December 2019

PR19 final determinations

Bristol Water – Aligning risk and return final decisions

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PR19 final determinations: Bristol Water – Aligning risk and return final decisions

In our draft determinations we published the 'Aligning risk and return actions and interventions' and the 'Securing long-term resilience actions and interventions' document for each company. This set out the required and advised actions in our initial assessment of plans, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we made as part of the draft determination.

This document sets out the decisions we are making for the final determination in response to representations received from companies on our draft determinations and changes for the final determination that are not resulting from representations received. We set out our response to thematic representations and representations from other stakeholders within the 'Aligning risk and return technical appendix' and the 'Allowed return on capital technical appendix'. Our 'Allowed revenue appendix' for the company is published alongside this document. These documents are intended to be fully consistent. In the event of any inconsistency, the other documents listed above take precedence over this document.

Table 1 below sets out the action/intervention reference, our assessment and rationale for the draft determination, a summary of the company representation, our assessment and rationale for the final determination and our decisions for the final determination.

Table 2 sets out any further decisions that are not resulting from an action and/or representation which we are making as part of the final determination.

Each action has a unique reference. The prefix 'BRL' denotes the company Bristol Water. The central acronym references the test area where the action has been identified, please see the '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. Draft determination interventions not resulting from an initial assessment of plans action are preceded with a 'C' and new interventions for the final determination not related to a previous action are preceded with a 'D.' For all other documents related to the Bristol Water draft determination, please see the final determinations webpage.

Table 1: Bristol Water – Representations in response to the draft determination

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
Risk and return	BRL.RR.A1	The company should remove the requested company specific adjustment from its plan and associated financial modelling or provide compelling evidence following the three-stage approach set out in the PR19 methodology if it continues to request a company specific adjustment.	The intervention we made at the draft determinations was for the company to apply our view of the allowed return on capital to the company's allowed revenues for draft determinations.	Representation made. Bristol Water has retained the assumption of a company-specific adjustment to its allowed return on capital in its representations, providing more evidence to support its view that it passes the three-stage assessment approach set out in the PR19 final methodology. The level of adjustment on the cost of embedded debt has reduced by 15 basis	No change for the final determination. Overall we consider the company has passed our customer support and levels assessment, but does not pass our benefits assessment, and thus fails the criteria overall for receiving a company-specific adjustment. For our levels assessment, the reduction in the company-specific adjustment results in an overall uplift of 38 basis points, which is within our plausible range of 25-40 basis points.	N/A

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				points to 40 basis points. The company also proposes an uplift of 30 basis points on the cost of new debt. At our ratio of new: embedded debt, the requested uplift on the cost of new debt is 38 basis points. The company has provided commentary on our benefits assessment, supported by further analysis from KPMG, suggesting alterations to our approach to measuring benefits which the company said would result in a pass on this assessment. The company has not provided new evidence on customer support in its representation, having been assessed to pass this assessment at draft determinations.	While this is higher than the 33 basis points which we consider is the appropriate level of uplift for successful applicants for a Company-Specific Adjustment, this change is due to information which was not available to the company in making its representation, so we consider that the company passes this assessment. For our benefits assessment, we have updated the models used to assess the benefits provided by the company remaining as an independent comparator, and we conclude that net benefits are negative in both our single period (2020-25) and our forward-looking (2025-50) analysis. After reviewing Bristol Water's arguments, we consider that there remains insufficient evidence of benefits which adequately compensate customers for the increased cost of funding an uplift. For our customer support assessment, we consider that evidence already submitted by the company to inform draft determinations is adequate to demonstrate that customers support funding its proposed uplift, with a majority of surveyed customers providing unconditional support. We set out the detail of our assessment in Annex A1 to our 'Allowed return on capital technical appendix'.	
Risk and return	BRL.RR.A2	The company should provide further information on its proposed uncertainty mechanism relating to Canal & River Trust costs – to consider specifically whether the cost	We have included a notified item in Bristol Water's draft determination that would allow for an interim price determination. The company should provide its views on this, and	No representation made.	No change for the final determination. We note the uncertainty mechanism will be applied symmetrically.	N/A

