August 2020

Reference of the PR19 final determinations: Final submission to the CMA (redacted)

Ofwat

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Contents

1. Ofwat final submission

1.1 The CMA redeterminations are important, not only for the disputing companies, but for every household and business that depends on these companies for water and waste water services.

1.2 PR19 comes at a critical time for the water sector in England and Wales, as it faces profound challenges including climate change, population growth, and shifting customer expectations. At the same time, the sector needs to address ongoing concerns about sustained operational performance failures and weaknesses in corporate behaviours. The PR19 framework provides a huge opportunity for the water sector to focus on improving operational performance and resilience for 2020-25 and for the long term.

1.3 The following section sets out our overall response to the issues raised by the disputing companies in their hearings and recent correspondence. Chapter 2 provides a more detailed response to issues raised on costs, outcomes and risk and return. There are two appendices to this document: one provides further data on specific issues raised in our response; and the second sets out our proposed approach to the PR19 blind year where we adjust revenues in relation to 2019-20 outturn performance.

Overall response

1.4 The disputing companies raise a range of issues in their hearings and recent correspondence. We continue to consider that the key issues are whether we have provided the companies with an appropriate level of stretch on costs and outcomes and set a reasonable allowed return on capital. **We consider that ensuring these building blocks are set at the right level are the key challenges for the CMA in its redetermination.**

1.5 We note that some of the disputing companies continue to claim wrongly that we prioritised lower customer bills at PR19, to the detriment of long-term resilience. **We have repeatedly set out the reasons why this is simply incorrect. For the avoidance of doubt, bills were an outcome of our price review process.** Specific levels of bill reduction were not, and could not be, under our methodology, targeted in and of themselves. Indeed, three out of four of the disputing companies received increased cost allowances compared to the amount that they have spent over the last five years. The difference between companies and Ofwat is the level of increase since PR14.

1.6 **At PR19 we focused more on resilience than ever before.** We challenged companies to understand and mitigate risks to their resilience in our methodology.[1] We funded enhancements to resilience where companies provided reasonable cases and stepped in to increase resilience funding where we were concerned that companies were not going far enough. **At the same time, we have a duty to protect customers from poorly justified claims for extra cost allowances or double recovery of costs from both base and enhancement cost allowances.**

1.7 The disputing companies also claim that we have ignored the results of their customer engagement. **On the contrary, when we have intervened, we have used their own customer research to better align company plans with customer preferences.** With respect to outcome delivery incentive (ODI) rates for the five customer facing common performance commitments,[2] setting aside our interventions to reduce companies' downside exposure across certain performance commitments (which worked unambiguously in companies favour), 54% of our targeted interventions were due to the company having conducted poor or no triangulation of the results of its customers research. A further 14% were due to the company providing insufficient evidence that its customers supported outperformance payments for a specific performance commitment. While in 21% of cases we intervened due to the company proposing a rate that was an extreme outlier compared to the rest of the sector for which companies' did not provide any supporting evidence to explain (and for which we had other corroborating concerns such as issues with past performance, the relative degree of stretch and the degree of customer protection relative to the 2015-20 period). **It is the role of a regulator to ensure that customer interests are protected based on the information provided by the company as well as the wider set of information available to it.**

1.8 **In sum, these claims distract from the reality that all companies had three separate opportunities to present sufficient evidence to justify their proposals to us.** Where we disallowed claims, it is because companies have not provided that evidence, even after receiving detailed feedback at previous stages of the process. The disputing companies have had further opportunity in the past six months to reach the evidential bar we set in our final methodology

[1] Ofwat, 'Delivering Water 2020: Our final methodology for the 2019 price review', December 2017, pp. 80-6.
[2] These are water supply interruptions, internal sewer flooding, pollution incidents, leakage and per capita consumption. These are the customer-facing performance commitments which the majority of companies had willingness to pay valuations for.

back in December 2017. We have already indicated to the CMA where we accept new evidence or arguments presented by the disputing companies.

1.9 **If the water sector is to make the step change it needs, it is important that companies are set a stretching determination.** However, we note that Anglian Water, Northumbrian Water and Yorkshire Water suggest the stretch we have imposed at PR19 is considerably larger than at PR14.[3] The overall level of stretch across costs and outcomes is similar across PR14 and PR19, with the key difference being that we have 'baked in' the performance improvements we expect companies to make across the three upper quartile performance commitments based on historical evidence of outperformance.[4] Indeed, three companies received a higher cost allowance than they requested in their original business plan.[5]

1.10 **We also note in this context that the listed water companies have stated they remain well on course to deliver and outperform the PR19 settlement.** South West Water and Severn Trent Water maintain that they expect to earn net outperformance payments in 2020-21, while United Utilities states that it remains 'well placed' for the start of AMP7.[6] As PR19 is set on the basis of comparative costs and performance data, the evidence that three companies serving nearly 30% of customers in England and Wales[7] across a range of urban and rural areas can meet and outperform their PR19 determinations is a compelling demonstration that the level of challenge in PR19 is appropriate and well calibrated.

1.11 **The listed companies continue to be valued at a premium of around 20% to their regulatory capital value despite the downward impacts of Covid on stock market valuations**. This premium is about twice the long run average premium since privatisation.[8] This provides further evidence that capital

[3] Anglian Water hearing transcript, p. 33; Northumbrian Water hearing transcript, p. 62; Yorkshire Water hearing transcript p. 47.
[4] The overall catch-up and frontier shift challenge at PR14 was 8.5%, compared with 7.8% at PR19. Further, the stretch on the three upper quartile performance commitments is similar to what has been achieved in PR14. See Ofwat, 'Reference of the PR19 final determinations: Introduction and overall stretch on costs and outcomes - response to cross-cutting issues in companies' statements of case', May 2020, pp. 50-3.
[5] Ofwat, 'Reference of the PR19 final determinations: Cost efficiency – response to common issues in companies' statements of case', May 2020, p. 12, Table 2.3.
[6] Severn Trent Water, 'Preliminary Announcement of Annual Results', May 2020, p. 8; Pennon Group, 'Full Year Results 2019/20', June 2020, p. 28; United Utilities, 'Annual Performance Report 2019/20', July 2020, p. 17.
[7] Ofwat, IAP investor call transcript, 31 January 2019, p. 18.
[8] Ofwat, 'Reference of the PR19 final determinations: Cross-cutting issues', March 2020, paragraph 5.14, p. 34. Figure 5.1 shows that the average premium of enterprise value to RCV for Severn Trent and United Utilities for the period 1993-2020 was 9%.

markets consider PR19 final determinations provide a reasonable allowed return and level of stretch on costs and outcomes.

