

July 2019

Trust in water

PR19 draft determinations

Northumbrian Water – Cost efficiency draft determination appendix

PR19 draft determinations: Northumbrian Water - Cost efficiency draft determination appendix

1. Wholesale water activities

1.1 Enhancement

The tables below summarise the adjustments we make to set the efficient level of enhancement totex for the water resources and network plus water price controls. Where appropriate, we reallocate enhancement expenditure between enhancement activities. In the table, we present the company requested cost for each activity where we made a material challenge, after any reallocation that we may have done. Our disallowances to company enhancement proposals include a challenge on the need to invest, on the efficiency of the proposals or on the classification of the expenditure as enhancement (in which case we consider that the expenditure is covered by our base allowance). For draft determinations we make an adjustment to the enhancement allowances to account for an implicit allowance for enhancement opex included within our base models. We set out our method of estimating the opex implicit allowance in 'Securing cost efficiency technical appendix'. Costs for new developments, new connections and addressing low pressure are now considered within wholesale water base ("totex plus") econometric models. We show details of specific areas of material disallowance or efficiency challenge in the table below and we provide details in our published feeder models.

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

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	14.6	14.6	11.7
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
-	-	-	

Note: Our enhancement totex allowance is net of an implicit allowance for enhancement opex.

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

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	262.6	246.7	136.2
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
Resilience	127.4	55.8	
Investment to address raw water deterioration	34.8	26.4	
SEMD and non-SEMD	16.8	9.3	
Freeform line - Infrastructure network reinforcement	14.4	0.0	

Note: Our enhancement totex allowance is net of an implicit allowance for enhancement opex. We have not netted off an implicit allowance for enhancement opex from our allowances for the individual enhancement lines.

1.2 Transition expenditure

Table 3 sets out our allowances in wholesale water controls under the transition programme for both base and enhancement expenditure. The programme allows companies to bring forward planned investment from 2020-25 to 2019-20, where it is efficient to do so and/or to enable the company to meet statutory deadlines early in the next regulatory period. Although the expenditure is incurred in 2019-20, for the purpose of cost performance incentives we consider it as expenditure incurred in the following regulatory period (2020-25).

Table 3: Allowed transition capital expenditure in wholesale water price controls 2019-20 (£ million, 2017-18 CPIH deflated prices)

Description of expenditure	Company requested expenditure		Our allowed expenditure		Rationale
	Water Resources	Water Network Plus	Water Resources	Water Network Plus	
Resilience	0.0	1.4	0.0	0.0	We do not allow all of the resilience expenditure the company proposes due to lack of evidence on its understanding of the risks it proposes to mitigate. We therefore do not allow the associated transition expenditure.

2. Wholesale wastewater activities

2.1 Enhancement

The tables below summarise the adjustments we make to set the efficient level of enhancement totex for the wastewater network plus and bioresources price controls. Where appropriate, we reallocate enhancement expenditure between enhancement activities. In the table, we present the company requested cost for each activity where we made a material challenge, after any reallocation that we may have done. Our disallowances to company enhancement proposals include a challenge on the need to invest, on the efficiency of the proposals or on the classification of the expenditure as enhancement (in which case we consider that the expenditure is covered by our base allowance). For draft determinations we make an adjustment to the enhancement allowances to account for an implicit allowance for enhancement opex included within our base models. We set out our method of estimating the opex implicit allowance in ‘Securing cost efficiency technical appendix’. Costs for new developments, new connections and addressing low pressure are now considered within wholesale water base (“botex plus”) econometric models. We show details of specific areas of material disallowance or efficiency challenge in the table below and we provide details in our published feeder models.

Table 4: Material disallowances of and efficiency challenges to enhancement costs for the wastewater network plus price control 2020-25 (£ million of 2017-18)

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	293.2	291.6	180.8
Material areas of disallowance in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
Resilience	87.8	33.6	
Security	20.1	3.9	
Freeform line – Infrastructure network reinforcement	8.7	0.0	

Note: Our enhancement totex allowance is net of an implicit allowance for enhancement opex. We have not netted off an implicit allowance for enhancement opex from our allowances for the individual enhancement lines.

Table 5: Material disallowances of and efficiency challenges to enhancement costs for the bioresources price control 2020-25 (£ million of 2017-18)

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	0.0	0.0	0.0
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
-	-	-	

2.2 Transition expenditure

Table 6 sets out our allowances in wholesale wastewater controls under the transition programme for both base and enhancement expenditure. See section 1.2 for detail about the transition programme.

Table 6: Allowed transition expenditure in wholesale wastewater controls 2019-20 (£ million, 2017-18 CPIH deflated prices)

Description of expenditure	Company requested expenditure		Our allowed expenditure		Rationale
	Wastewater Network Plus	Bioresources	Wastewater Network Plus	Bioresources	
Growth at sewage treatment works	1.2	0.0	0.0	0.0	This is a routine investment with no early statutory deadlines in the next regulatory period to be met. We therefore disallow the requested transition expenditure.
Resilience	0.2	0.0	0.0	0.0	We do not allow all of the resilience expenditure the company proposes due to lack of evidence on its understanding of the risks it proposes to mitigate. We therefore do not allow the associated transition expenditure.

