

December 2019

# PR19 final determinations

**Thames Water – Aligning risk and return final decisions**

## PR19 final determinations: Thames Water – Aligning risk and return final decisions

In our [draft determinations](#) we published the ‘Aligning risk and return actions and interventions’, the ‘Securing long-term resilience actions and interventions’ and the ‘Securing confidence and assurance 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 ‘TMS’ denotes the company Thames 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 Thames Water draft determination, please see the [final determinations webpage](#).

**Table 1: Thames 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	TMS.RR.A1	The company should amend its overall assessment of RoRE outcomes, or provide convincing evidence to explain why it is reasonable to assume totex outcomes should be asymmetrically skewed to the downside for a notional company within an incentive based regime.	Thames Water should consider whether any revisions to its RoRE risk range should be made in response to the draft determination.	Representation made.  Thames Water sets out that under its draft determination cost allowances it faces a significant downside skew to its RoRE risk range for totex. It represents that some downside cost risk have no corresponding upside.  Thames Water considers that the final determination should be set to give it a reasonably symmetrical RoRE risk range.	Change for the final determination.	See TMS.RR.D4.

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
				Thames Water provides updated App26 values reflecting a 'lower cost, lower investment' business plan scenario in its representation on the draft determination.		
Risk and return	TMS.RR.A2	The company should provide further evidence of how the Board has assured itself that the company remains financeable on its actual capital structure given the level of the S&P funds from operations: net debt ratio and the business plan setting out that this will continue through the next price review period.	<p>No intervention but further action required.</p> <p>The report provides sufficient evidence to support the notional target credit rating and references that for the actual structure, the company benefits from a one notch uplift due to the securitised structure. The third party states Standard &amp; Poor's has not provided clear guidance on what would trigger a downgrade so some estimates have been used within the report which we consider as part of our assessment of financial resilience.</p> <p>However, the level of FFO/Debt for the actual company remains tight. Pursuant with action TMS.LR.A4 on financial resilience we expect Thames Water to provide additional Board assurance that it will remain financeable in 2020-25 on both the actual and notional company structure in the context of interventions in our draft determination and reasonably foreseeable range of plausible outcomes of its final determination.</p>	<p>Representation made.</p> <p>The company provides representations that the draft determination is not financeable under any reasonable set of resilience tests as required by Ofwat on the notional or actual structures.</p>	<p>No change for the final determination.</p> <p>We retain our overall approach to the assessment of financeability. We carry it out in our financial model, on the basis of the notional capital structure on which we derive our allowed return on capital and we assume each company is able to achieve the benchmarks in our determinations.</p> <p>Consistent with the PR19 methodology and our approach in the draft determination, we advance revenue from future customers where a financeability constraint arises to ensure the final determination is financeable on the basis of the notional capital structure.</p>	We discuss our assessment of financeability in the 'Thames Water final determination' and the basis on which we consider Thames Water's final determination to be financeable on the basis of the notional capital structure.
Risk and return	TMS.RR.C1	Thames Water's approach to setting PAYG rates is to recover operating expenditure. 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	We are making a technical intervention to align PAYG rates to Thames Water's stated approach of recovering operating expenditure for each year for each wholesale control.	<p>Representation made.</p> <p>The company provides a revised business plan scenario which includes natural PAYG rates that reflect the revised totex.</p>	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.	Taking account of company representations, we have revised our approach to the calculation of the mix of operating and capital expenditure following our totex interventions.

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
		are no longer aligned with Thames Water's stated approach.		The company provides representations that if Ofwat chooses to allow a cost allowance that is different than that within the revised business plan scenario then the natural PAYG rates should be calculated assuming the change in totex is solely due to a change in capex.	We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.	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 how we apply the technical intervention in the 'Aligning risk and return technical appendix' and we have published our calculation of the PAYG rates for each company alongside our determinations.  We set out the specific interventions we make for Thames Water in relation to notional financeability in the 'Thames Water final determination' document.
Risk and return	TMS.RR.C2	We expect companies to update their RoRE risk range analysis in response to the draft determinations.	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.	Representation made.  In its representation on the draft determination, Thames Water sets out a view that PR19 penalties for poor performance are more material and that RoRE analysis highlights that there is more downside risk and more downside skew on ODIs.	Change for the final determination.	See TMS.RR.D4.
Risk and return	TMS.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 initial assessment of plans, 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	Representation made.  Thames Water provides an updated RoRE risk range assessment reflecting its lower cost, lower investment represented business plan.  Thames Water does not consider that the draft determination RoRE risk ranges reflected the balance between risk and return. The company says that, with respect to the draft determination, it faces an increased downside risk skew for totex and ODIs compared to its April 2019 business plan submission.  Thames Water says it would expect to see a reasonably symmetrical balance of	Change for the final determination.	See TMS.RR.D4.