1.12 Recent performance data on leakage, showing a 7% annual reduction across the sector in 2019-20 and six companies achieving reductions greater than 10%, further underlines the need for an appropriate level of stretch.[9] It also highlights the power of challenging the sector to do better. **The dramatic transformation in leakage performance with no additional funding after 19 years of stagnation follows our challenge to the sector to reduce leakage by at least 15% at PR19** and highlights the important role that a regulator can play in stimulating better performance.

1.13 **Other regulated industries are seeing companies consistently make significant improvements on comparable measures over successive price controls.** For example, in the energy sector, average customer supply interruptions (CI) performance has improved between 2009-10 and 2018-19 with the number of customers interrupted (per 100) reducing from 65 to 44, and time lost per customer (CML) has reduced from 63 to 35 minutes over the same period, with little year-on-year variability.[10] Ofgem has also recognised the potential for productivity improvements in the sector, with the recent RIIO-2 draft determinations applying a frontier shift of 1.2%-1.4%.[11]

1.14 At the same time, we understand the need to provide companies with a reasonable return on their investment. Companies that deliver excellent performance should be appropriately rewarded. But companies should not be rewarded for just doing 'their day job'. Customers rightly expect to be protected from monopoly exploitation – from high prices and poor service. **Easily achieved excessive returns only serve to diminish the incentives for companies to innovate and stretch to improve operational performance for customers and the environment.** In the long term, they damage the reputation of the industry and undermine interest from the responsible long-term investors they need. For these reasons, we designed PR19 to link performance and returns more closely. **We invite the CMA to take account of these considerations as it makes its redeterminations.**

[9] This is based on the companies reported figures following the new leakage reporting methodology.
[10] For 2018-19 data see Ofgem, '2018-19 RIIO-1 electricity distribution annual report supplementary data file', February 2020, tab 'ch2 outputs-reliability'; for 2009-10 data see National Infrastructure Commission, 'Performance data for water energy and telecoms', October 2019, p. 33.
[11] Ofgem, 'RIIO-2 Draft Determinations - Core Document', July 2020, p. 44.

Engagement with Ofwat

1.15 The disputing companies allege in their hearings that they only had limited opportunities to engage with Ofwat during the price review.[12] This is factually incorrect.

1.16 The price review is a comprehensive process as it involves the assessment of 17 separate company business plans in three specific stages of submission and assessment (initial assessment, draft and final determinations), with detailed feedback provided at each stage. PR19 included more stages than commonly used by other regulators (which are usually limited to draft and final determinations), with a far greater level of feedback provided to companies. The detail in this feedback has been broadly welcomed across the sector.

1.17 We took an even-handed but flexible approach to engagement, aiming to maintain an open dialogue with all companies. The CMA will recognise that in any decision making process the time for engagement must draw down so the decision can be made.

1.18 During the PR19 process, companies had a wide range of opportunities to engage with Ofwat on PR19 and other issues. These included:

- two formal meetings with Ofwat Board members (including non-executive members), to present their September 2018 business plan and to present and discuss their August 2019 representation on the draft determination;
- regular contact with our dedicated PR19 company engagement team, including calls and emails; and
- an extensive two-way query process where, as well as Ofwat being able to ask companies queries, companies were able to ask Ofwat for a response to queries about its assessment. See table 1.1 below. This included a query process about our business plan reporting requirements before companies submitted their business plans in September 2018 and numerous webinars where we explained our approach and decisions.

1.19 In addition to this engagement:

- **Anglian Water** met with David Black in April 2019 and three times in October 2019, in addition to the draft determination Board level representation meeting. Separately, our cost assessment team met with the company in February, March, April, August and October 2019. We had a

[12] Anglian Water hearing transcript, p. 20; Bristol Water hearing transcript, p. 12; Northumbrian Water hearing transcript, p.131; Yorkshire Water hearing transcript, p. 132.

significant amount of engagement with Anglian Water during the PR19 process, largely because of the size of the cost gap. This was an issue we engaged on in good faith, and we wrote to Anglian Water in June 2019 ahead of the draft determination to give the company extra time to reconsider its claims and prepare additional evidence. Following the draft determination process, both Anglian Water and Ofwat agreed to leave 'no stone unturned' to address the differences. This resulted in an intensive process of meetings and correspondence. We note that while substantial differences remain at final determination, the cost gap closed from 19% at draft determination to 12% at final determination.[13]

- **Bristol Water** had three CEO catch-up meetings with Rachel Fletcher during the PR19 process (November 2018, May 2019, November 2019) and one meeting between David Black and Mel Karam in October 2019. The company also had six working-level teleconferences on various issues over the PR19 process including elements of our outcomes assessment (February 2019), elements of our risk and return assessment (February 2019), the Canal & River Trust cost adjustment claim (July 2019), developer services (September 2019), and Canal & River Trust Notified Item (November 2019).
- **Northumbrian Water** met (face-to-face and via teleconferences) with David Black and our cost assessment team on water trading, sewer flooding and enhancements in March, June and August 2019. Jonson Cox, Rachel Fletcher and David Black also exchanged letters, emails and had calls with the Northumbrian Board Chair and company Chief Executive throughout 2018 and 2019. A number of these interactions were around the draft determination Board level representation meeting.
- **Yorkshire Water** met (face–to-face and via teleconferences) more than ten times with price review staff during the PR19 process. These included engagement on costs (March 2019, May 2019, July 2019), WINEP (August 2018, November 2018, May 2019, October 2019), developer services (September 2019) and outcomes (October 2019). David Black was involved in four of these meetings. Rachel Fletcher also had four meetings with Yorkshire Water during the PR19 process, in addition to a company visit and several meetings covering topics wider than the price review.