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
		item will remain uncertain at the time of draft and final determinations.	the associated proposals we set out in the 'PR19 draft determination: Aligning risk and return technical appendix' and our summary of Bristol Water's draft determination. In particular we ask Bristol Water to: • reflect any changes to charge levels for abstracting water from the Gloucester and Sharpness Canal (whether an increase or a decrease) and reflect the change in its annual performance reporting; and • In the event of an interim determination that increases baseline allowances, to collect only 75% of the increased amount in accordance with its proposal. We propose this to be achieved through adjustments to targeted revenue in the RFI for Bristol Water.			
Risk and return	BRL.RR.A3	The company has targeted a credit rating for the notional company that is one notch above the minimum investment grade rating. The company should provide convincing evidence to support its view that this is reasonable for the long term financeability of the notional company or actions that could be taken to secure the long term financeability of the notional company.	No intervention required. Following a query to clarify the target credit rating for the notional company, Bristol Water has completed the action. On the basis of the notional company, we consider the draft determination would allow the company to achieve a credit rating two notches above the minimum investment grade.	No representation made.	No change for the final determination.	N/A
Risk and return	BRL.RR.A4	The company has targeted a credit rating for its actual structure that is one notch above the minimum investment grade rating, and lower than its current credit rating. The company should provide further evidence, and Board assurance, to support its view	No intervention but action required. The company has only a limited debt financing requirement in 2020-25; this together with the Board assurance statement provides some comfort that the plan is financeable.	Representation made. The company confirms that the statements that were made in the Board Assurance statement to support the revised business plan in April 2019 applies to the response to the draft determination.	No change for the final determination.	N/A

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
		that this is reasonable for the financeability of the actual company.	However, consistent with action BRL.LR.A4 on financial resilience, there is limited headroom in the projected financial ratios and we require further Board assurance of the actions the company will take to maintain its financial resilience in the context of the draft determination, which includes, for example, an updated view of the cost of capital, our assessment of efficient costs and our assessment of outcome delivery incentives. Pursuant to action BRL.LR.A4, we require the company to provide additional Board assurance that the company will remain financeable in 2020-25 in the context of our draft determination.	The company has received third party assurance on the checks carried out on data tables and that the business plan tables are consistent, accurate and assured, based on the processes that delivered this assurance for the original business plan.		
Risk and return	BRL.RR.A5	Further evidence and Board assurance is required that the business plan is consistent with maintaining the target credit rating given the weak financial ratios set out in the plan.	No intervention but action required. Bristol Water has provided further evidence including a third party report to support its Board assurance that the business plan is financeable under the actual company structure. Bristol Water acknowledges certain financial ratios presented are weak for the actual company. However, the company has a low amount of debt to issue over 2020-25 to fund the draft determination. We are not intervening in Bristol Water's determination in respect of the financial ratios of its actual structure. Pursuant to action BRL.LR.A4, we require the company to provide additional Board assurance that the company will remain financeable in 2020-25 in the context of our draft determination.	Representation made as per BRL.RR.A4.	No change for the final determination.	N/A