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
			<p>to achieve and outperform regulatory benchmarks. Therefore where 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.</p>	<p>RORE upsides and downsides within the final determination with totex allowances and performance commitments on a P50 basis.</p> <p>We present our assessment of the RoRE risk range provided by the company in its representation in the 'Thames Water company specific appendix' which presents a downward skew to the overall risk range relating to totex risk and outcome delivery incentives.</p>		
Risk and return	TMS.RR.C4	<p>Our initial assessment of financeability, prior to intervening, is that financial ratios in the round do not provide sufficient headroom to a minimum investment grade credit rating. Prior to the intervention, our assessment of key financial ratios suggests there is insufficient headroom to a minimum investment grade. We consider the intervention is necessary to ensure financeability on the notional structure following our interventions elsewhere in the draft determination including the lower current view of the cost of capital.</p>	<p>We are intervening to increase the company's PAYG rates for each year for the water and wastewater network plus controls by 0.7%, advancing revenue of £41 million from future customers. We consider the use of financial levers is an appropriate method to address the notional financeability constraint in this instance. We discuss our approach to addressing financeability constraints in the 'Aligning risk and return technical appendix'.</p>	<p>Representation made.</p> <p>The company provides representations that when Ofwat complete the financeability assessment for the notional company, where a notional financeability constraint arises, Ofwat should continue to use PAYG rates to improve cash flows.</p>	<p>Change for the final determination.</p> <p>Following our assessment of financeability we are advancing revenue through the use of PAYG rates to align the financial ratios targeted by the company on a notional basis.</p> <p>We retain our overall approach to the assessment of financeability. We carry it out in our financial model, on the basis of the notional capital structure on which we derive our allowed return on capital and we assume each company is able to achieve the benchmarks in our determinations.</p> <p>Consistent with the PR19 methodology and our approach in the draft determination, we advance revenue from future customers where a financeability constraint arises to ensure the final determination is financeable on the basis of the notional capital structure.</p>	<p>RCV growth for Thames Water's final determination is more than 10%. Therefore consistent with our policy approach set out in 'Aligning risk and return technical appendix' we restrict the base dividend yield to maintain gearing around the notional level of 60% in 2025, consistent with the gearing level that underpins the calculation of our allowed return. The resulting dividend yield we assume is 1.79% with dividend growth of 1.18%.</p> <p>Following our assessment of financeability we are advancing revenue through the use of PAYG rates to align the financial ratios targeted by the company on a notional basis. We increase PAYG rates by 1.68% to bring forward £125m of allowed revenue from future periods.</p>