[13] Ofwat, 'Reference of the PR19 final determinations: Explanation of our final determination for Anglian Water', March 2020, Figure 1.1, p. 4.

Table 1.1: Queries to and from the disputing companies following the submission of business plans

	Queries from Ofwat	Queries from companies
Anglian Water	94	101
Bristol Water	72	65
Northumbrian Water	92	19
Yorkshire Water	112	35

Note: prior to the submission of business plans, the four disputing companies raised a total of 221 queries on the financial model and data tables, half of which were from Anglian Water.

1.20 In its hearing, Yorkshire Water cites our response to an email it sent in May 2020 about its per capita consumption performance commitment level as an example of what it calls our 'quite aggressive' behaviour.[14] Yorkshire Water's email describes the background to what it considered to be a straightforward change to adjust the final determination targets for this performance commitment and concludes with a request to discuss options.

1.21 Given we have a standard process of assessing these requests and making changes to final determinations, we wrote back to Yorkshire Water to explain our framework and our findings based on the information it provided. We copied the CMA into our correspondence and similar correspondence with Northumbrian Water due to the relevance with the redetermination process. We consider no more meaning should be attributed to our response other than providing written clarity over the process, which we consider very important, the need for which is demonstrated through the issue of Yorkshire Water's AMP6 revenue reporting and its impact on WRFIM.

Future of regulation

1.22 The disputing companies set out their views on the current and future regulatory framework in their respective hearings and submissions. Yorkshire Water expanded its observations in a letter to the CMA of 7 August. We also note the views provided in the third party submission from Stephen Littlechild.[15] In parallel, over the past few months, we have heard a range of views from companies and other stakeholders through our PR19 lessons learned process, the results of which we are due to publish in the autumn. We began our

[14] Yorkshire Water hearing transcript, p. 12, lines 5-8.
[15] Stephen Littlechild, 'Submission to the CMA on Ofwat price determinations', 24 May 2020.

preparatory work for PR24 this year, including developing our early thinking on the approach to customer engagement and starting to engage on the guidelines for the next round of water resource management plans.[16] We intend to work closely with the sector over the coming years to continue to develop our approach to PR24 and our wider regulatory framework and toolkit.

1.23 Firstly, we note that the regulatory framework has displayed considerable adaptability over time, and has evolved by way of the lessons learned from previous price controls. However, there are certain statutory parameters within which the framework must operate, which include the decision-making roles allocated to Ofwat and the CMA. It is ultimately a matter for Parliament whether any major changes should be made to the legal environment within which we operate. In the meantime, working within these parameters, we continue to use the flexibility available to us to refine and improve the regulatory framework.

1.24 In this context we note that the PR19 regulatory framework was co-created with the sector, including companies and wider stakeholders, via the three-year Water 2020 process. Alongside the industry body Water UK, we introduced the marketplace for ideas, which invited contributions on how the regulatory framework should evolve.[17] Water companies alone submitted over 60 papers and we continued to engage through industry workshops and working groups to develop what would become the PR19 methodology. Yorkshire Water acknowledges the participatory nature of this process, which was followed by multiple consultations on cost modelling, the outcomes framework and our draft methodology.[18]

1.25 The price review itself has seen a number of companies really challenge themselves and step up to provide high-quality proposals that will deliver a step change for customers and the environment. Six companies, for example, proposed wholesale base costs for 2020-25 that were lower than their historical base costs, and overall our base cost allowances were just 0.4% below company plans.[19] All companies accepted the challenge to reduce leakage by at least 15%, and several companies proposed performance commitment levels that were beyond the forward looking upper quartile. We were also pleased that the majority of companies who received 'significant scrutiny' status at the initial

[16] Draft water resource management plan (WRMP) guidelines were published in July 2020, with final guidelines due to be published in January 2021. Draft WRMPs are due to be published in summer 2022, with final plans a year later.
[17] Water UK, 'Marketplace for ideas'.
[18] Yorkshire Water hearing transcript, p. 118.
[19] Ofwat, 'Reference of the PR19 final determinations: Introduction and overall stretch on costs and outcomes – response to cross-cutting issues in companies' statements of case', May 2020, p. 63.

assessment stage made significant efforts to address our concerns and made substantive improvements to their plans.[20] In the end, 13 companies accepted the challenge we set and are now getting on with delivering a transformative settlement for the industry.

1.26 While the detailed calculations underlying the current regulatory framework are (as in other comparable industries) complex, the premise of the framework is simple: to protect customers from monopoly exploitation. What matters most, in our view, is how well our regulatory framework delivers outcomes for customers and the environment. Bristol Water and Yorkshire Water acknowledge that the water sector is in itself complex.[21] Complexity or sophistication may increase the benefits of the framework, such as introducing new controls or incentives to motivate or moderate company behaviour. At the same time, where we have considered that complexity serves little benefit, we have sought to remove it, such as the replacement of menu regulation with totex cost sharing at PR19.

1.27 We do not consider that the complexity of PR19 is significantly higher than at PR14 or PR09. We note that the disputing companies have cited little evidence in support of their assertion. Indeed, the redetermination process has seen companies propose a number of additional mechanisms that they claim would improve the framework.[22] In terms of our own resource, we estimate that the cost of PR19 is no higher than PR14, which suggests that the regulatory cost associated with PR19 is consistent with the previous price review.

1.28 The basic RPI-X framework includes a significant degree of methodological flexibility which allows regulators to adapt to challenges and changes at each successive price control. While the RPI-X mechanism itself provides incentives to improve cost efficiency, it does not address other important factors in the water sector such as service quality, long-term asset management and responsiveness to customers. Through our price control methodology development we have sought to adjust the RPI-X framework to effectively address these areas for the benefit of customers and the environment. The flexibility of the framework is precisely what gives us the opportunity to reflect on our approach for PR24 and consider how we can further develop our framework to drive company performance and meet long-term challenges.

[20] See Ofwat, 'PR19 final determinations: Significant scrutiny companies – Application of lower cost sharing rates and outcome delivery incentive cap', December 2019.
[21] Bristol Water hearing transcript, p. 13; Yorkshire Water hearing transcript, p. 118.
[22] For example Anglian Water suggests new true-ups for productivity growth, growth and real price effects, see Ofwat, 'Reference of the PR19 final determinations: Response to Anglian Water's 27 May submission to the CMA', June 2020, paragraph 4.3, p. 25.

