

December 2019

# PR19 final determinations

**Northumbrian Water – Accounting for past delivery final decisions**

## PR19 final determinations: Northumbrian Water - Accounting for past delivery final decisions

In our [draft determinations](#), we published the ‘Accounting for past delivery 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. It also set out any further interventions that were not resulting from an action, which we made as part of the draft determination.

This document sets out the decisions on accounting for past delivery we are making for the final determination. Our decisions and interventions set out here are relative to the company’s 15 July 2019 past delivery submission (the ‘15 July 2019 submission’). They also take into account the representations made on all our draft determinations, responses from companies to our queries and additional information provided following further engagement with companies and other stakeholders as part of the final determination process.

Table 1 below sets out all the initial assessment of plans actions, the model the action relates to, a summary of the company’s response to the initial assessment of plans action, our assessment of the company’s response, any further interventions we made as part of the draft determination, a summary of the company’s updated submission and / or representation on the draft determination, our assessment of the company’s updated submission and / or representation and our final interventions for the final determination. Table 1 also sets out any further interventions that are not resulting from an action which we are making as part of the final determination.

Our final determination and the final decisions set out in this document take account of Northumbrian Water’s actual performance in 2018-19 and updated evidence for its forecast performance in 2019-20 (taking into consideration its actual performance in 2018-19) as submitted on 15 July 2019 or in updated information submitted as part of its 30 August 2019 representation.

Each action and further intervention that is not resulting from an action has a unique reference. The prefix ‘NES’ denotes the company Northumbrian 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 from the initial assessment of plans. Actions whose numbers are preceded with a ‘B’ denote advised actions from the initial assessment of plans. 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.’ Both draft and final interventions are 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. Where a company submits updated information as part of its 30 August 2019 representation and we reflect this in our final determination, we identify this intervention in our final determination models with the reference NES.PD.REP. The past delivery model codes are set out below.

Model	Code
ODIs	002
Land sales	003
WRFIM	005
Totex	006
Water trading	007
Residential retail	008
Residential retail SIM	009
RCV adjustments feeder model	010
Revenue adjustments feeder model	011
South West Water aggregation model	012
Thames Water / Southern Water revenue profiling model	013
Business retail SIM	014
Southern Water enforcement revenue adjustments	015

For all other documents related to the Northumbrian Water’s final determination, please see the [final determinations webpage](#).

**Table 1 – Accounting for past delivery final decisions for Northumbrian Water**

Model	Ref.	IAP action	Summary of company response to the IAP action	Our assessment and rationale for the draft determination	Summary of company updated submission and / or representation	Our assessment and rationale for the final determination decision	Decision for in the final determination	
All models	NES.PD.A7	<b>PR14 reconciliations:</b> 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.	No company action required for the draft determination.	No intervention required.  We will review Northumbrian 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.	In its 15 July 2019 submission, Northumbrian Water updates all of its PR14 reconciliations with actual performance for 2018-19 and provides evidence for its forecast performance in 2019-20.	Our final interventions take account of Northumbrian Water's actual performance in 2018-19 and updated evidence for its forecast performance in 2019-20 (taking into consideration its actual performance in 2018-19) as submitted on 15 July 2019 and in its 30 August 2019 representation.	N/A	
All models	NES.PD.REP	<p>In its 30 August 2019 representation, Northumbrian Water submits the following updated past delivery business plan tables to reflect our draft determination:</p> <ul style="list-style-type: none"> <li>App5 (PR14 reconciliation performance commitments) and App27 (PR14 reconciliation - outcome delivery incentives summary).</li> </ul> <p>Unless otherwise stated, our final determination and any interventions we have made for the final determination as set out in the table below, take account of Northumbrian Water's latest updated information.</p>						
Outcomes	NES.PD.A1	<b>PR14 Outcome delivery incentives:</b> Northumbrian Water is required to remove the adjustment for the tax rate in the values reported in table App 27 and resubmit.	Northumbrian Water provides table App27 with values not adjusted for tax.	No intervention required but action required by Northumbrian Water.	In its 15 July 2019 submission, Northumbrian Water removes the adjustment for tax in its updated tables App5 and App27.	No intervention required.  The company addresses the issue appropriately in its 15 July 2019 submission.	N/A	