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	N/A	N/A	N/A	<p>Representation made.</p> <p>The company provides a revised business plan scenario. The financeability assessment is underpinned by an appointee WACC of 2.6% based on a third party report.</p>	No change from the draft determination.	<p>The allowed return on capital for the wholesale price controls is 2.92% (on a CPIH basis, 1.92% on a RPI basis), a reduction of 0.38 percentage points from our fast track draft determination, based on our assessment of market evidence. The allowed retail margin for the household retail control remains at 1.0%, consistent with the draft determination</p> <p>We set out our assessment of the allowed return in the 'Allowed return on capital technical appendix'</p>
Securing confidence and assurance	TMS.CA.A5	On gearing outperformance sharing the company has not included our default sharing mechanism from our 'Putting the sector in balance' position statement or an alternative proposal which provides equivalent customer benefits, despite forecasting high gearing over 2020-25. We propose to include our default mechanism in the company's draft determination in the absence of company action to include it in its resubmitted business plan, so that customers will receive bill reductions if gearing in any year is above the 70% threshold.	Intervention we made at the draft determination we expect Thames 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.	<p>Representation made.</p> <p>Thames Water restate its view presented in its April 2019 revised business plan. It disagrees with the underpinning principles and design of the gearing sharing mechanism, however propose an alternative mechanism.</p> <p>The alternative mechanism includes amendments to our default proposal with different sharing rates at different levels of gearing and an increase of the reference point to 70%.</p> <p>The company suggest the step-tiered sharing rates makes increasing gearing less likely and incentivise to reduce gearing.</p>	<p>Change for the final determination.</p> <p>We do not consider that Thames Water's mechanism, with step-tiered sharing rates and increase in reference point, provides benefits that are equivalent, in the round, to our glide path sharing mechanism.</p> <p>With the company's own mechanism in place in its business plan, the reduction in gearing in 2020-25 is not as ambitious as other companies. The company will remain highly geared in 2020-25. From the company annual performance report, gearing is 81.89% and forecasted in the April 2019 revised business plan to be at 76.9% for the end of the control period.</p> <p>Evidence of links to wider customer benefits are not convincing and financial benefits by our estimates are materially lower for customers compared to the default mechanism. Most of the gain relative to our default mechanism is achieved without having to reduce gearing at all.</p>	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
Securing confidence and assurance	TMS.CA.A7	<p>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: position statement' to include:</p> <p>commitment to transparency about how the dividend policy in 2020-25 takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25 and when determining dividends.</p> <p>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.'</p>	<p>No intervention but further action needed by Thames Water.</p> <p>We expect Thames 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 putting the sector in balance position statement. We expect the company to respond to this issue in its response to our draft determination.</p> <p>We expect the company 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.</p>	<p>Representation made.</p> <p>The company provides some additional information in response to some of our actions.</p> <p>The company sets out how its dividend policy for 2020-25 will take account of obligations and commitments to customers and other stakeholders and provides sufficient detail on the specific obligations and commitments to customers that will be considered. In subsequent correspondence the company confirms that the level of performance delivery considered will be as set out in the final determination.</p> <p>The company hasn't indicated that dividends may be either increased or lowered from the base depending on the actual performance of the company and provides insufficient detail on how performance delivery will impact on dividends paid.</p>	<p>Change for the final determination.</p> <p>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'.</p> <p>Under our current assessment the company falls short in a number of areas set out below. We expect Thames 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, specifically how performance delivery has impacted on the dividends paid.</p>	<p>We expect Thames 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'.</p>
Securing confidence and assurance	TMS.CA.A8	<p>On executive pay the company is required to confirm it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> <li>visibility and evidence of substantial linkage of executive remuneration to delivery to customers;</li> <li>clear explanation of stretching targets and how they will be applied;</li> <li>clearer explanation of how the policy will be rigorously applied and monitored;</li> <li>commitment to report how changes, including the underlying</li> </ul>	<p>No intervention but further action needed by Thames Water.</p> <p>There remain some details to be finalised, for example detail on which target metrics will be used and the formal approval of the policy by the remuneration committee and TWUL Board. Once finalised, we expect Thames 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'.</p> <p>We expect the company and its remuneration committee to ensure its performance related executive pay</p>	<p>Representation made.</p> <p>In its response the company has provided some additional information to that previously provided. It states that it is committed to move in the direction of expectations set out in 'Putting the sector in balance' position statement, which includes:</p> <ul style="list-style-type: none"> <li>Design of incentives for AMP7. The majority of targets across the annual management bonus and LTIP have been set for the delivery of customer service (e.g. C-Mex) or customer delivery (e.g. leakage EPA)</li> <li>Targets will be stretching performance as metrics will reflect those used in the final determination.</li> </ul>	<p>Change for the final determination.</p> <p>Thames Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance: position statement'. However based on our calculations, the overall percentage of alignment of incentives to customers falls short of 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'. We therefore consider that there is scope for the company to improve this position.</p>	<p>We expect Thames 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 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'.</p>

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
		<p>reasons, are signalled to customers; and</p> <ul style="list-style-type: none"> <li>commitment to publish the executive pay policy for 2020-25 once it has been finalised.</li> </ul> <p>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.'</p>	<p>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.</p> <p>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.</p>			
Tax	N/A	N/A	N/A	<p>Representation made.</p> <p>Thames Water provided updated tax information to remove a tax adjustment made to ensure that there was no tax funding generated, in relation to the intercompany loan interest income.</p>	<p>Change for the final determination.</p> <p>We have accepted Thames Water's updated tax information to remove part of the tax adjustment relating to the intercompany loan for Thames Water, as we agree that as our final determination excludes the intercompany loan, the adjustment is not required. Following further information provided in response to a query we understand that part of the remaining adjustment to taxable profits included in its revised business plan relates to deficit repair pension contributions that are funded by shareholders. As our financial model only reflects the deficit repair payments that are funded by customers through price limits (consistent with the expectations set out in IN 13/17), this adjustment is not required. Thames Water subsequently agreed that this element</p>	<p>We reflect the decision to remove the elements of the adjustment to taxable profits relating to the intercompany loan and the deficit repair pension contributions in our final determinations.</p>