1.29 In October 2019, we set out our future approach to driving progress in the water sector in our strategy, 'Time to act, together'. We placed a high priority on working collaboratively, and committed to exploring how we could better align price reviews to the delivery of long-term aspirations.[23] We also committed to driving further improvements in operational resilience, and our ongoing project to improve the sectors' understanding of asset health has been welcomed by Anglian Water in its submission.[24] Our strategy, which was developed in collaboration with (and welcomed by) the sector, will strongly inform our approach to future price reviews.

1.30 Anglian Water, Northumbrian Water and Stephen Littlechild invite the CMA to consider the regulatory approach taken by Water Industry Commission for Scotland (WICS).[25] We regularly engage with WICS, including on the development of the regulatory framework. We note that the current price review period 2015-21, WICS has price controls to deliver falling real bills,[26] along with improving levels of performance. Since its establishment in 2002, Scottish Water bills have fallen by 5% in real terms, while in England and Wales, the average increase has been 19%.[27]

1.31 WICS has set out its methodology, but has yet to set draft and final determinations for the 2021-27 period. In its methodology, it has noted the importance of the regulatory framework limiting the impact of asymmetries of information and time.[28] We note that WICS also expects a step up in asset maintenance funding, similar to the change we saw in England and Wales, ten to fifteen years ago. We consider asset replacement and refurbishment should be determined on an efficient long term basis.

1.32 The structure of the water industry in Scotland is materially different to England and Wales. Water in Scotland is provided by a single publicly-owned company, which eliminates the risk we face of setting over-generous price controls resulting in excessive returns being paid out to shareholders. Scottish Water borrows from the Scottish Government and the amount that it is able to borrow

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[23] Ofwat, 'Time to act, together: Ofwat's strategy', October 2019, pp. 11, 35.
[24] Anglian Water, 'Reply to Ofwat's Response to Anglian's Statement of Case, Part G: Reply to Ofwat's Response on Cost Issues', May 2020, p. 16.
[25] Anglian Water hearing transcript, p. 155; Northumbrian Water hearing transcript, p. 154; Stephen Littlechild, 'Submission to the CMA on Ofwat price determinations', 24 May 2020.
[26] Water Industry Commission for Scotland, 'The Strategic Review of Charges 2015-21: Final determination', November 2014, p. 7.
[27] Water Industry Commission for Scotland, 'The Strategic Review of Charges 2021-27: Methodology refinements and clarifications', November 2018, p. 14.
[28] Water Industry Commission for Scotland, 'The Strategic Review of Charges 2021-27: Methodology refinements and clarifications', November 2018, p. 6.

is limited by the Scottish Government. It is this limitation along with increased investment which is driving expectations for an increase in real bills above inflation.[29] We note that in England and Wales, companies are freely able to raise finance from capital markets and so increased investment allowed in 2020-25 final determinations does not necessarily require an increase in real bills.

1.33 We also note Yorkshire Water's and Northumbrian Water's comments on the Public Accounts Committee (PAC) final report.[30] The report itself makes the following recommendation:

> 'The Department should provide more guidance to water companies on the level of investment needed to ensure resilience by 2050 and how they should balance this in their business plans with pressure to reduce consumer bills.'

1.34 The report itself does not make a reference to resilience investment being underprovided. Instead we consider that Yorkshire Water (and Anglian Water, in its hearing) is referring to a recent letter from the PAC to Defra which followed a meeting with three water companies.

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1.35 Finally, we note that the CMA has mainly heard from disputing companies with regard to future regulation. We consider it would be appropriate to consider a wider range of viewpoints before reaching any views on the direction for any future framework, which would impact on all stakeholders in the sector. In particular, we note that no fast-track companies attended the CMA's hearing with third-party companies.

[29] Water Industry Commission for Scotland, 'The Strategic Review of Charges 2021-27: Prospects for prices', February 2020, p. 7.
[30] Yorkshire Water, 'Letter to the CMA', 7 August 2020, p. 4; Northumbrian Water transcript, p. 149.

Response to Covid-19 principles

1.36 As Rachel Fletcher set out in her letter to companies of 14 July:

> 'In March we assured you that Ofwat would assess whether any ex-post adjustments were appropriate once there had been sufficient time to understand the impacts of Covid-19. It is still too early for a rounded and balanced assessment across all of the issues, not least because there is still a lot of uncertainty about what will unfold over the coming months. Without pre-judging whether anything other than the mechanisms already built into the price control will be needed to ensure that companies bear the appropriate level of risk, we have been able to start some important work with Water UK.'

1.37 We welcome Anglian Water, Northumbrian Water and Yorkshire Water's statements in their joint letter that:

- the CMA should reflect the current economic environment as it makes its redeterminations (as far as it is possible to do so);
- the impacts of Covid-19 are sector wide and remain uncertain, but a joint comparative Ofwat/Water UK study is being undertaken to understand the scale of potential impacts; and
- it is unlikely that sufficient evidence will be available for impacts to be assessed robustly during the timeframe for the redeterminations.

1.38 We note that the water companies propose that a sector wide approach with a reconciliation mechanism would be most appropriate, and suggest that the CMA should set out the principles to be applied to that mechanism.

1.39 We do not consider that it would be appropriate to suggest that the CMA set out principles for any reconciliation mechanism as part of its redetermination for only four companies:

1.40 **As the companies accept, this is a sector-wide issue. That makes it unsuitable for resolution as part of this process**. The redetermination process by definition, even allowing for third party representations, can be concerned only with the outcomes appropriate for the disputing companies. But the approach to Covid-19 needs to be determined on a whole-industry basis, after engagement with all interested parties and consideration of wider evidence than will be available to the CMA over this timeframe.

1.41 **It would be best to have a clearer understanding of the impacts before concluding whether or not, and how, to intervene.** A full analysis of the joint Ofwat/Water UK study would help inform final decisions.

1.42 **It is essential that any principles adopted should be fully aligned with Ofwat's statutory duties.** We do not consider that the proposed principles put forward by the companies would meet this test.