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Outcomes	NES.PD.A2a	<p><b>PR14 Outcome delivery incentives:</b> Northumbrian 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>	No company action required for the draft determination.	<p>No intervention required.</p> <p>We will review Northumbrian Water's updated data before making any interventions for the final determination.</p>	<p>In its 15 July 2019 submission, Northumbrian Water provides evidence for its updated forecast performance for 2019-20 in light of its actual performance in 2018-19 for all of its performance commitments.</p> <p>In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to the specific actions NES.PD.A2a to NES.PD.A2m.</p>	<p>No intervention required.</p> <p>The company addresses the issue appropriately in its 15 July 2019 submission.</p>	N/A
Outcomes	NES.PD.A2b	W-C3: Water mains bursts (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2c	W-C4: Leakage (MI/d) Northumbrian area	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2d	W-C5: Leakage (MI/d) Essex & Suffolk area	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2e	S-B5: Transferred drains and sewers - internal sewer flooding	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a

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Outcomes	NES.PD.A2f	S-C1: Sewage treatment works discharge compliance (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2g	W-B2: Overall drinking water compliance (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2h	W-B1: Satisfaction with taste and odour of tap water	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2i	W-B3: Discoloured water complaints (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2j	W-C2: Properties experiencing poor water pressure (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2k	S-B2: Properties flooded internally	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2l	S-B4: Sewer collapses (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a
Outcomes	NES.PD.A2m	S-C2: Pollution incidents - category 3 (3-year average)	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a	As NES.PD.A2a

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Residential retail	NES.PD.A3a	<b>PR14 Residential retail:</b> Northumbrian Water is required to clarify what the correct number is in table R9 for retail revenue for unmetered water and wastewater customers in 2017-2018.	The company clarifies that the correct retail revenue for unmetered water and wastewater customers in 2017-18 is £22.801 million and ensures consistency between table R9 and the submitted reconciliation model.	No intervention required.  The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Residential retail	NES.PD.A3b	<b>PR14 Residential retail:</b> Northumbrian Water is required to provide further clarity on the reasons for the difference between reforecast customer numbers and actual customer numbers in 2018-2019.	The difference between actual and reforecast customer numbers in 2018-2019 is due to the forecast actual customer numbers figure being a more recent forecast.	No intervention required.  The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Residential retail	NES.PD.A3c	<b>PR14 Residential retail:</b> Northumbrian Water is required to also provide further evidence to back up the forecasts for metered wastewater-only customers in 2018-2019 and 2019-2020.	Northumbrian Water provides evidence to support its forecasts by referring to consistency with WRMP data included in other business plan tables.	No intervention required.  The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Residential retail	NES.PD.A3d	<b>PR14 Residential retail:</b> Northumbrian Water is required to also provide further evidence to back up the forecasts for metered water-only customers in 2019-2020.	Northumbrian Water provides evidence to support its forecasts by referring to consistency with WRMP data included in other business plan tables.	No intervention required.  The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A

Model	Ref.	IAP action	Summary of company response to the IAP action	Our assessment and rationale for the draft determination	Summary of company updated submission and / or representation	Our assessment and rationale for the final determination decision	Decision for in the final determination
Residential retail	NES.PD.C008.01	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to round Northumbrian Water's modification factor figures to two decimal places to ensure consistency with the '<a href="#">PR14 reconciliation rulebook</a>'.</p>	<p>In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention retained.</p>	<p>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:</p> <ul style="list-style-type: none"> <li>• unmetered water-only customer;</li> <li>• unmetered wastewater-only customer;</li> <li>• unmetered water and wastewater customer;</li> <li>• metered water-only customer;</li> <li>• metered wastewater-only customer; and</li> <li>• metered water and wastewater customer.</li> </ul> <p>Our interventions reduce the total residential retail revenue payment at the end of the 2015-20 period from - £1.160 million to - £1.156 million (nominal price base).</p>