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
					of the adjustment should also be removed.	
Securing long-term resilience	TMS.LR.A4	<p>The company has provided a Board assurance statement that its business plan achieves the credit metrics for a Baa1/BBB+ credit rating under the actual capital structure based on our early view cost of capital. However the company expects to be highly geared (remaining above 77% by the end of 2025).</p> <p>The company is responsible for maintaining its long term financial resilience. Further assurance is required about how the company will maintain its financial resilience in the context of our draft determination, which includes, for example, an updated view of the cost of capital, our assessment of efficient costs, our assessment of outcome delivery incentives and the requirement to include our default gearing outperformance mechanism.</p> <p>The company should provide further detail and Board assurance about its plans to maintain its long term financial resilience in the context of our draft determination, as referenced in action TMS.LR.C1.</p> <p>In its future reporting, we expect Thames Water to apply suitably robust stress tests in its long term viability statements in 2020-25.</p>	N/A	<p>Representation made.</p> <p>Thames Water says that its central expectation is that the draft determination will not generate sufficient returns to enable it to recover its cost of capital, attract new equity, and finance its statutory duties.</p> <p>Thames Water considers it would be financially resilient on the basis of its represented plan, which incorporates a higher return on capital than its business plan, assuming that capital markets continue to operate under normal market conditions.</p> <p>Thames Water says that is has reduced gearing by £250m during 2019 through an equity injection and that the company has decided to retain all equity returns by not paying external dividends for the three years from 2017/18 to 2019/20, with a further commitment to further dividend restraint and limited external dividends in its PR19 business plan to build operational and financial resilience.</p> <p>Thames Water provides an updated board assurance statement on the financeability and long-term financial resilience of its business plan scenario.</p> <p>Thames Water has committed to assess its financial resilience beyond 2025 in its next long term viability statement.</p>	<p>No change for the final determination.</p> <p>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 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.</p> <p>Therefore, on account of Thames Water's high level of gearing, the cost of capital in our final determinations that is lower than the draft determinations and limited headroom in its credit ratings the company may need to take steps to improve its financial resilience in 2020-25 in the context of our final determination.</p>	<p>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.</p> <p>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. Thames Water has committed to assess its financial resilience beyond 2025 in its next long term viability statement.</p>
Securing long-term resilience	TMS.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	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	See TMS.LR.A4.	See TMS.LR.A4.	See TMS.LR.A4.

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
		<p>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.</p>	<p>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'.</p>			

**Table 2: Thames 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	TMS.RR.D1	<p>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.</p> <p>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.</p> <p>We set out the basis for the allowed return on capital in our 'Allowed return on capital technical appendix'.</p>	<p>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.</p> <p>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.</p>
Gearing outperformance sharing mechanism	TMS.RR.D2	<p>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'.</p>	<p>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.</p>
Financeability	TMS.RR.D3	<p>We consider that Thames 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.</p>	<p>We discuss our assessment of financeability in the 'Thames Water final determination' and the basis on which we consider Thames Water's final determination to be financeable on the basis of the notional capital structure.</p>
Return on Regulatory Equity (RoRE) - Financial Risk Assessment	TMS.RR.D4	<p>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.</p> <p>Our approaches are set out in the 'Aligning risk and return technical appendix' and the risk ranges for Thames Water are set out in the 'Thames Water final determination'.</p> <p>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.</p>	<p>The final determination risk range reflects the following interventions that we make for all companies:</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• The financing cost risk range is based on our assessment of the range for a notional water company including both embedded and new debt.</li> <li>• The ODI risk range has been determined under our Outcomes Framework.</li> <li>• 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.</li> <li>• 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.</li> </ul>
Financial Risk Assessment – Uncertainty Mechanisms	TMS.RR.D5	<p>We are including a PR24 reconciliation mechanism for business rates in our final determination for Thames Water along with all other companies because:</p>	<p>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</p>

Test area	Actions/intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
		<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul> <p>We are also including a PR24 reconciliation mechanism for Environment Agency abstraction licence costs in our final determination for Thames Water along with all other companies serving England because:</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul>	<p>receiving appropriate protection against material cost increases. Conversely, customers will receive a benefit if outturn costs are lower than the allowance levels we have set. Details will be set out in the PR19 Reconciliation Rulebook.</p>
Return on Regulatory Equity (RoRE) - Financial Risk Assessment	TMS.RR.D6	Thames Water presents a downside risk range in its representation for retail activity.	We include a change in our final determination for Thames Water to reduce the downside risk range for retail activity costs in its representation submission, so that it is symmetrical with its upside risk range. Although we note the company' view on bad debt risks, we do not consider that it has provided sufficient evidence to justify a downward skew to its risk range.

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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