“**Appointment**” means the appointment of the Appointee as a water undertaker for the purposes of Chapter I of Part II of the Water Industry Act 1991;

“**Charging Year**” has the meaning given in Condition A of the Appointment;

“**Notified Item**” has the meaning given in paragraph 12.1 of Condition B of the Appointment;

“**Review of CRT Charges**” means the review of the annual and volumetric charges payable by the Appointee under clause 5 of the Agreement with effect from 1 April 2018 that has been called for by CRT under the process set out in clause 16 of the Agreement; and

“**Volumetric Charge**” means the charge in pounds per megalitre referred to in clause 5.2 of the Agreement.

Additional notes:

1. In the event of an Interim Determination, no account will be taken of any costs to the extent that they would have been, or would be, avoided by prudent management action (and for this purpose what constitutes “prudent management action” shall be assessed by reference to the circumstances which were known or which ought reasonably to have been known to the Appointee at the relevant time). In relation to this Notified Item, Ofwat will consider, in particular, whether the Appointee has engaged actively and effectively in any discussions and arbitration proceedings, taking account of all relevant factors. But nothing in this paragraph means that the Appointee is under an obligation to instigate discussion or arbitration proceedings.
2. For the avoidance of doubt, legal costs, including those associated with arbitration in respect of the Annual Charge and the Volumetric Charge, are not included in, or attributable to, this Notified Item.
3. Any adjustment to the level of a Price Control or Price Controls in an Interim Determination that is attributable to this Notified Item would be dealt with outside the standard totex cost sharing mechanism at the 2024 Periodic Review. Instead, the proposed approach is that attributable costs or savings would be shared between customers and the Appointee on a 75% (customers) / 25% (the Appointee) basis.

Land sales

When making the final determination of Price Controls Ofwat proposes to give notice that for each of the five consecutive Charging Years starting on or after 1 April 2020:

- the value attributable to Relevant Disposals of Land allowed for in making the determination is zero; and
- variations in value received or expected to be received from Relevant Disposals of Land shall constitute a Relevant Change of Circumstance.

Appendix 2: In-period Outcome Delivery Incentives (ODIs)

Ofwat proposes to notify the Appointee in accordance with Part 3A of Condition B that the Price Controls to be determined in respect of the Appointee's Retail Activities, Water Resources Activities and Network Plus Water Activities may be adjusted to reflect the Appointee's performance in relation to the following Performance Commitments:

Table A2.1: In-period financial performance commitments - Common PCs

Name of Common Performance Commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Water quality compliance (CRI) [PR19BRL_PC01]	Financial - Under; In-period	Water network plus
Water supply interruptions [PR19BRL_PC02]	Financial - Out & under; In-period	Water network plus
Leakage [PR19BRL_PC18]	Financial - Out & under; In-period	Water network plus
Per capita consumption [PR19BRL_PC19]	Financial - Out & under; In-period	Water network plus; Residential retail
Mains repairs [PR19BRL_PC03]	Financial - Under; In-period	Water network plus
Unplanned outage [PR19BRL_PC04]	Financial - Under; In-period	Water network plus
C-Mex: Customer measure of experience [PR19BRL_PC12]	Financial - Out & under; In-period	Residential retail
D-Mex: Developer services measure of experience [PR19BRL_PC13]	Financial - Out & under; In-period	Water network plus

