

July 2019

Trust in water

PR19 draft determinations

South Staffs Water – Accounting for past delivery actions and interventions

PR19 Draft Determinations: South Staffs Water - Accounting for past delivery 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, the model the action relates to, 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. Table 1 also sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each action and further intervention that is not resulting from an action has a unique reference. The prefix 'SSC' denotes the company South Staffs 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. Actions whose numbers are preceded with a 'B' denote advised actions. Interventions not resulting from an action are preceded with a 'C' followed by a three digit code for the model the intervention is relevant to, and a two digit reference for the interventions in that model. The model codes are set out below.

Model	Code
ODIs	002
Land sales	003
WRFIM	005
Totex	006
Water trading	007
Residential retail	008
SIM	009
RCV adjustments feeder model	010
Revenue adjustments feeder model	011

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

Table 1 – South Staffs Water’s response to required actions and interventions for draft determinations

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Land disposals	SSC.PD.A1	Required	PR14 Land sales: South Staffs Water is required to provide sufficient evidence to support the forecast trajectory in table App9.	1 April 2019	South Staffs Water provides additional evidence to support the forecast trajectory in table App9 stating “We have not sold any land in the first three years of the current period. There is also no expectation that we will sell any land in either 2018/19 and 2019/20. Although we constantly review our land portfolio, most surplus land is not suitable to sell as it is ‘greenbelt’ land and so only has agricultural value. We do not believe it would be in customers’ interests to sell this land unless future local plans look to allocate some of this land for development.”	No intervention required. Commentary supplied confirming zero sales is sufficient.	N/A
Outcomes	SSC.PD.A2	Required	PR14 outcome delivery incentives: South Staffs Water is required to calculate the outcome delivery incentive: '1.2: acceptability of water to customers (combined company)' based on performance reported to 2 decimal places in tables App5/App6/App27.	1 April 2019	South Staffs Water states that it has calculated its financial incentives in line with its previous Annual Performance Reports. It considers that reporting to additional decimal places is fairer for its customers.	The ‘PR14 final determination company-specific appendix’ states that performance commitment 1.2 (acceptability of water to customers) is measured "in nr / 1000 population to two decimal places" (pages 95-96). 1.2 (acceptability of water to customers) is measured "in nr / 1000 population to two decimal places" (pages 95-96).	We are intervening to adjust the 2015-16 and 2017-18 underperformance payments for performance commitment 1.2 (acceptability of water to customers) so that they are calculated using actual performance levels to two decimal places. The adjustment that we are applying to the 2015-16 underperformance payment is -£3,816 (2012-13 prices) The adjustment that we are applying to the 2017-18 underperformance payment is -£6,360 (2012-13 prices) Our intervention decreases the total net performance payment from £3.352 million to £3.341 million (2017-18 FYA CPIH deflated price base).

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Outcomes	SSC.PD.A3a	Required	<p>PR14 outcome delivery incentives: South Staffs Water is required to update its forecast for 2019-20 performance to take account of the actual 2018-19 performance for all its performance commitments.</p> <p>We expect the company to pay particular focus where we found the evidence provided in its business plan for the 2018-20 forecasts to be insufficient which was for:</p>	15 July 2019	No company action required for the draft determination.	<p>No intervention required.</p> <p>We will review South Staffs Water's updated data before making any interventions for the final determination.</p>	N/A
Outcomes	SSC.PD.A3b	Required	1.1: Mean zonal compliance (MZC, combined company)	15 July 2019	As SSC.PD.A3a	As SSC.PD.A3a	As SSC.PD.A3a
Outcomes	SSC.PD.A3c	Required	1.2: Acceptability of water to customers (combined company)	15 July 2019	As SSC.PD.A3a	As SSC.PD.A3a	As SSC.PD.A3a
Residential retail	SSC.PD.A4a	Required	<p>PR14 Residential retail: South Staffs Water is required to clarify the justification for its 2019-2020 forecast for the number of metered water customers which departs from the previously observed trends in table R9.</p>	1 April 2019	South Staffs Water provides evidence to support its forecasts by referring to improvements to the process of calculating property numbers.	<p>No intervention required.</p> <p>The company provides sufficient evidence in support of its forecast.</p>	N/A