2. Our response to issues raised

Table 2.1: Summary of response to issues raised – costs

Topic	Reference	Summary of issue	Response
Frontier shift productivity growth	Anglian Water, Covid-19 Impacts - July Update Final, page 24 Northumbrian Water Covid Submission - Annex 1 - 31 July 2020, page 6 Anglian and Northumbrian Water transcripts (page 157 and 49 respectively)	The latest productivity forecasts are much lower than historical trends and the CMA should take this into account in its decision.	The OBR published new productivity and wage forecasts on 14 July. These forecasts take into account the OBR's latest view of the impact of Covid. All three scenarios show an initial increase in productivity as the lowest productivity workers are furloughed or lose their jobs, followed by a subsequent reduction in productivity as the effect is reversed by the furlough scheme ending and the labour market adjusting. Given the very limited furloughing of workers by the water sector we do not consider that these adjustments are relevant to the water sector. Over the entire forecast period, under the upside scenario there is no overall impact on productivity. For the central and downside scenario the OBR has reduced productivity forecasts due to a level of economic scarring due to the downturn. We do not consider that these reduced productivity forecasts are relevant to the water sector. Around a quarter of the productivity reduction is due to capital shallowing, where the capital investment per worker is reduced. We do not consider that Covid has reduced capital investment per worker in the water sector, given the capital expenditure programmes that are set out and funded as part of the price control. The remainder of the impact is due to wider productivity falls, partly due to business failures and capital scrapping. As we set out in our previous submissions the water sector is less affected than the rest of the economy by slowdowns in total factor productivity during recessionary periods, in particular as it has largely fixed revenues. Indeed the water sector might well benefit from the recession as while its income is largely fixed it will

Topic	Reference	Summary of issue	Response
			benefit from lower input costs due to the economic impact of the crisis. We consider that Covid impacts on productivity are better addressed in terms of individual cost and outcome impacts and should be considered when we consider other impacts of Covid. We note that the most recent data on the expected impacts of Covid indicates a lower than previously expected impact on economic growth, for example in August the Bank of England[31] expected UK GDP to fall by 9.5% 2020 compared to 14% in May report.[32] We note that Ofgem have recently included frontier shift productivity improvements of 1.2% to 1.4% per year in their draft determinations for the RIIO2 controls.[33] **OBR labour productivity forecasts per hour – July 2020**.[34]

	2019	2020	2021	2022	2023	2024
Upside	0.0	5.7	-0.4	-1.2	0.6	1.0
Central	0.0	5.0	-2.1	-0.5	0.3	0.8
Downside	0.0	4.3	-5.6	0.0	1.2	1.3
March 2020	0.0	0.9	1.2	1.2	1.1	1.2

31 Bank of England, 'Monetary policy report', August 2020, p. 11.
32 Bank of England, 'Monetary policy report', May 2020, p. 7.
33 Ofgem, 'RIIO2 Draft determinations: Core document', July 2020, paragraph 5.36.
34 OBR, 'Economic and fiscal outlook', March 2020, Table 2.7 and OBR, 'Fiscal sustainability report', July 2020, Tables 2.2-2.4.

Topic	Reference	Summary of issue	Response
Frontier shift productivity growth	Anglian Water response to RFI11 Q25 and 26	Anglian Water does not separate out frontier shift productivity growth	Anglian Water in its query response just refers to productivity growth and that frontier shift is the net impact of productivity growth and real price effects. In this query response, which follows a similar point in its statement of case, Anglian does not separate out catch-up and frontier shift productivity growth. In Table App24a the company identifies frontier shift productivity growth of 1% for application to base and enhancement costs. This is consistent with the supporting reports that it provided at the time, and is less than the implied productivity growth that Anglian Water states that it has applied in this query response (which averages 6.4% and 5.4% over the period for unmodelled and enhancement costs respectively, equivalent to 2.2% and 1.8% per year if spread over five years, or 1.9% and 1.6% per year if spread over six years). Anglian Water does not explain this discrepancy.
Real price effects - overall	Anglian Water, Covid-19 Impacts - July Update Final, page 24.	Anglian Water states CPIH forecasts will be lower and that a true-up mechanism should be put in place for all price effects due to the increased uncertainty since the final determinations	A true-up mechanism for all input prices is disproportionate, given that any real price effects for some input prices are likely to be immaterial as a proportion of totex and will in any case be shared under the totex cost sharing mechanism. It will also provide a disincentive for management to manage costs. One of the key drivers of lower CPIH is lower energy prices as set out in the recent Bank of England report 'CPI inflation has been affected by lower energy prices, as oil prices fell markedly in response to the fall in global GDP. That accounts for a large part of the fall in inflation from 1.7% in Q1 to 0.6% in Q2.'[35] The fall in energy prices is likely to benefit water companies by more than the general economy due to the higher share of energy in water company costs (9% compared to 5.2%).[36]
Real price effects - labour	Northumbrian Water Covid submission - Annex 1 - 31 July 2020, page 5, table 3.	Northumbrian Water reference to OBR earnings per hour forecasts	The figures in the Northumbrian Water response seem to be taken from the latest OBR report (Table 2.2 on p.49) which are average earnings per employee, so we think Northumbrian has simply mis-labelled the data as earnings per hour. Average earning per hour

[35] Bank of England, 'Monetary policy report', August 2020, p. 3.
[36] Europe Economics, 'Real Price Effects and Frontier Shift – Final Assessment and Response to Company Representations', December 2019, p. 38.