Table A2.2: In-period financial performance commitments - Bespoke PCs

Name of Bespoke Performance Commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Customer contacts about water quality – appearance [PR19BRL_PC06]	Financial - Out & under; In-period	Water network plus
Customer contacts about water quality – taste and smell [PR19BRL_PC07]	Financial - Out & under; In-period	Water network plus
Properties at risk of receiving low pressure [PR19BRL_PC08]	Financial - Out & under; In-period	Water network plus
Turbidity performance at treatment works [PR19BRL_PC09]	Financial - Under; In-period	Water network plus
Unplanned maintenance – non-infrastructure [PR19BRL_PC10]	Financial - Under; In-period	Water network plus
Void properties [PR19BRL_PC17]	Financial - Out & under; In-period	Residential retail
Meter penetration [PR19BRL_PC20]	Financial - Out & under; In-period	Water network plus
Raw Water Quality of Sources [PR19BRL_PC21]	Financial - Out & under; In-period	Water resources
Biodiversity Index [PR19BRL_PC22]	Financial - Out & under; In-period	Water resources; Water network plus
Waste disposal compliance [PR19BRL_PC23]	Financial - Under; In-period	Water network plus
Water Industry National Environment Programme Compliance [PR19BRL_PC24]	Financial - Under; In-period	Water resources
Local community satisfaction [PR19BRL_PC25]	Financial - Out & under; In-period	Water resources; Water network plus
Abstraction Incentive Mechanism (AIM) [PR19BRL_PC26]	Financial - Out & under; In-period	Water resources

Appendix 3: Revenue Forecasting Incentive formula

On the assumption that an appropriate modification is made to Condition B (Charges) before December 2019, Ofwat proposes to notify the Appointee that subparagraph 8.1 of Condition B will not prevent the Appointee from levying charges to recover a Relevant Shortfall in the Charging Years beginning 1 April 2021, 1 April 2022, 1 April 2023 and 1 April 2024 (each of which will be a “Relevant Charging Year” for these purposes) where the “Relevant Shortfall” means any positive amount calculated for a Relevant Charging Year in accordance with the following formula:

Revenue Forecasting Incentive: Water network-plus

The RFI for water network plus activities will be determined according to the following formula:

$$\begin{aligned} \mathbf{RFI}_t = & - (\mathbf{RR}_{t-2} - \mathbf{AR}_{t-2}) \times \left(\mathbf{1} + \frac{\mathbf{D}}{\mathbf{100}} \right)^2 \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \\ & - \mathbf{PS}_{i,t} \times \frac{\mathbf{PR}}{\mathbf{100}} \times \left| \mathbf{RR}_{t-2}^* - \mathbf{AR}_{t-2}^* \right| \times \left(\mathbf{1} + \frac{\mathbf{D}}{\mathbf{100}} \right) \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \end{aligned}$$

The RFI for water network plus activities, \mathbf{RFI}_t is added to allowed revenues for water network plus activities, \mathbf{R}_t , to calculate adjusted allowed revenues for water network plus activities, according to the following formula:

$$\mathbf{AR}_t = \mathbf{R}_t + \mathbf{BYA}_t + \mathbf{RFI}_t$$

Revenue Forecasting Incentive: Water resources

The RFI for water resources activities will be determined according to the following formula:

$$\begin{aligned} \mathbf{RFI}_t = & - (\mathbf{RR}_{t-2} - \mathbf{AR}_{t-2}) \times \left(\mathbf{1} + \frac{\mathbf{D}}{\mathbf{100}} \right)^2 \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \\ & - \mathbf{PS}_{i,t} \times \frac{\mathbf{PR}}{\mathbf{100}} \times \left| \mathbf{RR}_{t-2}^* - \mathbf{AR}_{t-2}^* \right| \times \left(\mathbf{1} + \frac{\mathbf{D}}{\mathbf{100}} \right) \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \end{aligned}$$

The RFI for water resources, \mathbf{RFI}_t is added to allowed revenues for water resources, \mathbf{R}_t , to calculate adjusted allowed revenues for water resources, according to the following formula:

$$\mathbf{AR}_t = \mathbf{R}_t + \mathbf{BYA}_t + \mathbf{RFI}_t$$

Where for each of controls to which the RFI relates:

$$\mathbf{BYA}_t = \mathbf{TBYA} \times \mathbf{Y}_t \times \left(1 + \frac{\mathbf{D}}{100}\right)^{\mathbf{T} - 2019} \times \mathbf{CPIH \text{ adjustment factor}}_t$$

\mathbf{AR}_{t-2} The adjusted allowed revenue stated in £ millions in charging year t-2 with the first year starting on 1 April 2020.

