

December 2019

PR19 final determinations

**Targeted controls, markets and innovation
final decisions**

PR19 final determinations: Targeted controls, markets and innovation final decisions

In our [draft determinations](#) we published the 'Targeted controls, markets and innovation 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 interventions that did not result from an initial assessment of plans action, which 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 on our draft determinations and changes for the final determination that are not resulting from representations received.

Table 1 below sets out the action reference, initial assessment of plans actions, a summary of the relevant 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 representation on the draft determination, our assessment of the company's representation and our final 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.

These tables do not cover actions that are discussed elsewhere or where we have separately engaged with companies. For example, they do not cover actions related to:

- direct procurement for customers as these are covered in 'Delivering customer value in large projects';
- the classification of fixed and variable costs related to bioresources as these are covered in 'Our methodology for the classification of bioresources costs and revenues';
- Drainage and Wastewater Management Plans and the Bid Assessment Framework as we have already responded to companies directly; and
- advised actions, for example, regarding those regarding innovation.

Each action has a unique reference. The prefix denotes the relevant company, for example 'AFW' denotes Affinity 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 the relevant required actions. Draft determination interventions not resulting from an initial assessment of plans action are preceded with a 'C'. New interventions and considerations for the final determination not related to a previous action are preceded with a 'D'.

For all other documents related to the relevant companies' final determinations, please see the [final determinations webpage](#).

Table 1 – Company representations in response to the draft determinations

Action or company reference	Initial assessment of plans 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	Decisions for the final determination
ANH.CMI.D1	N/A	N/A	We set a bilateral entry adjustment in the 'Notification of the PR19 draft determination of price controls for Anglian Water' letter.	<p>Representation made.</p> <p>Anglian Water stated that it considered the bilateral market entry mechanism had not been adequately explored. It was concerned about the interaction between the investment in schemes for resilience, the bilateral market and the sustainability of new entrant schemes. In particular, it had raised the following issues that relate to our implementation of a bilateral entry adjustment:</p> <p>Design of the market: The concern was that new entrants may not be able to guarantee the same security of supply as incumbents. The company stated that, if incumbents are expected to act as supplier of last resort, it was not clear on how it should be funded and whether it should be included in a company's plan to ensure resilience in their supplies. There was also a concern that new entrants would not have the same sustainability obligations (e.g. abstraction management, catchment risk assessments) as incumbents to safeguard the environment to ensure a level playing field.</p> <p>Duration of adjustment: The concern was that the adjustment mechanism of the post-2020 investment was not time limited. The company stated that its infrastructure and interventions tend to have long asset lives, so accurately forecasting market entry over the lifetime of its supply interventions is impossible considering the rapid pace of change in the sector. It considers that it is unreasonable for companies who have made an efficient investment to avoid a supply-demand deficit and ensure supply to their customers, then</p>	<p>No change for the final determination.</p> <p>Once the bilateral market opens we do not expect that initial levels of third party entry to be high and the calculation of the equalization payment would deter inefficient entry. Furthermore, company engagement through the bidding market and with stakeholders more broadly should enable reasonably accurate market entry forecasts. Our approach to setting the bilateral entry adjustment reflects companies' projected entry from third parties, meaning they are not penalized if their forecasts are accurate. Furthermore, we anticipate that the company would be able to manage any bilateral market entry within their existing headroom.</p> <p>We considered the duration of the adjustment in 'Appendix 5: Water resources control' of our methodology. As we said in that document, while our focus in this document is the control for 2020-25, we would expect these arrangements to be carried forward into subsequent control periods. For example, there could be an in-period adjustment in 2025-30 for any capacity built by an incumbent during 2020-25 not being used as planned due to unexpected bilateral market entry. We will consider such issues as we develop our methodology for the next price review</p>	N/A