Topic	Reference	Summary of issue	Response
			figures will be far less impacted by furloughing of staff as they only reflect the earnings of staff that are working.
Partnership funding and customer protection for Hull and Haltemprice – Living with Water	Partnership funding: Yorkshire Water's hearing transcript, page 95	Yorkshire Water states that it will have to seek additional funding for the £20m partnership funding, which may be from government and not the partnership agencies it is working with in Hull.	It is new information that the partners involved in Hull may not be funding the work and we note elsewhere that Yorkshire Water has requested the additional £21.3m funding directly from Government. There is therefore considerable uncertainty that the additional funding will be found which puts the full scope of the proposals in jeopardy.
	Customer protection: Yorkshire Water's response: RFI 012A	Yorkshire Water proposes a new financial underperformance payment equal to any Hull enhancement allowance that proposes to return unspent money to customers in 2025. It proposes only a reputational performance commitment for non-delivery of the proposed benefits in terms of reduced sewer flooding risk.	We note that Yorkshire Water has not considered the clear overlaps with internal and external sewer flooding performance commitments and outcome delivery incentives which incentivise the type of investment proposed in Hull in the long term. We consider that should the CMA make an enhancement allowance then it would be more appropriate to claw the money back if the expected modelled outputs are not delivered. The incentive as proposed could promote inefficient investment that does not deliver the benefits to customers.
Base Allowance – extent of the funding gap	Anglian Water's hearing transcript, line 4, page 13 and multiple other points.	Anglian Water states that it proposed flat base totex (botex) and that Ofwat reduced the proposed flat botex by £265 million.	We have previously shown[37] that Anglian Water did not propose a flat botex profile. It has significantly increased its over historical levels, with increase botex plus costs of around 10% in its business plan. This is particularly evident when compared to more modest increases in cost forecast, or decreases, made by other companies.
Customer protection for the Interconnector scheme	Anglian Water's hearing transcript, pages 123 to 127.	Anglian Water states that progressing the Elsham scheme through DPC will result in a two-year delay and as a result it will	Anglian Water has not raised any concerns previously (during our working level meeting on DPC nor through the CMA referral process) that the DPC process will hamper the delivery of its interconnector scheme.

[37] Ofwat, 'Reference of the PR19 final determinations: Response to Anglian Water's statement of case', May 2020, Table 3.3, p. 38.

Topic	Reference	Summary of issue	Response
		incur under-performance payments on the Interconnector scheme	The timely delivery of the DPC is within management control. Therefore, to ensure continued management focus in this area we do not consider that it is appropriate to re-profile the incentives for the delivery of the interconnector scheme nor change the approach towards outputs rather than outcomes. We will continue to work with Anglian Water as it develops proposals for DPC and are committed to working with it to avoid undue delays. We note that the company states that the uncertainty around funding the scheme will be resolved by lowering the IDoK materiality threshold (line 13, page 125).
Including Average Pumping Head in the base econometric models	Anglian Water's hearing transcript, from page 21.	Anglian Water argues that average pumping head should be included as a variable in the base econometric models.	Anglian Water has not made representations in favour of the use of average pumping head (APH) before the CMA appeals process. The company's emphasis on the use of this variable now seems to be driven by the potential it identified in our alternative model specifications we developed for final determinations. Companies reported APH at a low confidence grade[38]. Figure 1, in appendix 1 of this document, shows that companies have reported data on APH with much lower confidence than the confidence they reported the number of booster pumping stations. Of all companies, Anglian Water reported data on APH with the lowest confidence. This is contrary to what it reported at the hearing (line 4, page 22). Anglian Water, in particular, raised concerns about the reporting quality of this variable in its response to our initial assessment of plans[39] : "We strongly agree with Ofwat that topography is a key determinant of costs and support the inclusion of a variable to control for it. We also share Ofwat's disappointment that there remains insufficient

[38] The confidence grade is an alphanumeric code that companies assign to each data point in their annual performance review submissions. It consist of a letter and a number. The letter refers to reliability and the number to accuracy.
[39] Anglian Water, 'Response to the initial assessment of plans', April 2019, p. 40, submitted to the CMA with Anglian Water's statement of case, SOC104 (CONF_AW_IAP Response).

Topic	Reference	Summary of issue	Response
			consistency in reporting across the industry to allow the use of its preferred variable, average pumping head (APH). Efforts to address this issue must continue." The concern over data quality was raised by a number of companies. Analysis of the APH data reveals irregularities that are difficult to explain, and would impact on modelling results. And indeed, the poor data quality was reflected in modelling results which showed that APH was generally insignificant, unstable and sensitive to sample period: APH is very insignificant in the water resources plus and wholesale models. In our treated water distribution model, it became significant only with the addition of the new data in 2018-19, making it sensitive to sample period. However, this model was still unstable, as after removing the density squared term the APH variable was no longer significant, while the booster pumping station variable remained significant. The use of number of booster pumping stations instead of APH is supported by companies. Notably Severn Trent in its third-party submission ("We consider the booster stations variable to provide a helpful way of capturing the energy costs involved with operating a water network") and SES Water, which recommended to continue using booster pumping stations in our models in light of poor quality APH data, and address its unique circumstances as part of a cost adjustment claim. Our analysis shows that Anglian Water does not have a high energy consumption per length of main compared to the rest of the industry (see Figure 2 in appendix 1 of this document), as may be expected if this was a uniquely important cost driver for the company. We therefore do not consider that the company has unique circumstances which the booster pumping stations variable, along with the other factors included in our models (eg length of mains and density), do not adequately address.

Topic	Reference	Summary of issue	Response
Support for challenges in meeting leakage targets	Anglian Water's hearing transcript, pages 106 to 107	Anglian Water states that it has provided evidence from Dr. T. Farewell that shows that it has specific challenges in tackling leakage due to soil conditions.	The evidence provided by Dr. Farewell is categorised as a third-party submission.[40] In our opinion the submission does not draw any clear conclusions regarding the ease of managing leakage within the Anglian Water supply region compared to other companies. Managing leakage is a function of management action, i.e. investment strategy, use of technological innovation, resource productivity, and the characteristics of the supply region, i.e. urbanisation, and the interactions between the assets and the environment. The evidence focuses on only a subset of these factors and no information is given as to relative importance of the factors presented nor is it clearly stated that Anglian Water is more exposed to these factors than other companies. The information is, in general, presented in map form and thus it is not possible to discern the precise differences between company regions. For example, visually large areas of the southerly areas of England appear to be as exposed, if not more exposed, to the effects of corrosive soils than East Anglia. The evidence presents many environmental factors that influence leakage, which are generally accepted across the industry. There is evidence that the South East of England, and particularly East Anglia, experiences larger fluctuations of soil moisture. However, for many of the factors the net effect is not clearly stated. For example, the report states leak detection methods work better on metallic pipes, but metallic pipes have the highest failure rates of all materials and are subject to corrosion. Anglian Water has lower levels of metallic pipes than other companies and its pipelines are not substantially older and thus less exposed to corrosion over their lifetime. As a result of this, and other similar examples, the report falls well short of making a compelling case for the company.