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
Risk and return	BRL.RR.A6	The company should ensure it is using the correct assumptions, including the cost of debt without a company specific adjustment, for the notional company in assessing the key financial ratios.	No intervention required. Bristol Water has completed the action; financial ratios both with and without the company specific adjustment are presented in the plan.	No representation made.	No change for the final determination.	N/A
Risk and return	BRL.RR.A7	The company should provide further evidence to support the calculation of RCV run-off rates and demonstrate that the rates are consistent with the approach set out in the business plan.	No intervention required. Bristol Water has completed the action. Bristol Water has provided sufficient evidence in support of the proposed RCV run off rates. The company has provided the details of the calculation of the natural rates for each control with a breakdown of the capital expenditure, depreciation, net book value and grants and contributions. The company has also provided the details of any adjustments to the natural rate to account for the transition from RPI to CPIH.	Representation made. The company confirms it has not amended the approach to calculating RCV run-off rates.	No change for the final determination.	N/A
Risk and return	BRL.RR.C1	Bristol Water's approach to setting PAYG rates is to recover operating expenditure including infrastructure renewal expenses included in operating costs. The application of efficient totex in our draft determination has resulted in a change to the mix of opex and capex in totex to the extent that PAYG rates are no longer aligned with Bristol Water's stated approach.	We are making a technical intervention to align PAYG rates to Bristol Water's stated approach of recovering operating expenditure for each year for each wholesale control.	Representation made. The company provides representations that the PAYG rates within the draft determination are suitable after deducting the adjustments the company made for smoothing bills. The company states that the split of opex and capex within the draft determination was reasonable as it broadly reflects the adjustments within the company revised plan. The company expects Ofwat to use the same approach for the final determinations.	Change for the final determination. A number of companies and stakeholders have made similar representations in relation to the proportion of operating expenditure in cost allowances and the determination of PAYG rates. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.	Taking account of company representations, we revise our approach to determine the mix of operating and capital expenditure to take better account of the nature of our decisions on cost allowances. We apply the updated approach in our technical intervention to PAYG rates. In order to calculate the mix of operating and capital expenditure we follow the approach set out in 'Securing cost efficiency technical appendix'. We set out our approach to assessing notional financeability and for addressing financeability constraints for the notional

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
						company for final determinations in the 'Aligning risk and return technical appendix'. We set out the specific interventions we make for Bristol Water in relation to notional financeability in the 'Bristol Water final determination' document.
BRL.RR.C2	We are intervening to align the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework. This approach seeks to take account of covariance in performance on individual outcome delivery incentives.	We are intervening to align the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework.	No representation made.	N/A	N/A	N/A
BRL.RR.C3	We expect companies to update their RoRE risk range analysis in response to the draft determinations.	We expect companies to update their overall RoRE risk range analysis in updated App26 submissions as part of their response to the draft determination. This should take account of the guidance we have provided in the 'Aligning risk and return technical appendix' that accompanies our draft determination and 'Technical appendix 3: aligning risk and return' published with the IAP, and the context that achieved cost and outcomes performance has been positively skewed at a sector level in previous price review periods. Companies are strongly incentivised to achieve and outperform regulatory benchmarks. Therefore where	Representation made. Bristol Water say that it based the RoRE risk range values in its draft determination representation on its views of totex requirements, performance commitment levels, and other factors, rather than the draft determination itself. Bristol Water represents that: • its base return on regulatory equity has been reduced by the lower allowed return in the draft determination; • Ofwat's draft determination view of risk ranges for ODIs was not representative of risks, inconsistent with the PR19 methodology, and should be rebalanced; and	Change for the final determination.	Change for the final determination.	See BRL.RR.D3.

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		companies consider there to be a potential downward skew in forecast risk ranges for returns, we expect companies to provide compelling evidence that this is expected to be in the context of expected performance delivery of the company, taking account of the company's reported level of actual performance delivered in 2015-19 and taking account of the steps it is already taking or plans to take to deliver against regulatory benchmarks and mitigate downside risk.	• Use of historical totex outcomes to establish PR19 risk ranges is of limited value. We present our assessment of the RoRE risk range provided by the company in its representation in the 'Bristol Water company specific appendix' which presents some downward skew to the overall risk range relating to totex risk and outcome delivery incentives.			
Risk and return	N/A	N/A	N/A	Representation made. The company provides representations on the Ofwat approach to the financial ratios used to assess notional financeability. It considers that the ratios within the draft determination are misleading as the ratios do not align with the approach used by the credit rating agencies which in reality provide the investment grade credit ratings required to ensure the business remains financeable. The company states that Ofwat continues to assume that companies have a choice of accounting policies, specifically the treatment of infrastructure renewals expenditure. Bristol Water states that credit rating agencies do not take each company policy into account when comparing across the industry.	Change for the final determination. A number of companies and stakeholders have made similar representations in relation to financeability of the notional company. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'. In presenting the ratios for our final determinations we exclude the effect of differing accounting treatment of infrastructure renewal expenditure from the numerator of the adjusted interest cover ratio to improve comparability of the financial ratios between companies. We set out the revised calculation in table 5.2 of the company final determination document for those companies affected.	BRL.RR.D4
Risk and return	N/A	N/A	N/A	The company has provided a representation on "totex sharing mechanism was skewed in draft	No change for the final determination. We consider that the upfront payment is not appropriate as companies tend	N/A