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				to be unable to recover the costs of that investment due to unforeseeable market entry several years later.		
SRN.CMI.D1	N/A	N/A	N/A	Representation made. As part of one of its query responses in relation to its bulk supply agreements with Portsmouth Water, the company expressed its intention to apply for water trading incentives in PR24. The company said that while it currently does not have a developed trading and procurement code approved by Ofwat, its intention is to develop one in order to be eligible for water trading incentives in the future.	No change for the final determination.	This not a change related to PR19. However, we consider that it is important, in light of the company's representation, to clarify our expectations in regards to PR24. For future trades, we expect Southern Water to have an Ofwat-approved trading and procurement code in place within a year of an agreement being entered into to export or import water in the 2020-25 period if it plans to claim PR19 import incentives. As set out in the in our May 2018 'Trading and procurement codes - guidance on requirements and principles' (p.5), we expect that only in exceptional circumstances would a trade be eligible to be claimed in PR24 which was operating in the 2015 to 2020 period. We consider that such circumstances do not apply in Southern Water's case and therefore the company would not be able to claim PR14 import incentives for bulk supplies starting over the 2015 to 2020 period in PR24.
SRN.CMI.D2	N/A	N/A	We set the AUC to be used in the water resources control in 'Table 4: Price Control for Water Resources Activities bilateral entry adjustment numbers' in the 'Notification of the PR19 draft determination of price controls for Southern Water' letter.	No representation made.	No change for the final determination.	We have adjusted the AUC where appropriate to reflect the efficiency challenge that we apply in our assessment of supply-demand balance enhancement expenditure to the schemes that contribute to new water resources capacity.
WSX.CMI.A3	The company should explain the boundaries between the appointed and	The company provided insufficient detail in response to our action in its business plan	Intervention required. We are not convinced that the price of the biogas charged to the non-	Representation made. Wessex Water disputed our intervention on three points:	Change for the final determination. We are partially changing our intervention following the Wessex	We have revised the revenue adjustment from £10.2m in the draft determination to £8.5m. 2021: £1.7m

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	<p>non-appointed activities within its bioresources strategy and clarify how the risks and benefits are shared with customers.</p>	<p>submission on 1 April. Subsequently, we have raised a number of queries to understand Wessex Water's methodology for determining what it considers to be the appropriate value charged by the appointed business to the non-appointed business for the supply of biogas and biosolids produced during the sludge treatment process.</p>	<p>appointed business is the most appropriate value.</p> <p>While customers of the appointed business benefit from buying electricity at close to the wholesale price of electricity, we are not convinced that the charge for biogas reflects the costs of producing biogas nor its value in producing renewable energy. Linking biogas production to electricity infrastructure charges seems counterintuitive.</p> <p>We are concerned that the company's approach may understate the price it should charge for biogas sold to the non-appointed business and overstate the efficient cost of purchasing electricity from a closely located associated business. Wessex Water did not provide compelling evidence to justify this approach. We are not convinced that this is the most suitable method and overall it appears the appointed business may be making an inappropriate charge for biogas supply to the non-appointed business.</p> <p>We are intervening to adjust the value of the biogas transferred to the non-appointed business by reducing Wessex Water's revenue allowance.</p> <p>We consider our approach better reflects the relationship between gas supply and income from electricity generation. It should still enable the non-appointed business to earn an appropriate return on the electricity generation assets and retain 100% of the subsidy income.</p> <p>This amounts to a reduction in revenue covered by customer bills and an addition in revenue coming from other sources of the following</p>	<p>i) Ofwat benchmarking already reflects their structure:</p> <p>Wessex Water consider that we had already benchmarked allowed revenues through against efficient bioresources costs and so already reflects their structure as other companies can reduce their bioresources costs with 'income treated as negative expenditure'.</p> <p>Wessex Water argue that the effect of this benchmarking approach is that the allowance of one company is largely determined by the costs and income of other companies and therefore the proposed adjustment to an already benchmarked allowance is inconsistent.</p> <p>Wessex Water state that, 'It unnecessarily and excessively penalises Wessex Water for having taken a different approach to investing in energy generation.'</p> <p>Wessex Water suggest an alternative might be to make the adjustment to their net cost dependent variable used for the bioresources econometric benchmarking exercise and then run the benchmarking exercise again.</p> <p>ii) Risks setting a precedent that unregulated returns can be captured retrospectively. This will act as a barrier to innovation.</p> <p>Wessex Water state that their structure is innovative and therefore the Ofwat decision to apply an adjustment is at odds with the PR19 messaging and will stifle markets and innovation as others will be more cautious about doing similar things.</p> <p>Wessex Water also says, 'Government direction to Ofwat is that</p>	<p>Water representation by amending our calculations.</p> <p>We do not amend our intervention on the basis of the benchmarking or innovation points raised.</p> <p>i) Ofwat benchmarking already reflects their structure:</p> <p>We acknowledge that the benchmarked allowances implicitly reflects negative income, but it also implicitly includes allowances for funding for bioresources assets that they do not have.</p> <p>Making an adjustment to Wessex Water's net cost dependent variable used for the bioresources econometric benchmarking exercise is likely to unduly favour them. They would benefit from some costs being reduced by the estimated power costs, but it would not account for them avoiding certain OPEX costs (such as maintaining and operating some electricity generating assets) which currently sit in their non-appointed business.</p> <p>Wessex Water have not stated their case with enough evidence to enable us to look in detail at the effect of benchmarking.</p> <p>ii) Risks setting a precedent that unregulated returns can be captured retrospectively. This will be a barrier to innovation.</p> <p>We support innovation and the promotion of markets where it is in customers' interests. Our intervention does not challenge Wessex Water's company structure. The intention of our intervention is to more accurately reflect what we consider to be a more appropriate value for the biogas</p>	<p>2022: £1.7m 2023: £1.7m 2024: £1.7m 2025: £1.7m 2020-2025: £8.5m</p>