[40] Submissions from third parties – Timothy Farewell

Topic	Reference	Summary of issue	Response
Relationship between population density and leakage	Anglian Water's hearing transcript, from page 106 Anglian Water's letter to CMA 12th August 2020	Anglian Water states that within its region, at DMA level, the higher the population density the lower the levels of leakage per property.	Based on engineering rationale we expect leakage per km of main to increase in areas with greater population density. This is because there are more service connections to properties per km of main in these areas. These connections are potentially a point of weakness that may be susceptible to leakage. In addition, customer supply pipe losses will increase with the number of properties in a given area.
Funding for Smart metering	Anglian Water's hearing transcript, from page 128 and Anglian Water's letter to CMA 12th August 2020	Anglian Water accepts that were its cost adjustment claim for Smart metering to be accepted it would recoup this cost again in AMP8	We welcome the CMA highlighting to the company that should the company's future plans not contain an adjustment for the accelerated maintenance of basic meters it would recoup the funding twice (line 21, page 129). We note also in its letter 12th August 2020[41] that the company is now committing to reducing its maintenance cost in this area in future AMPs. However, in this area of capital maintenance, as in the other areas we make a long-term average allowance. We believe that it is in the best interest of customers, and reduces the complexity of the regulatory framework, that the onus is on companies to manage the peak and troughs in individual elements of their investment portfolio. This is particularly so for those, like Anglian Water, that have a large, diverse asset base.
Company efficiency factor	Anglian Water's hearing transcript, from page 140	Anglian Water does not consider there is any rationale to assume efficiency in base costs implies efficiency in enhancement costs and states that it has efficient in delivering enhancement projects in the past.	First, in the case of Anglian Water there is clear correlation between inefficiency on base and on enhancement. This is true, although to a lesser extent, for the majority of companies: companies that are inefficient on base costs are generally inefficient in the majority of enhancement models, providing some validation to our approach. We also note that our efficiency challenge in enhancement deep and shallow dives, which is based on the company efficiency factor, is conservative compared to the gaps we observe in enhancement benchmark models between modelled and proposed costs. We acknowledge that these gaps do not entirely capture inefficiency,

[41] Anglian Water, Letter from Peter Simpson, Anglian Water Chief Executive, to Kip Meek, 12 August 2020.

Topic	Reference	Summary of issue	Response
			but it still provides a sense that our starting challenge of 10% maximum is sensible. Second, Anglian Water argues that it has been efficient in the delivery of prior enhancement projects, so Ofwat should assume as a starting point that the company is efficient in enhancement (p. 140). However, that the company has a history of requesting high costs in each price review relative to the costs it ends up incurring, and that all signs suggest that this is the case again with its PR19 proposals, is more relevant information with which to challenge its enhancement proposals in the interest of customers. We would like to clarify that the company efficiency factor is based on our assessment of PR19 base expenditure proposals and not on PR14 expenditure as stated in the Anglian Water hearing transcript (lines 14-15, page 141).
Bioresources capacity funding	Anglian Water's response to RFI012 questions 9,12 and 13 and Ofwat response to question 10	Anglian Water's proposed investment at Whitlingham to provide additional bioresources treatment capacity.	We have previously provided a copy of Anglian Water's query response ANH-FD-CA-004. In it Anglian Water states it calculated a fully loaded gate fee, but that its "calculation is based on our own costs which may be less efficient than those of third party treatment providers". As part of our assessment we calculated that the efficient fully loaded gate fee suggested by Anglian Water was lower than Anglian Water's cost to build and operate its own capacity at Whitlingham, even without taking into account the additional costs to customers of depreciation or any additional capex to maintain the company's assets if it were to build its own capacity. Our final determination allowance was for 2.5 years of a contract plus three years of operational costs of dealing with the sludge before the contract is up and running. We consider that this provides Anglian Water with sufficient funding to deal with the potential growth in sludge, while not constraining the development of the market. Although the company proposes additional capacity at Whitlingham, one of the factors constraining its choice of site was the existing layout of its sites and its ability to retrofit additional

Topic	Reference	Summary of issue	Response
			capacity. Without such constraints it is not clear that Whitlingham is the optimum location for additional capacity. We note that Anglian Water and Yorkshire Water both require additional bioresources treatment capacity in the next five to ten years and that they are neighbouring companies. A market solution on the border between the two companies would be ideal for accommodating such requirements. We also note as set out in our final determinations feeder model "Anglian Water provides insufficient evidence to confirm that using the bioresources market by contracting with a third party provider is a more costly option than building its own capacity. ….." . "We note that the company states that plants treating other organic wastes will not accept wastewater sludge because of the restrictions imposed by environmental regulations. This is not the case as co-treatment is possible as long as the appropriate permits are obtained. It may be economically viable for a third party with currently unused digester capacity to either co-digest or co-locate treatment facilities for both materials. This option does not appear to have been considered by the company."
Green recovery	Northumbrian Water, Update on Covid-19, page 8, paragraphs 14 to 16	Northumbrian Water invites us to reconsider our position on the two resilience schemes it highlights to the CMA (the North East sewer flooding risk reduction and Abberton-Hanningfield raw water transfer schemes), in light of the Green Economic Recovery initiative set out by us and other stakeholders in a recent letter.	We note that the Green Economic Recovery letter highlights the need for regulatory consideration of proposals in line with our duties, including the extent to which any proposals secure value for money for customers. The establishment of the initiative does not absolve companies of the requirement to provide sufficient and convincing evidence of need and efficiency. Northumbrian Water has not provided sufficient evidence to justify these additional cost allowances. We have explained our reasoning in previous submissions to the CMA. We suggest that the CMA may wish to consider the extent to which Northumbrian Water has sufficiently demonstrated the need for the Essex resilience investment, and, in terms of its proposals to reduce sewer flooding risk in the North East, whether our final determination already covers the investment requested.