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Residential retail	NES.PD.C008.02	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>	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.	Intervention retained.	<p>For Northumbrian 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 Northumbrian Water's 15 July 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>
Residential retail service incentive mechanism (SIM)	NES.PD.A4	<b>PR14 Service incentive mechanism:</b> Northumbrian Water is required to provide more evidence to support the forecast trajectory in table R10.	Northumbrian Water provides an explanation for its forecast trajectory in its response to action NES.PD.A4.	No intervention required. The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A

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Residential retail service incentive mechanism (SIM)	NES.PD.C009.01	N/A	N/A	Intervention required. We are intervening to adjust Northumbrian Water's residential retail revenue as a result of its SIM performance from 2015-16 to 2018-19.	In its representation, Northumbrian Water considers that, in Table 3.1 of the past delivery appendix, unless there has been a restatement of its Table R10, Yorkshire Water's four year average score should be nearer 83.6. The company requests that we review our calculations.	Intervention retained. We are updating our analysis to take account of companies' finalised scores for 2018-19 and correct a known error, identified by Northumbrian Water in its representation, relating to Yorkshire Water in our draft determination SIM model.	We are intervening to set the residential retail service incentive mechanism adjustment to +1.90% of residential retail revenue, which is £5.698 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'.
Totex	NES.PD.A5a	<b>PR14 Totex:</b> Northumbrian Water is required to update the value for transitional expenditure in 2014-15 to match actual spend.	Northumbrian Water updates the value for water transitional expenditure but does not update the value for sewerage transitional expenditure in its business plan table WWS15.  However, the company includes this correct value for sewerage transitional expenditure in its totex reconciliation model submitted on 1 April 2019.	No intervention required We are using the value for sewerage transitional expenditure taken from the company's totex reconciliation model.	In its 15 July 2019 submission, Northumbrian Water submits the incorrect value for its sewerage transitional costs in table WWS15. It reports a zero value when the correct actual reported outturn figure is £3.730 million (2012-13 prices).  However, the company includes this correct value for sewerage transitional expenditure in its totex reconciliation model submitted on 15 July 2019.  In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	Intervention retained. We continue to consider it appropriate to use the correct figure from the company's totex reconciliation model.	We are intervening to replace Northumbrian Water's sewerage transitional costs figure of £0.000 million with the actual outturn sewerage transitional costs figure of £3.730 million (2012-13 prices) as reported in Table 4.1 Actual transition expenditure (' <a href="#">Updated 2010-15 reconciliation</a> ').  The company correctly included this figure in its totex reconciliation model.

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Totex	NES.PD.A5b	<b>PR14 Totex:</b> Northumbrian Water is required to provide a more detailed explanation to support its forecasted performance for years 2018-19 and 2019-20 in tables WS15/WWS15 and the model.	Northumbrian Water provides a detailed explanation to support its forecast performance in its 'Action tracker – NES' document.  The company's performance is driven by increased operating costs due to adverse weather conditions and also by increased chemicals prices.	No intervention required.  The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Totex	NES.PD.D006.01	N/A	N/A	N/A	In its 15 July 2019 submission, Northumbrian Water submits a different 'Water: actual totex' figure for 2018-19 and its 2019 annual performance report. In its 15 July 2019 submission the figure is £378.651 million.  Following subsequent engagement through query NES-APR-PD-001, Northumbrian Water confirms the correct figure should be £378.373 million as reported in its annual performance report.	Intervention required.  We are including the figure reported in Northumbrian's annual performance report for 'Water: actual totex' in 2018-19. The company confirms this is the correct figure to use.	We are intervening to change the 'Water: actual totex' figure for 2018-19 from £378.651 million to £378.373 million.

