

July 2019

Trust in water

PR19 draft determinations

**Affinity Water – Securing cost efficiency
actions and interventions**

PR19 Draft Determinations: Affinity Water – Securing cost efficiency actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised 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 ‘AFW’ denotes the company Affinity Water. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions and actions whose numbers are preceded with a ‘B’ denote advised 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 ‘AFW’ denotes the company Affinity Water. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Intervention numbers are preceded with a ‘C’.

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

Table 1: Affinity 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	AFW.CE.A1	Required	We have provided our view of efficient costs for the company along with our reasoning. We expect it to address areas of inefficiency, or lack of evidence, in the revised business plan. Where appropriate, we expect it to withdraw investment proposals if either: the need for investment is not compelling; or there is no need for a cost adjustment claim beyond our existing cost baseline.	1 April 2019	Affinity Water has accepted some of our cost challenges in wholesale and reduces totex by £26m in its April resubmission. The gap between the company’s resubmitted costs and our efficient view of totex is now £132m, of which £73m is enhancement. It removed two of its cost adjustment claims which we rejected at the initial assessment of its plan and retained two claims for population transience and regional wages.	Intervention required. We review the company responses and incorporated these into our assessment for draft determination. To ensure customers pay only for efficient costs we continue to challenge these costs where required. The company’s retail costs are slightly inefficient.	We provide our view of efficient costs for the company along with our reasoning. We expect the company to continue to address areas of inefficiency and lack of evidence.

					<p>The company provides further detail in the area of supply demand balance enhancement following the production of its revised draft water resources management plan. It removes enhancement expenditure for activities funded through the base modelled allowance and the costs reflect the revised plan scope. However, Affinity Water increased expenditure associated with leakage in order to deliver an additional 3% leakage reduction.</p> <p>It accepted our efficiency challenge on the following components of SDB enhancement: supply-side 2020-25 enhancement; Sundon import conditioning long-term enhancement.</p>		
	AFW.CE.A2	Required	<p>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 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.</p> <p>The company's allocation is made on the basis of having clear deliverables and customer protection for the gated delivery of the development of Abingdon reservoir, a regional transfer from Thames Water, and an eastern regional solution/transfer. The following actions are required to ensure the efficient delivery of this development 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 	1 April 2019	<p>The company's strategic regional water resources submission includes a joint statement by six companies via Water Resources South East. This joint statement considers: the principles for joint working; timing of the gateways; increased detail of the work between the proposed gates; the principles of a change protocol to manage changes to schemes in the proposal and to change the current list of schemes when required; development of the principles of an outcome delivery incentive type mechanism to allow funding to be recovered by customers in the event of the scheme not progressing and for the non-delivery or late delivery of outputs.</p> <p>In an addendum to the joint statement, submitted on 3 May 2019, the same companies specify key principles for a 'hybrid</p>	<p>Intervention required.</p> <p>We have assessed the revised submissions (both joint and company specific) to intervene for the draft determinations. This includes updates to cost allowances for this development programme, gate delivery updates and the end of period reconciliation mechanism to protect customers. The detailed assessment and rationale is provided in the 'Strategic regional water resource solutions appendix'.</p>	<p>Company to present joint solutions consistently with solution partners and clearly set out the costs related to strategic regional water resource solutions in its representation to the draft determination.</p>

			<ul style="list-style-type: none"> Propose outcome delivery incentive-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>Intervention updates and clarifications: We sent clarification of our expectations for information relating to this action that we expected information submitted on 1 April to be as accurate and complete as possible, but accepted that given the timescales and joint working implications this may be in draft form. However, we wanted clarity on the costs relating to strategic regional water resource solutions and the solutions this relates to be summarised by 12 April, with the final information covering the action by 3 May.</p>		<p>approach' outcome delivery incentive mechanism.</p> <p>Affinity Water included a freeform line for Strategic Regional schemes in its resubmitted table WS2; and scheme-specific reports for: Abingdon Reservoir; Anglian to Affinity transfer and reservoir; Grand Union Canal to Affinity Water transfer; Thames to Affinity transfer; and Thames to Southern transfer.</p>		
	AFW.CE.A3	Required	<p>We require further clarity on the company's proposals for a cost adjustment mechanism for the Amber WINEP schemes included in its investment programme. The company should therefore advise how the sustainability reductions and 28 river morphology projects referred to in section 10.19 of Appendix 10 map on to the 13 Amber schemes listed in WINEP3. The company should also provide a breakdown of the expenditure (capex and opex) allocated for these 13 schemes between lines in Tables WS2. We also need clarity on how the volumes and costs set out in the tables in section 10.19.1 relate to the corresponding data in the table on p68 of Appendix 6. Finally, the company should explain why it considers it appropriate to propose a single unit cost for supply and demand-side measures rather than separate unit costs given the differing nature of the work and costs involved.</p>	1 April 2019	<p>Affinity Water provides a table mapping the sustainability reductions/river morphology projects on to the 13 Amber schemes listed in WINEP3, and a breakdown of expenditure in a copy of Table WS2 in its 'Securing Cost Efficiency appendix AFW.CE.A3.1'. A summary table shows how the volumes and costs set out in section 10.19.1 relate to p.68 of Appendix 6. Regarding unit costs, the appendix also clarifies that demand-side measures will be removed, and the company now proposes one unit cost for supply-side measures in its Central region and a different unit cost for those in the East.</p>	<p>Intervention required.</p> <p>The additional information has enabled us to assess the adequacy of the company's proposals for a cost adjustment mechanism for the Amber WINEP schemes included in its business plan.</p>	<p>We provide our view of the unit rates to be used in the cost adjustment mechanism in 'Affinity Water - Cost efficiency draft determination appendix'.</p>
	AFW.CE.A4	Required	<p>There may be significant impacts in terms of investment or type of investment as a result of the metaldehyde ban. The company should investigate and agree with the DWI the scale and timing of any potential changes compared to its submitted plans. Significant changes and uncertainty may require an outcome delivery incentive to protect customers in the instance of expenditure not being required. Should the company propose a performance commitment and outcome delivery incentive, the company should provide evidence to justify the level of the performance commitment and the outcome delivery incentive rates proposed, in line with our Final Methodology. We expect to receive evidence of customer support for outperformance payments, where proposed, and that the incentive rates proposed are reflective of customer valuations.</p>	1 April 2019	<p>The company states its initial assessment of plans did not include investment for the treatment of metaldehyde. A bespoke uncertainty mechanism was included at the initial assessment of plans stage but has been removed at draft determination.</p>	<p>No intervention required for draft determination but further action needed by the company.</p> <p>We accept the removal of the bespoke uncertainty mechanism.</p>	<p>Company to provide evidence to confirm DWI agreement with its submitted plans/revised undertakings and that no metaldehyde specific treatment or substitution costs are included in the requested allowance.</p>

	Advised actions	Advised	No advised actions	N/A			
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Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
<p>We explain our approach to cost assessment, including the allowances we set for each control, assumption on revenue recovery from grants and contributions, opex-capex split and totex profiling, in 'Securing cost efficiency technical appendix'. We set out other company specific interventions, and the allowances we set for each control, in section 3 of the company's draft determination summary and its cost efficiency appendix.</p>		

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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