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				determination with removal of ex-ante revenue impact".	to outperform their business plan submissions, and the upfront payment could lead to an even greater negative adjustments at PR24 than without it. The upfront payment also means that customers are likely to pay more for the 2020 to 2025 period and above the level of efficient costs. We set out further detail in the 'Securing cost efficiency technical appendix'.	
Risk and return	N/A	N/A	N/A	Representation made. The company provides representations that it proposes a dividend yield of 3.4% and dividend growth of 0.9% p.a. which splits the blended cost of equity of 4.3% by the 80% embedded debt assumption.	Change for the final determination.	We revise our notional dividend yield to 3.00% (from 3.16% in the fast track draft determination) and apply a dividend growth of 1.18% (1.36% in the fast track determination) in our notional financeability assessment for Bristol Water. This takes account of the allowed cost of equity in the final determination.
Risk and return	N/A	N/A	N/A	Representation made. The company has provided a representation on "bill profiling in draft determination was inappropriate given £2 bill variation in 2026. Customers prefer below CPIH bills rather than forcing higher bills in 2020 and then in line with CPIH thereafter" The company states that it assumes no revenue re-profiling in the draft determination response, and Ofwat should only intervene for clear and material reasons to do so, rather than as standard.	Change for the final determination.	We remove the adjustments for bill profiling that were retained in the draft determination. We set out the profile of bills in section 6.1 of 'Bristol Water final determinations summary'.
Risk and return	N/A	N/A	N/A	Representation made. The company provides representations that it proposes to use its own definition of gearing rather than the regulatory gearing reported in the annual	No change for the final determination.	We set out our approach to the company proposal in the 'Aligning risk and return technical appendix'.

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
				performance report. The company considers its preference shares should be treated as equity rather than debt in the definition of gearing for the mechanism. The company states that the exclusion of this instrument from our allowed cost of debt implies inconsistency in our approach.		
Securing confidence and assurance	BRL.CA.A4	On dividend policy the company is required to confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' to include: clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders. Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.	No intervention but further action needed by Bristol Water. We expect Bristol Water to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our position statement and we expect the company to be clear about how it will take account of the particular risks to its long term financial resilience, set out in the securing long-term resilience actions and interventions tracker. We expect the company to respond to this issue in its response to our draft determination. We expect Bristol Water to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. In doing so, the company should refer to the examples of best practice we have identified among companies.	Representation made. The company provided some additional information in response to our action. The company sets out how its dividend policy for 2020-25 will take account of obligations and commitments to customers and other stakeholder and it provides insufficient detail on the specific obligations and commitments to customers that will be considered with reference to the commitments in our business plan. The company has also provided further information on how performance delivery will impact on dividends paid. The company indicates that dividends may be increased or lowered from the base depending on the actual performance of the company although we note that diagrams provided by the company could make this clearer. We address the company's response in relation to how it will take account of particular risks to its long term financial resilience in the securing long-term resilience decisions document.	Change for the final determination. We have updated our assessment of the reasonable base dividend for water companies in 2020-25 as set out in the 'Aligning risk and return technical appendix' Under our current assessment the company falls short in a number of areas set out below. We expect Bristol Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25 and demonstrate how it has taken account of obligations and commitments to customers and other stakeholders, including specifically how performance delivery has impacted on the dividends paid.	We expect Bristol Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25, to demonstrate how it has delivered on the commitments in relation to its dividend policy and to ensure it meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning risk and return technical appendix'.
Securing confidence and assurance	BRL.CA.A5	On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set	No intervention but further action needed by Bristol Water. There remain a number of details to be finalised, for example the exact structure and weightings of the measures within the annual and long	Representation made. In its response the company states that its position is substantially unchanged from the information it has previously provided. It has however provided	Change for the final determination. Bristol Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance: position statement'. Based	We expect Anglian Water to be transparent when explaining and reporting the application of its performance related executive pay policy over 2020-25, to demonstrate how it exhibits a