\mathbf{RR}_{t-2}^* This has the same meaning as \mathbf{RR}_{t-2} , except in this case the relevant controls this applies to are the sum of both the water network-plus and water resource controls.

\mathbf{AR}_{t-2}^* This has the same meaning as \mathbf{AR}_{t-2} , except in this case the relevant controls this applies to are the sum of both the water network-plus and water resource controls.

\mathbf{PR} The penalty rate. Denoting the forecast error $(\mathbf{RR}^{*t-2} - \mathbf{AR}^{*t-2}) / \mathbf{AR}^{*t-2} = x\%$, the penalty rate is:

- 3% for all variations if $|x\%| > 3\%$;
- $3\% * (|x\%| - 2\%) / (3\% - 2\%)$ if $2\% < |x\%| \leq 3\%$;
- zero if $|x\%| \leq 2\%$.

The result enters the above formula as a number. For example, for a penalty rate of 3%, PR enters the formula as number 3.

$\mathbf{PS}_{i,t}$ is the share of the penalty that the Appointee chooses to allocate to the control in charging year t,

- where i = water network-plus or water resources control; and
- the \mathbf{PS}_i values must sum to one³ for each charging year.

³ That is, $\mathbf{PS}_{\text{water resources}} + \mathbf{PS}_{\text{water network plus}} = 1$

BYA_t The blind-year adjustment, stated in £ millions, to the allowed revenue of the network plus control⁴ in each year over the charging years 2021/22 to 2024/25, inclusive.

TBYA = Blind year adjustment stated by Ofwat in 2017/18 year average prices. Any such adjustment would be made by a future determination.

Y_t is the percentage of the blind year adjustment that the company has elected to receive in period t of the AMP. This allows the company to spread the impact of the blind year adjustment over the relevant years. The Y_t values must

- sum to one, if the blind year adjustment is negative;
- sum to one or less, if the blind year adjustment is positive; and
- be greater than or equal to zero.

T = the year in which the relevant charging year begins – for example

- for the charging year 2022-23 then T = 2022;
- for the charging year 2023-24 then T = 2023; and
- for the charging year 2024-25 then T = 2024.

⁴ The blind-year adjustments will be made to the network-plus control; it cannot be allocated to the water resources control.

Appendix 4: Glossary

Common terms used in formulae in this document are defined below.

Term	Where used	Definition
t	All	A suffix added to a term to indicate the Charging Year. For example, R_t refers to the relevant Charging Year.
t-1	All	A suffix added to a term to indicate the Prior Year. For example, R_{t-1} refers to the Charging Year starting one year before the start of relevant Charging Year.
t-2	All	A suffix added to a term to indicate the Charging Year commencing on 1 April immediately prior to the Prior Year. For example, R_{t-2} refers to the Charging Year starting two years before the start of the relevant Charging Year.
R_t	Network-plus, water resources,	Revenue stated in £ millions allowed to the Appointed Business in a Charging Year by a Price Control in respect of the activities concerned
RR_t	RFI	The revenue stated in £ millions recovered by the Appointed Business in a Charging Year in outturn prices. In the RFI, the first year, t, starts on 1 April 2022 so that year t -2 starts on 1 April 2020.
$CPIH_t$	Network-plus, water resources, RFI	The percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for the immediately preceding November.
FYA CPIH	Water resources	The percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the average level of the Consumer Prices Index (H) across the twelve months of the Charging Year compared to the average level of the Consumer Price Index (H) across the twelve months of the Prior Year.

K_t	Network-plus, water resources	A specified number for the relevant Charging Year which may be a positive number or a negative number or zero.
D	Water resources, RFI	The specified discount rate of [<i>to be set at the final determination</i>], which enters the relevant formula as an integer. We will use the Weighted Average Cost of Capital (WACC) that we use to set Price Controls in the final determination and apply this constantly over the period.
CPIH adjustment factor_t	Water resources, RFI,	One plus the percentage change in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for November 2016.

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.

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