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Wholesale revenue forecasting incentive mechanism (WRFIM)	NES.PD.A6	<b>PR14 Wholesale revenue forecasting incentive mechanism:</b> Northumbrian Water is required to use June 2018 update version of the model to calculate the adjustments.	Northumbrian Water uses the June 2018 update version of the model to calculate the wholesale revenue forecasting incentive mechanism adjustments.	No intervention required. The company provides sufficient evidence in response to this action.	In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A

Model	Ref.	IAP action	Summary of company response to the IAP action	Our assessment and rationale for the draft determination	Summary of company updated submission and / or representation	Our assessment and rationale for the final determination decision	Decision for in the final determination
Water trading	NES.PD.C007.01	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to disallow the water trading export incentive claim for the trade with Thames Water. The principles of the water trading incentives policy were set out at PR14. The policy intent of the incentives was to encourage new transfers of water between water companies. In order to be able to claim water trading incentives, the 'PR14 methodology' set out a requirement for companies to have an Ofwat-approved trading and procurement code in place consistent with those principles. Northumbrian Water has an Ofwat approved trading and procurement code, 'Northumbrian Water - trading and procurement code' consistent with the water trading incentives policy set out at PR14 which we approved on 12 February 2018. However, the net effect of the water trade with Thames Water is to implement a reduction in the amount of water that is exported from Thames Water to Northumbrian Water under a modification of a pre-existing bulk supply agreement with Essex and Suffolk Water. Therefore, the incentive claim for this water trade is inconsistent with the criteria set out in the trading and procurement code which requires a new export agreement and with the policy intent of the water trading incentives as set out in the PR14 methodology to encourage new water transfers. Therefore, we are intervening to disallow the claim.</p>	<p>In its representation, Northumbrian Water reiterates its April 2019 revised business plan position: that the trade with Thames Water is consistent with its trading and procurement code and therefore qualifies for water trading incentives. It considers that we have intervened in a way which considers the trade agreement in a narrow legalistic way and misses the "substance over legal form" tests. The company argues that we would have allowed the trading incentives if it had created a new, entirely separate contract to effect the trade and laid a parallel main to send water back to Thames Water rather than reducing the existing import from Thames Water.</p>	<p>Intervention retained.</p> <p>We consider that Northumbrian Water's representation does not present any new evidence compared to the evidence provided in its April 2019 revised business plan. We are retaining our intervention to disallow the claim.</p> <p>The policy intent of the PR14 water trading incentives was to encourage new transfers of water between water companies.</p> <p>We do not consider that the trade between Northumbrian Water and Thames Water is a new transfer. The effect of the updated bulk supply agreement is to reduce the amount of water imported from Thames Water which is a reduction in an existing trade. We consider that this reduction of an existing import cannot qualify as an export for Northumbrian Water.</p> <p>We consider that water resources capacity was increased through the expansion of Abberton reservoir beyond the near-term needs. As a result, Northumbrian Water took the rational and efficient decision to enter into an agreement with Thames Water to reduce the amount of water it imports. We would have also disallowed the incentive if the companies had agreed a contract with no reference to the legacy contract or had duplicated the existing transfer infrastructure because the net effect would still be to reduce an existing trade as it reduces exports to the Essex and Suffolk Water region.</p>	<p>Our interventions reduce the total PR14 water trading revenue payment at the end of the 2015-20 period from £7.065 million to £0 million (2017-18 FYA CPIH deflated price base).</p>

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Revenue adjustments	NES.PD.C011.01	N/A	N/A	<p>Intervention required.</p> <p>We are standardising the discount factor used to profile revenue adjustments.</p> <p>Companies can choose to apply revenue adjustments 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.</p> <p>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 Northumbrian Water's choices for profiling revenue adjustments in 2020-25.</p>	<p>In its representation, Northumbrian Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention required.</p> <p>We are intervening to reflect our updated view of the wholesale WACC.</p> <p>We are not intervening in Northumbrian Water's choices for profiling revenue adjustments in 2020-25.</p> <p>Where profiling selections have been made for controls with no revenue (Dummy control and/or Business retail) we have set these selections to '0'. This has no impact on the modelling outputs.</p>	<p>We are using our view of the wholesale WACC (2.92%) as the discount factor to preserve the net present value of the outperformance or underperformance payments due when spreading adjustments over the period.</p>

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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