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
		out in 'Putting the sector in balance' to include: clear explanation of stretching targets and how they will be applied; and commitment to report how changes, including the underlying reasons, are signalled to customers. Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.	term bonus schemes, and how they demonstrate a linkage to substantial service delivery for customers. Once finalised, we expect Bristol Water to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations we have set out in 'Putting the sector in balance' position statement . We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25. We expect the company to report transparently, in its annual performance report, about further updates to the development of its policy that will apply in 2020-25.	extracts from its current policy for its annual bonus highlighting the areas that will continue into AMP7. In addition it also provided the proposed performance areas and link to customers interests for the LTIP for AMP7, being: • 20% - Totex performance • 10% - RoRE • 25% - ODI performance measures (leakage, metering, water quality, supply interruptions, and CRI) • 10% - C-Mex • 10% - Company monitoring framework (or equivalent) • 10% - PR24 preparedness • 15% - Resilience in the round (asset health, resilience project and biodiversity index)	on our calculations, the overall percentage of alignment of incentives to customers is in line with the 60% we highlighted as evidence of good practice amongst the companies we regulate in our document, 'PR19 draft determinations: Aligning risk and return technical appendix'. However, we consider that there is scope for the company to improve this position.	substantial alignment to the delivery of service for customers and meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning risk and return technical appendix'.
Securing confidence and assurance	BRL.CA.C1	The company accepts the gearing outperformance mechanism, but proposes it's out gearing calculation will exclude £12.5 million of preference shares, as it considers these specific historical financing arrangements can be considered an element of equity, rather than debt in some	We expect Bristol Water to apply our default benefit sharing mechanism. If the company does not apply the default mechanism set out in the 'Putting the sector in balance: position statement', we intend to make an adjustment at PR24 to ensure benefits are adequately shared with customers.	Representation made. Bristol Water restates its view that its £12.5 million of preference shares should be treated as equity rather than debt in the calculation for gearing. The company does not agree that the default benefit sharing mechanism should include preference shares as debt in the calculation for gearing. The company says there is an inconsistency	Change for the final determination. We do not consider that Bristol Water's mechanism, with its bespoke definition of gearing, provides benefits for customers that are equivalent, in the round, to our glide path sharing mechanism. Bristol Water argued at CMA appeal in 2015 (with supporting KPMG report) that its preference shares	We apply our revised mechanism which introduces a glide path as described in the 'Aligning risk and return technical appendix' for the final determination.