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			<p>amounts in each year and for the total AMP7 period:</p> <p>2021: £1.9m 2022: £2m 2023: £2m 2024: £2.1 2025: £2.2 2020-2025: £10.2m</p> <p>We are not intervening in relation to biosolids income.</p>	<p>markets in the water sector should be pursued where they can be shown to be in customers' interests'. Wessex Water states this risks setting a precedent that unregulated returns can be captured retrospectively once the risks have been borne outside of the regulated business.</p> <p>Wessex Water said their approach transferred all construction risk for gas to grid and shields regulated customers from technical, operational and legislative risk – and ensures customers receive a fair value for 100% of the gas produced based on electricity market prices</p> <p>iii) The method of calculation of the adjustment</p> <p>Wessex Water state that, 'The mechanical calculation of it is flawed in that it treats nominal figures (including our business plan view on the power RPE) as 2017-18 CPIH deflated figures. We have queried this and set out what true 2017-18 prices (with the draft determination view that there is no RPE over CPIH on power) would be.'</p>	<p>transferred to the non-appointed business. We note that Wessex Water, not having the technical, operational or legislative burden or risk to finance of the construction risk for gas to grid also increases their efficiency over other companies that do. We would expect Wessex Water Services to share the value of the avoided transmission, distribution and retail elements of electricity from co-located plant.</p> <p>Furthermore, we note that the Wessex Water structure may have be considered innovative at its inception however it has been in place for a number of years and significantly pre-dates the PR19 methodology and incentives.</p> <p>iii) The method of calculation of the adjustment</p> <p>In calculating our adjustment we used the data Wessex Water provided and did not make any adjustments for RPEs or inflation. We said we would expect to calculate our adjustment in the Final Determination in 2017/18 FYA CPIH deflated prices. When we re-ran the numbers in the right price base and RPEs we have revised our adjustment from £10.2m to £8.5m.</p> <p>Ofwat will be considering if any further action is required to satisfy itself that Wessex Water's costs and charging arrangements comply with transfer pricing obligations.</p>	
YKY.CMI.D1	N/A	N/A	<p>We set the AUC to be used in the water resources control in 'Table 4: Price Control for Water Resources Activities bilateral entry adjustment numbers' of the company's 'Notification of the PR19 draft determination of price controls for Yorkshire Water' letter.</p>	No representation made.	No change for the final determination.	We have adjusted the AUC where appropriate to reflect the efficiency challenge that we apply in our assessment of supply-demand balance enhancement expenditure to the schemes that contribute to new water resources capacity.

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AFW.CMI.D1	N/A	N/A	<p>We set a bilateral entry adjustment in our 'Notification of the PR19 draft determination of price controls for Affinity Water' letter.</p>	<p>Representation made.</p> <p>Affinity Water resubmitted business plan tables Wr6 and Wr7. Affinity Water states:</p> <p>'The line guidance for pre-2020 capacities asks for capacities based on sources 'forecast forwards to account for any changes'. We have assumed these changes to mean climate change and sustainability reductions.</p> <p>We have included existing inter-company transfer volumes that are not typically classified as DO, as AFW.CA.A6 requested they were included within the pre-2020 capacity. Similarly, although Grafham requires a new treatment works to remove an existing constraint, the entire volumetric benefit of this source has been included within pre-2020 capacity.</p> <p>We have included the transfer volumes from the renewal of existing bulk supply agreements within the pre-2020 capacity.'</p>	<p>Change for the final determination.</p> <p>We have reviewed Affinity Water's resubmission where it has reallocated capacity for the water resource zone Dour. That is, 2.07MI/d is moved from line 10 (post-2020) to line 8 (pre-2020) and from line 11 (post-2020) to line 9 (pre-2020).</p> <p>For the purposes of BEA, we are intervening and apply the change to the 'ICC' and 'TCC' figures as published in Table 4: Price Control for Water Resources Activities bilateral entry adjustment numbers' of the company's 'Notification of the PR19 draft determination of price controls'.</p> <p>We remove 2.07MI/d from the figures for the final determinations because it relates to potable transfer (within water network plus) not water resources capacity.</p> <p>We have not updated numbers for pre-2020 because it should not be in the Wr6 table at all because it relates to water network plus.</p>	<p>For the final determination, we have updated the post-2020 lines as presented in the draft determination representation for final determination.</p>
PRT.CMI.C1	N/A	N/A	<p>We have reviewed the company's Annualised Unit Cost (AUC) that inform the water resources price control. We judge that the company incorrectly transferred the '£000s' value from the Reckon model into table Wr7 that did not correctly reflect the '£' units as required for the AUC line in table Wr7.</p> <p>We are therefore intervening to correct the conversion from £000s to £. We are intervening to set the AUC to be used in the water resources control.</p> <p>We have reflected this in 'Table 4: Price Control for Water Resources</p>	<p>No representation made.</p>	<p>No representation made.</p>	<p>We have adjusted the AUC where appropriate to reflect the efficiency challenge that we apply in our assessment of supply-demand balance enhancement expenditure to the schemes that contribute to new water resources capacity.</p>

