

December 2019

PR19 final determinations

**Portsmouth Water – Cost efficiency
final determination appendix**

PR19 final determinations: Portsmouth Water – Cost efficiency final determination appendix

About this document

This document is a cost efficiency appendix to 'PR19 final determinations: Portsmouth Water final determination'. This document provides further details of the company specific issues related to cost allowances and is structured as follows:

- Section 1 provides a summary of our decisions on the company's cost adjustment claims;
- Section 2 provides a summary of our decisions on the company's enhancement proposals, by enhancement area;
- Section 3 provides our decision on costs proposed by the company under the transition programme;
- Section 4 provides our decision and unit cost adjustment related to the WINEP/NEP uncertainty mechanism.

Further information on our assessment and our approach can be found in the 'Securing cost efficiency technical appendix' and the various excel feeder models that we have published.

1. Cost adjustment claims

Table 1 summarises our consideration and allowances for the cost adjustment claims submitted by the company. For completion we include all claims that were part of our draft determination decisions, as well as additional or revised claims the company submitted in its representation to the draft determination. We give further details in our published cost adjustment claim feeder model for Portsmouth Water.

Table 1: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million, nominal)¹

Description of Claim	Value of company claim	Our allowed adjustment	Rationale for decision
Bill size (residential retail)	1.0	0.0	Portsmouth Water claims to be penalised by our retail econometric models for having the lowest bill size in the industry. We do not find sufficient and convincing evidence of the need to make an adjustment to the company's allowance. See 'Portsmouth Water final determination' for further information.

¹ The value of the cost claim for the residential retail control ('bill size') is in nominal terms.

2. Enhancement assessments

Our approach to assessing enhancement expenditure is detailed in our publication 'Securing cost efficiency technical appendix'. We generally assess enhancement expenditure separately for each enhancement category, as defined by the individual enhancement cost lines in company business plan tables. We assess multiple lines together where there is a potential for costs to be apportioned differently by companies and where there is some synergy between programmes.

Our preferred method of assessment is benchmarking analysis. Where the investment area does not lend itself to statistical modelling we rely more on the evidence provided by companies in their business plans. We follow a risk-based process of having a lighter touch ('shallow dive') assessment for low materiality costs and a more thorough assessment of the evidence ('deep dive') of high materiality costs.

Tables 2 summarises our consideration and allowances for the enhancement expenditure cost lines submitted by the company. We give further details in our published enhancement feeder models for Portsmouth Water.

Table 2: Assessments of water enhancement expenditure, 2020-25 (£ million of 2017-18)

Enhancement cost	Company view in August 2019 business plan (after reallocations)	Our final determination allowance	Rationale for decision
Meeting lead standards	0.3	0.2	We use a benchmark model to make allowances for these costs. Portsmouth Water is less efficient than our benchmarks and we do not allow the full amount requested. Our allowance is unchanged from draft determination.
Supply and demand side enhancements: Total	4.2	2.7	We do not allow enhancement costs for leakage reduction, because the company's stretching performance commitment level does not go beyond the forecast upper quartile threshold. We allow the remaining request within the 2020-25 supply-demand balance enhancement component in full because the company's unit cost is lower than the efficient industry benchmark. See 'Portsmouth Water final determination' for further information.

Metering (excluding new connections) for meters requested by optants, customers and businesses	5.2	5.2	We use a unit cost model to make allowances for these costs. Portsmouth Water is more efficient than our benchmarks and we allow the requested cost in full.
Resilience	2.8	1.2	Our allowance is unchanged from draft determination. We use our deep dive approach and challenge the need, cost efficiency and/or optioneering of the proposed investments. See 'Portsmouth Water final determination' for further information.
Investment to address raw water deterioration	5.8	5.5	We use our deep dive approach to set the allowance. All schemes are supported by the Drinking Water Inspectorate. We find evidence of optioneering and scales of flows to be treated and pass proposals.
Total clean water WINEP	4.8	4.1	We use our deep dive approach to set allowances for eels regulations and drinking water protected areas programmes. In both cases we find insufficient evidence that costs are efficient. In the drinking water protected areas programme we apply the company deep dive efficiency factor. For the eels regulation programme we disallow the cost for the risk of screen extension due to a lack of evidence of the cost efficiency of this component.
Total water enhancement	23.0	18.8	

3. Transition expenditure

The transition 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 sets out our allowances under the transition programme for wholesale water. We allow costs when reasonably justified in order to make efficient use of resources to minimise whole life costs, where it is efficient or in customers' interests to bring forward an investment, or to enable companies to meet early statutory deadlines.

For the avoidance of doubt, a disallowance of a proposed expenditure in Table 3 should not be interpreted as a disallowance of the expenditure from our 2020-25 cost allowance; only as a disallowance under the transition programme.

Table 3: Transition expenditure in wholesale water price controls 2019-20 (£ million of 2017-18 CPIH deflated)

Description of expenditure	Control	Requested expenditure	Allowed expenditure	Rationale
Havant Thicket	Havant Thicket separate control	5.2	5.2	<p>The investment relates to starting work on Havant Thicket reservoir in order to provide water supply to Southern Water by 2029.</p> <p>The company provides extensive evidence to explain that the investment was not part of the long-term planning from PR14 due to additional information arising in 2017-18 on the need of additional water and further specifications of the project, which were agreed with Southern Water. Furthermore, the company justifies that it is efficient to bring this investment forward. Delays to the scheme would impact on the ability for the company to transfer water to Southern Water, hence we accept the need for transition funding.</p>

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. As Portsmouth Water's WINEP does not list any schemes with 'amber' status there is no need for such a mechanism and we are not specifying one.

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

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

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