Test area	Actions/intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
		circumstances. We do not accept that treating preference shares as equity for the purposes of the calculation is in the customer interest as it is unlikely interest payments on preference shares could be reduced to reflect, for example, circumstances related to poor performance or to maintain financial resilience.		with the cost of capital assumptions by taking this view. The company also states that we had argued the opposite with the CMA in 2015.	were more like debt. We exclude from WACC as their irredeemable nature makes them non-pure debt which we considered an unlikely inclusion in an efficient notional company's debt financing mix. Contractual, fixed payments suggest they should contribute to gearing (as per annual performance report position).	
Tax	N/A	N/A	N/A	Representation made. Bristol Water provided updated tax information to reflect the most up to date information available on its opening capital allowance pool balances.	Change for the final determination. We accept the updated information provided by the company.	We reflect the updated capital allowance information on tax provided by Bristol Water in our final determinations.
Securing long-term resilience	BRL.LR.A4	Bristol Water is responsible for maintaining its long term financial resilience. The company has provided a Board assurance statement that its plan is financeable on the basis of its actual structure. While the company has assessed its financial resilience with and without the requested company specific adjustment (which has not been allowed in our draft determination), there is limited headroom in the projected financial ratios, which are also impacted by past performance adjustments. In its response to our draft determination Bristol Water should provide further detail and Board assurance about its plans to maintain its long term financial resilience in the context of targeting a Baa2 credit rating (that is only one notch above the lowest	N/A	Representation made. Bristol Water says that its updated scenario analysis shows that its draft determination response is necessary for financial resilience and it provides financial resilience assurance on this basis. It says its financial sensitivity modelling shows that a number of scenarios put pressure on its financial ratios, and mitigating actions would need to be undertaken to manage this position. However, it notes that in many scenarios the impact on one ratio is more extreme than on the other ratio, and mitigating actions could be managed taking into account a balance between these two assessments. However, it also presents evidence and assurance on the steps that the company would take in practice to ensure that financing was maintained irrespective of the draft determination. It says it has undertaken stress testing of its response to the draft determination using Ofwat's required scenarios (along	No change for the final determination. We consider that our determinations are financeable for an efficient company with a notional capital structure. However, there is also a need for companies to ensure that that they are financially resilient under their actual structures. We have not accepted all of the company's representations and the allowed return is lower in the final determination reflecting market expectations on the cost of finance. Therefore, on account of Bristol Water's gearing which is above the notional level, the cost of capital in our final determinations that is lower than the draft determinations, the company may need to take steps to maintain its financial resilience in 2020-25.	We will closely monitor changes in levels of the company's gearing, credit ratings and other key financial metrics during 2020-25 to test that adequate steps are being taken by management and that financial resilience is being maintained. In its future reporting, we expect the company to explain clearly in its long term viability statement how the Board has identified and assessed the potential risks to its financial resilience and the mitigating actions it is taking to address those risks.

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		investment grade rating and lower than the target credit rating the company states it targets on a notional basis), and our draft determination as referenced in BRL.LR.C1. In its future reporting Bristol Water should undertake suitably robust stress tests to support its long term viability statements.		with Board's own scenario and stress testing as per its annual Long Term Viability Statement assessment). Bristol Water says that, based on its response to the draft determination and the stress testing set out in the response, its directors confirm they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period ending March 2030. Bristol Water considers targeting Baa2 is acceptable for 2020-25 with respect to its low new debt requirement. Bristol Water has committed to assess it financial resilience beyond 2025 in its next long term viability statement.		
Securing long-term resilience	BRL.LR.C1	The Board assurance on actual and notional financeability and financial resilience in the revised business plan was provided on the basis of the assumptions made in the business plan, prior to any interventions we have made in the draft determination and our updated view of the cost of capital. There is evidence of further downward pressure on the cost of capital in very recent market data which will be considered for our final determination.	We expect companies to provide further Board assurance, in their responses to the draft determination, that they will remain financeable on a notional and actual basis, and that they can maintain the financial resilience of their actual structure, taking account of the reasonably foreseeable range of plausible outcomes of their final determination, including evidence of further downward pressure on the cost of capital in very recent market data as we discuss in the 'Allowed return on capital technical appendix' and the specific issues we have set out related to the financial resilience of the actual financial structure.	See BRL.LR.A4.	See BRL.LR.A4.	See BRL.LR.A4.