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			Activities bilateral entry adjustment numbers' of the 'Notification of the PR19 draft determination of price controls for Portsmouth Water' letter.			
SEW.CMI.C1	N/A	N/A	<p>We have reviewed the company's Annualised Unit Cost (AUC) that inform the water resources price control. We judge that the company incorrectly transferred the '£000s' value from the Reckon model into table Wr7 that did not correctly reflect the '£' units as required for the AUC line in table Wr7.</p> <p>We are therefore intervening to correct the conversion from £000s to £. We are intervening to set the AUC to be used in the water resources control.</p> <p>We have reflected this in 'Table 4: Price Control for Water Resources Activities bilateral entry adjustment numbers' of the 'Notification of the PR19 draft determination of price controls for South East Water' letter.</p>	<p>No representation made.</p> <p>The company accepts our intervention for the draft determination and has resubmitted Wr7. It has updated in line with Ofwat's intervention to correct an error in the units used.</p>	No change for the final determination.	N/A
SSC.CMI.C1	N/A	N/A	<p>We have reviewed the company's Annualised Unit Cost (AUC) that inform the water resources price control. The company's proposed AUC is lower than our own estimate when we populated the Reckon model with the companies' submitted information in table Wr7.</p> <p>We are therefore intervening for the draft determination and have uplifted AUC to match our calculated AUC values. If the company disagrees, it should provide us with its populated Reckon model to demonstrate why the uplift is not necessary as part of its DD representation for us to review for the final determination.</p>	<p>Representation made.</p> <p>The company accepts our intervention for the draft determination to uplift its Annualised Unit Cost.</p>	No change for the final determination.	N/A

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			<p>We are intervening to set the AUC to be used in the water resources control.</p> <p>We have reflected this in 'Table 4: Price Control for Water Resources Activities bilateral entry adjustment numbers' of the 'Notification of the PR19 draft determination of price controls for South Staffs Water' letter.</p>			

Table 2 – Further decisions that are not in response to an action

Company reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
PRT.CMI.D1	<p>Change for the final determination.</p> <p>For one of the potential bulk supplies between Portsmouth Water and Southern Water starting in 2020-2025 (“World’s End” bulk supply), Portsmouth Water does not forecast any projected bulk supply export revenues. This is driven by the uncertainty of the final commercial agreement that can be reached with Southern Water at the time of the company’s PR19 submissions. As a result, we have not taken account of the revenues for this potential trade in the final determination. Taking the forecast revenues into account in our final determination by netting them off the relevant wholesale water controls is essential for the appropriate application of our PR19 water trading incentives policy. Otherwise, Portsmouth Water’s customers fund the cost of the bulk supply without enjoying the benefit of any profits derived from the bulk supply export.</p>	<p>We are intervening to ensure that Portsmouth Water would only recover 50% of the NPV of the economic profits of the project over 2020-2025, aligned with the policy intent of the PR19 water trading incentives.</p> <p>If Portsmouth Water applies for PR19 water trading incentives for the potential export to Southern Water in relation to the World’s End bulk supply and the trade qualifies for water trading incentives, then we would net off the forecast revenues derived by Portsmouth Water from the final awarded incentive to take account of the fact that the revenues were not taken into account in our final determination.</p> <p>We want to keep the policy consistent with the PR19 framework of returning the 50% of the expected profits from bulk supply exports to customers. Therefore, we require Portsmouth Water to report to us on the expected revenues from the trade as soon as these become clear, which may be well in advance of the bulk supply commencing. This information is to be provided along with the company’s APR submission in the first July after agreeing the bulk supply. We’ll use the expected revenues provided at that time to net off any PR19 water trading incentives claim by the company in PR24.</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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December 2019

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