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Residential retail	SSC.PD.A4b	Required	PR14 Residential retail: South Staffs Water is required to provide further clarity on the reasons for the difference between reforecast customer numbers and actual customer numbers in 2018-2019.	1 April 2019	South Staffs clarifies that there is a difference between actual and reforecast customer numbers in 2018-19 because the forecast actual customer numbers figure is a more recent forecast. In addition, the improvements to the process of calculating property numbers were first applied to the forecast actual customer numbers in 2018-19, resulting in further differences.	No intervention required. The company provides a satisfactory response to this action.	N/A
Residential retail	SSC.PD.C008.01	Intervention not resulting from an action	N/A	N/A	N/A	Intervention required. We are intervening to round South Staffs Water's modification factor figures to two decimal places to ensure consistency with the 'PR14 reconciliation rulebook'.	We are rounding to two decimal places, modification factor figures for 2015-16 to 2019-20 associated with the following lines in business plan table R9: <ul style="list-style-type: none"> • unmetered water-only customer; • unmetered wastewater-only customer; • unmetered water and wastewater customer; • metered water-only customer; • metered wastewater-only customer; and • metered water and wastewater customer. Our interventions do not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period which remains at £1.002 million (2017-18 FYA CPIH deflated price base). Please see published draft determination residential retail revenue reconciliation model for South Staffs Water.

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Residential retail	SSC.PD.C008.02	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to apply the appointee WACC as the discount rate to be used to provide a financing adjustment for the time value of money of the reward or penalty in line with the 'PR14 reconciliation rulebook'. This may be required if the materiality threshold for financing adjustment is exceeded.</p> <p>Our intervention ensures that there is no mismatch between the discount rate used and the revenue control to which it is applied.</p>	<p>For South Staffs Water, we are including a figure of 3.74% for the 'Materiality threshold for financing adjustment - Discount Rate.' This replaces the figure of 3.6% contained in South Staffs Water's April 2019 submission.</p> <p>Our interventions do not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period because the materiality threshold is not exceeded.</p> <p>Please see published draft determination residential retail revenue reconciliation model for South Staffs Water.</p>
SIM	SSC.PD.C009.01	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to adjust South Staffs Water's household retail revenue as a result of its SIM performance from 2015-16 to 2018-19.</p>	<p>We are intervening to set the service incentive mechanism adjustment to +2.22% of household retail revenue, which is £1.726 million (2017-18 FYA CPIH deflated price base) in total over the period. We further explain how we calculate this in the 'Accounting for past delivery technical appendix'.</p>

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
WRFIM	SSC.PD.A5	Required	<p>PR14 Wholesale revenue forecasting incentive mechanism: The company proposes that there is no WFRIM adjustment for additional revenue from higher developer contributions than forecast. South Staffs Water is required to provide further evidence in support of its claim, specifically to cover the following elements:</p>	1 April 2019	<p>South Staffs Water partially responds to this action as noted in SSC.PD.A5a to A5e below.</p>	<p>Intervention required.</p> <p>We have assessed the complex revenue claim for £18.9 million (outturn prices) in respect of higher grants and contributions revenue than included in the 2014 price review final determination.</p> <p>Some of the elements of the company's claim are not within the scope of the adjustment as set out at PR14 which related to the demand for new connections only. We have not accepted the elements of the claim where the variance has been driven by the cost or type of new connection.</p> <p>We also consider that claims due to errors companies made in completion of business plans at PR14 are outside the scope of the adjustment mechanism, so we have not accepted the element relating to main requisition charges.</p> <p>As the company has explained and evidenced the approach taken to develop its PR14 forecasts and demonstrated that the increase in connection volumes is due to brownfield development that was unexpected and is harder to forecast, we have accepted the elements of the claim that are driven by the volume of new connections.</p>	<p>We are intervening to reduce the aggregate value of the revenue claim to £6.004 million (outturn prices).</p> <p>Our intervention increases the total WRFIM adjustment at the end of the 2015-20 period from - £1.883 million to - £16.891 million (2017-18 FYA CPIH deflated price base).</p>