Table 2: Bristol Water – Changes to the draft determination that are not in response to an action or representation

Test area	Actions/intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
Allowed return on capital	BRL.RR.D1	We have revised our assessment of the allowed return drawing on market data up at 30 September 2019 and taking account of revisions to our approach following our assessment of representations. We have revised our assessment of the required retail margin deduction down from 0.11% to 0.04%, reflecting our view that the double-counted component of return in the household retail margin has reduced since PR14. We set out the basis for the allowed return on capital in our 'Allowed return on capital technical appendix'.	The sector allowed return on capital for the appointee price controls in our final determinations is 2.96% – CPIH deflated (1.96% – RPI deflated), 23 basis points lower than in the draft determination. The sector allowed return on capital for the wholesale price controls in our final determinations is 2.92% – CPIH deflated (1.92% – RPI deflated), 16 basis points lower than in the draft determination.
Gearing outperformance sharing mechanism	BRL.RR.D2	In our final determinations, we have amended our gearing outperformance sharing mechanism to contain a glidepath. We explain this in the final determination 'Aligning risk and return technical appendix'.	We have changed the trigger from a fixed trigger of 70% in the draft determination to a glide path which will start at 74% for the year 2020-21 and will reduce by 1% each year, ending at 70% for the year 2024-25 in the final determination.
Financeability	BRL.RR.D3	We consider that Bristol Water's final determination is financeable based on the allowed revenues which include a reasonable allowed return on capital. The final determination is sufficient to ensure it will be in a position to deliver its obligations and commitments to customers.	We discuss our assessment of financeability in the 'Bristol Water final determination' and the basis on which we consider Bristol Water's final determination to be financeable on the basis of the notional capital structure.
Return on Regulatory Equity (RoRE) - Financial Risk Assessment	BRL.RR.D4	We have revised our approach to assessing RoRE risk ranges for five of the risk areas set out in the PR19 methodology to take account of changes we have made in our final determinations to address concerns raised by companies on the overall level of stretch in our draft determinations, and evidence on past performance that we have observed in the sector. Our approaches are set out in the 'Aligning risk and return technical appendix' and the risk ranges for Bristol Water are set out in the 'Bristol Water final determination'. Taking account of changes in our final determination, the RoRE risk ranges at P10 and P90 confidence limits in our final determinations are, in most cases, more symmetrical than the risk ranges represented by companies. Our view of risk ranges also indicates more scope for outperforming companies to earn higher returns, but also for underperforming companies to receive lower returns.	The final determination risk range reflects the following interventions that we make for all companies: • The totex range is our assessment of the plausible range based on evidence of the historic sector performance and taking account of the company's cost sharing rates that apply in its final determination. • The financing cost risk range is based on our assessment of the range for a notional water company including both embedded and new debt. • The ODI risk range has been determined under our Outcomes Framework. • The C-MeX risk range is calculated as 12% upside and 12% downside of residential retail revenue, reflecting the cap and collar limits for this incentive. • The D-Mex risk range is calculated as 6% upside and 12% downside of developer services revenue, reflecting the cap and collar limits for this incentive.
Financial Risk Assessment – Uncertainty Mechanisms	BRL.RR.D5	We are including a PR24 reconciliation mechanism for business rates in our final determination for Bristol Water along with all other companies because: • There is uncertainty about business rates costs because the Valuation Office Agency (VOA) will be carrying out revaluation exercises during 2020-25, and increases (or decreases) in cost levels could be material.	In each case, the cost variance to the company's PR19 cost allowance will be subject to a 75 (customer share):25 (company share) symmetrical sharing rate in the totex reconciliation at PR24. This means that the company will still be incentivised to manage costs efficiently, whilst receiving appropriate protection against material cost increases. Conversely, customers will receive a benefit if outturn costs are lower

Test area	Actions/intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
		• Companies can only exercise limited control over cost levels by engaging with the VOA and, possibly, by considering the business rate implications of asset development choices. We are also including a PR24 reconciliation mechanism for Environment Agency abstraction licence costs in our final determination for Bristol Water along with all other companies serving England because: • The Environment Agency expects to consult on changes to its basis for setting abstraction licence fees during 2020 meaning that there is material uncertainty about company cost levels in 2020-25. • Companies can only exercise limited control over cost levels by engaging with the consultation process and providing accurate information when required for licence fee setting purposes.	than the allowance levels we have set. Details will be set out in the PR19 Reconciliation Rulebook.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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