3. Cost adjustment claims

Northumbrian Water does not include any cost adjustment claims in its April 2019 plan.

However, we have used the cost adjustment claim process to deep dive Northumbrian Water's atypical wastewater growth expenditure and show our assessment in the company's feeder model.

4. WINEP uncertainty mechanism

Our totex allowance for 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, which is after we make our final determinations in December 2019. Unconfirmed requirements in WINEP are known as ‘amber’ schemes.

Where we make an allowance for amber schemes, we use a mechanism to adjust our totex for schemes which are later confirmed as not required.

Table 7 sets out the adjustments we will make for each scheme in Northumbrian Water’s WINEP programme that is currently unconfirmed, if the scheme is confirmed as not required for the period 2020-25. We will make the adjustments at the end of the control period. Our adjustments are based on the company’s totex estimates as adjusted by our company specific efficiency factor or, in the case of wastewater schemes, our programme wide efficiency challenge.

Table 7: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP schemes included in our draft determination (£ million in 2017-18 prices)

Unique ID	Scheme category / name	Company’s totex unit rate	Our allowed totex rate
WINEP/NEP ~ Water Framework Directive Improvement Schemes – Nutrients (P removal)			
7NW200531	Slaley - in combination effect with De Vere Hotel		£1.895m
7NW200472	Longnewton	£2,223,565.14 x (p.e.) ^{-0.94} per p.e.	£3.212m
7NW200494	New Moors		£3.728m

7NW200556	Teeside Airport		£4.077m
7NW200044	Bishop Middleham		£1.989m
7NW200508	Pity Me		£4.194m
7NW200509	Plawsworth		£3.250m
7NW200463	Kirklevington STW		£3.256m
7NW200507	Pittington		£3.199m
7NW200012	Aldin Grange		£3.281m
7NW200461	Kelloe		£2.277m
7NW200065	Carlton Redmarshall		£3.344m
7NW200089	Fishburn		£2.522m
7NW200078	Dipton		£2.060m
7NW200067	Chilton Lane		£3.387m
7NW200524	Sedgefield		£3.741m
7NW200568	Trimdon		£4.477m
7NW200086	Esh Winning		£0.000m
7NW200071	Crookhall		£1.454m
7NW200527	Sherburn		£3.516m
7NW200521	Sacrison		£4.201m
7NW200465	Lanchester		£4.541m
7NW200464	Knitsley		£3.802m
7NW200583	Witton Gilbert		£2.859m

7NW200051	Bowburn		£0.000m
7NW200057	Browney		£0.147m
WINEP/NEP ~ Water Framework Directive Improvement schemes – Sanitary parameters reduction			
7NW200525	Sedgeleth	£2,223,565.14 x (p.e.) ^{-0.94} per p.e.	£4.900m
WINEP/NEP ~ Chemicals removal			
7NW200110	Hustledown STW (CIP2 T1)	£5.684m	£4.729m
7NW200112	Hustledown STW (CIP2 T1)	£0.000m	£0.000m
WINEP/NEP ~ Eels Regulations (Measures at intakes)			
7NW10005	Barrasford raw water pumping station - Rede to Gunnerton Burn, Barrasford to S Tyne, Watersmeet to Tidal Limit - Eels Regs and MM3	£1.071m	£1.071m
7ES100130	LANGHAM A, B, C & E	£0.055m	£0.055m
7ES200010	Eel measures at Ormesby Broad	£0.000m	£0.000m
WINEP/NEP ~ Water Framework Directive measures			
7NW100001	Balder - d/s Hury Resvoir dam wall - - continue AMP 6 adaptive management trial putting seasonality to compensation release then implement end of AMP 7 - MM5, MM2, MM7 and MM8	£0.083m	£0.083m
7NW10088	BLACK BURN catchwater, feeds into Burnhope Burn d/s of Catchwater 100% take. MM5, MM7	£0.133m	£0.133m
7NW10009	Burnhope Burn catchwater to River Derwent MM1 and MM2 , MM5, MM7	£0.244m	£0.244m

7NW100011	Harthope burn catchwater - Water supply asset - MM1 and MM7	£0.177m	£0.177m
7NW100013	Ireshope - Wham pasture MM1. MM7 Burnhope res supply	£0.177m	£0.177m
7NW100014	Ireshope Burn - Greenwell Craggs - MM1, MM7 Burnhope res supply	£0.177m	£0.177m
7NW100002	Lune - Grassholme Res Dam wall - continue AMP 6 adaptive management trial putting seasonality to compensation release then implement end of AMP 7 - MM5, MM2, MM7 and MM8	£0.083m	£0.083m
7NW10006	Pont - channel d/s of sluice - MM6 and MM7	£0.150m	£0.150m
7NW100016	River Derwent - implement outcomes of Adaptive Management trials for end of AMP 7 - MM5	£0.083m	£0.083m
7NW100017	Smiddy Shaw and Hisehope reservoirs Surface Water Transfer , MM5, MM7 and MM8	£0.083m	£0.083m
7NW100003	Waskerley Res - d/s dam wall - implement outcomes of Adaptive Management trials for end of AMP 7 - MM5, plus MM1, MM2, MM4, MM8	£0.083m	£0.083m
7NW100012	Wear Pipe crossing St Johns Chapel -fish passage MM1	£0.177m	£0.177m

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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