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
WRFIM	SSC.PD.A5a	Required	<ul style="list-style-type: none"> Evidence to demonstrate the company took all necessary steps to understand development pipeline and number and type of connections and that the reasons for the variance were outside of management control. For example, how the company took account of evidence from sources that underpin the company's connection forecasts, such as location, type (brownfield / greenfield) and timing of developments coming forward in both the South Staffordshire area and the Cambridge area. 	1 April 2019	South Staffs Water responds to this action.	See SSC.PD.A5 above	See SSC.PD.A5 above
WRFIM	SSC.PD.A5b	Required	<ul style="list-style-type: none"> Evidence to support the company's assumption that the proportion of self-lay would increase significantly. For example, what steps has the company taken to promote the take-up and delivery of self-lay for new connections in your area and what additional steps have been taken to achieve the projected significant increase in self-lay. 	1 April 2019	South Staffs Water does not respond to this action.	See SSC.PD.A5 above	See SSC.PD.A5 above

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
WRFIM	SSC.PD.A5c	Required	<ul style="list-style-type: none"> For cost efficiency while we acknowledge the report referenced by the company, further evidence is required as to how much of the additional costs incurred are covered by the unit costs for connection scenarios in the report. 	1 April 2019	South Staffs Water does not respond to this action.	See SSC.PD.A5 above	See SSC.PD.A5 above
WRFIM	SSC.PD.A5d	Required	<ul style="list-style-type: none"> Evidence to support why it is appropriate to base the business plan forecasts for the number of connections in 2018-19 and 2019-20. Including evidence to support the company's view that it is appropriate to base its forecasts on a short period relating to the final quarter of 2017-18 and the first two months of 2018-19. 	1 April 2019	South Staffs Water does not respond to this action.	See SSC.PD.A5 above	See SSC.PD.A5 above
WRFIM	SSC.PD.A5e	Required	<ul style="list-style-type: none"> Mains requisitions - error correction. South Staffs Water is required to update table WS13 and the WFRIM model to remove this adjustment or provide compelling evidence to support why the adjustment is appropriate. 	1 April 2019	South Staffs Water does not respond to this action.	See SSC.PD.A5 above	See SSC.PD.A5 above

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
All models	SSC.PD.A6	Required	PR14 reconciliations: Further to the actions we have set out to address our concerns over the evidence provided in its business plan for the individual reconciliations, we will require the company to refresh all of its PR14 reconciliations to replace its 2018-19 forecast performance with 2018-19 actual performance and update the evidence for its forecast 2019-20 performance taking into account of the actual 2018-19 performance.	15 July 2019	No company action required for the draft determination.	No intervention required. We will review South Staffs Water's responses to its actions and further information provided for all the PR14 reconciliation models before making any further interventions for the final determination.	N/A
Revenue adjustments	SSC.PD.C011.01	Intervention not resulting from an action	N/A	N/A	N/A	Intervention required. We are standardising the discount factor used to profile revenue adjustments. Companies can choose to apply revenue adjustments in either in the first year, or, spread over a number of years in the 2020-25 period to minimise the impact on bills or to generate a bill profile that is appropriate for its customers. We consider the wholesale WACC is an appropriate discount factor as this is a measure of the time value of money that is consistent with the price control framework. We are not intervening in South Staffs Water's choices for profiling revenue adjustments in 2020-25.	We are using our view of the wholesale WACC (3.09%) as the discount factor to preserve the net present value of the outperformance or underperformance payments due when spreading adjustments over the period.

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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