

December 2019

PR19 final determinations

**South Staffs Water – Cost efficiency
final determination appendix**

PR19 final determinations: South Staffs Water – Cost efficiency final determination appendix

About this document

This document is a cost efficiency appendix to 'PR19 final determinations: South Staffs 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 on cost adjustments related to the WINEP 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 summarizes 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 South Staffs Water.

Table 1: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million of 2017-18)

Description of Claim	Value of company claim	Our allowed adjustment	Rationale for decision
Treatment works investment	68.5	68.0	The company requests expenditure for the upgrade of two water treatment works (Hampton Loade and Seedy Mill) to address the risk of poor water quality. We find sufficient and convincing evidence of the need of investment, but apply the company deep dive efficiency factor to the requested cost for the mains cleaning work. See 'South Staffs Water final determination' for further information.

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 South Staffs 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
Improving taste / odour / colour	68.5	68.0	We carry out the assessment of this expenditure within the cost adjustment claim for treatment works investment. See ‘South Staffs Water final determination’ for further information.
Meeting lead standards	3.0	3.0	We use a benchmark model to make allowances for these costs. South Staffs Water is less efficient than our benchmarks and we do not allow the full amount requested. The company revised the requested cost in its response to the draft determination and accepts our allowance.

Supply and demand side enhancements: Total	16.1	5.8	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 unit cost is lower than the efficient industry benchmark. See 'South Staffs Water final determination' for further information.
Investment to address raw water deterioration	15.9	12.7	The company proposes expenditure for three water treatment works. We allow the capital expenditure of two of the treatment works but challenge the optioneering of one of the programmes. We consider that operating costs are covered by our base allowance. See 'South Staffs Water final determination' for further information.
Metering (excluding new connections) for meters requested by optants, customers and businesses	11.7	11.4	As at draft determination we make an allowance for metering based on our unit cost model. At final determination we apply the frontier shift to the model output which results in a minor reduction in the allowance.
Resilience	4.1	1.9	We use our deep dive approach and challenge the need, cost efficiency and/or optioneering of the proposed investments. See 'South Staffs Water final determination' for further information.
Total clean water WINEP	9.2	8.8	We use our shallow dive approach to set allowances, applying the company shallow dive efficiency factor only, for ecological improvements, non-native invasive species and drinking water protected areas. We use our deep dive approach to set allowances for the eels regulations and water framework directive measures programmes and challenge the cost efficiency. See 'South Staffs Water final determination' for further information.
Total water enhancement	128.5	111.6	

3. Transition expenditure

South Staffs Water does not request any expenditure under the transition programme.

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.

In the case of South Staffs Water, WINEP includes 10 'amber' water resources schemes. Owing to significant uncertainty regarding the need, scope and solution for these schemes the company did not include costs within its April 2019 business plan for delivering them in the 2020-25 period but stated it would consider its position over the coming months as it gained more certainty around our requirements. In its representation on our draft determination, following further discussions with the Environment Agency, the company includes a total of £1.541 million capital expenditure for nine of these schemes that it considers reasonably certain to be required before 2025 in an updated environmental programme and proposes a cost adjustment mechanism to be applied should this not be the case. We have taken this addition into account in our deep dive of the company's proposals for Water Framework Directive measures.

Table 3 sets out the adjustments we will make for each scheme in South Staffs Water's WINEP programme that is currently unconfirmed, if the scheme is confirmed as not required for the period 2020-25. We have also included one Eels Regulations scheme which, while nominally certain (and therefore colour coded 'green' in WINEP), may not go ahead owing to questionable benefits.

We will make the adjustments at the end of the control period. Our adjustments are based on the company's totex estimates (after reallocations) as adjusted by our company specific efficiency factor.

Table 3: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP schemes included in our final determination (£ million in 2017-18 prices)

Unique ID	Scheme name	Company's PR19 cost estimate (£m)	Our allowed adjustment (£m)
WINEP/NEP ~ Water Framework Directive			
7SS100051	Rising Brook	0.63	0.60
7SS100041	Blithfield Reservoir	0.41	0.39
7SS300007			
7SS300040	Nethertown		
7SS100001	Little Hay - Borehole	0.26	0.25
7SS100052	Bourne – Black Brook	0.22	0.21
7SS100053	Bourne – Black Brook (Footherley Brook)		
7SS300008	Bourne – Black Brook (Crane Brook)		
7SS300003	Nethertown	0.021	0.02
WINEP/NEP ~ Eels Regulations (measures at intakes)			
7SS200009	Nethertown Blithe Pumpback	0.25	0.24

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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