Topic	Reference	Summary of issue	Response
			We recognised the priority of resilience investment to the company, its customers and stakeholders, and allowed funding for all proposals from Northumbrian Water that were well-evidenced and efficient.
Notified item on metaldehyde	Anglian Water's transcript, pages 149 and 150	CMA notes that Ofwat has indicated a willingness to review the materiality threshold	We noted previously[42] that in our final determination we committed to considering the case for amending Condition B following a consultation to introduce a specific interim determination process with bespoke criteria (and eventually a materiality threshold) for direct procurement for customers. However we should clarify this amendment would not apply to the metaldehyde notified item. We accepted that costs to address metaldehyde could be material for Anglian Water if a ban on the outdoor use of metaldehyde as a pesticide is not reintroduced. We considered a Notified Item is the appropriate tool to deal with this uncertainty in a way that best protects the interests of customers and provides the company with protection to the extent that material costs arise. We also included an equivalent Notified Item in our final determination for Affinity Water, the other company for whom we accepted that costs to address metaldehyde could be material. Interim determinations and Notified Items are an established and familiar mechanism that allow price controls to be changed in-period in appropriate cases where there are material changes in costs. Although not all items may reach the materiality threshold on their own, interim determination applications can include other eligible items (relevant changes of circumstance specified in Condition B or any other notified items).

[42] Ofwat, 'Reference of the PR19 final determinations: Response to Anglian Water's statement of case', May 2020, p. 42 and pp. 110-111.

Table 2.2: Summary of response to issues raised - outcomes

Topic	Reference	Summary of issue	Response
Customer challenge groups	Letter from Yorkshire Water to Kip Meek, "Chairman of the PR19 Redetermination Group", dated 7 August	The company's letter states that "Ofwat felt that the consumer challenge groups had not added value".	We do not recognise Yorkshire Water's representation of our view of customer challenge groups (CCGs). We consider that the company may be referring to the views expressed by Stephen Littlechild in his submission to CMA. Rather, we have emphasised the importance of the CCG role in assuring the quality of each company's customer engagement and the extent to which business plans reflect the results of that engagement. We refer CMA to comments made by Rachel Fletcher at our first hearing on 15 July: "I think the quality and the quantity of customer research included in the companies' business plans, and, indeed, the final determinations, is greater than it ever has been, actually, in price control reviews. Some of the credit has to be given to the CCGs. I think, increasingly, the exercise around PR19 has now embedded an importance in the industry of continually listening to customers and using that to drive day to day operations." On page 162 of the 15 July hearing transcript we also explicitly acknowledge the value of CCGs, particularly for bespoke PCs where we have less comparative information across companies.
Outcomes process	Northumbrian Water's hearing transcript, page 65	In response to the question "What generally are your observations on the process followed by Ofwat in reviewing and changing the levels of PCs and ODIs?" the company states "Changes were made very late in the process and they weren't consulted on to the same degree."	We do not understand what changes the company refers to. We did not intervene in any of the company's proposed PCs and ODIs until our draft determination, which was a formal consultation. We explained our Outcomes methodologies and how we applied them in determining PCs and ODIs in the technical documentation published alongside our draft determinations. Any changes we made following this in the final determinations were the direct result of consideration of stakeholders' responses to the draft determinations and additional information provided by the company.

Topic	Reference	Summary of issue	Response
			We note that we consider that all the changes we made to PCs and ODIs between draft and final determinations are in the company's favour. The changes and reasons are published.[43] Perhaps the most contentious change but, as the company admits, not the most material item in its statement of case,[44] was the change to the ODI RORE sharing rate threshold. However, even this was in the company's favour. At draft determination we set a **gross** sharing threshold at 2% RORE, which we had thought was the company's proposal, and which provided more protection for customers than our sector view of a gross sharing threshold of 3%. After we understood that the company's proposal was on a **net** basis and did not provide greater protection to customers, we increased the threshold to 3% RORE on a **gross** basis in our final determinations, which is the threshold all other companies have.
ODI RoRE ranges	Yorkshire Water's hearing transcript, pages 82-83	The company erroneously states that Ofwat "summed up all the individual P10s and P90s for each individual ODI and said, 'That is the answer'". The company also highlights what it considers is an inconsistency between our risk analysis showing Yorkshire Water as having more upside and downside and a view that Yorkshire Water is inefficient.	The company's statements are incorrect. In our risk analysis we completed further analysis to consider the overall risk at a company level (i.e. we did not just sum them additively) as we set out in our response on common outcomes issues. We derived and applied scaling factors because simply summing the risk of each ODI would overstate risk at a company level.[45] Furthermore, our risk analysis was on the basis of an efficient company.[46] There is no inconsistency between a view that an efficient company has more upside than downside and that an inefficient company will have more downside.

43 Ofwat, 'Northumbrian Water – Delivering outcomes for customers final decisions', December 2019.
44 Northumbrian Water hearing transcript, p. 78.
45 Ofwat, 'Reference of the PR19 final determinations: Outcomes – response to common issues in companies' statements of case', May 2020, pp. 74-6.
46 Ofwat, 'Reference of the PR19 final determinations: Outcomes – response to common issues in companies' statements of case,' May 2020, pp. 52 and 56.

Topic	Reference	Summary of issue	Response
ODI rates - PCC	Bristol Water's hearing transcript, page 101	Bristol Water states that it is unreasonable for Ofwat to use 'standardised incentives' for per capita consumption because compulsory metering powers differ across companies.	Ofwat provided companies with multiple opportunities to explain the difference in their proposed ODI rates relative to other companies'. At no point has Bristol Water submitted evidence of a relationship between customer willingness to pay and metering penetration to justify why their ODI rate should be nearly 20% lower than the average of the 'reasonable range.' This point that the company is now making remains an assertion which is not supported by any evidence. Similarly, no other companies have provided any evidence of a relationship between willingness to pay variations and meter penetration. Furthermore, contrary to the company's claim, we did not apply a 'standardised incentive' to its ODI rate for per capita consumption. Instead our intervention was to set the ODI rate at the value implied by the output of the company's own customer research.
ODI rates	Yorkshire Water's hearing transcript, page 141	Yorkshire Water states that the ODI rates in its final determination for leakage are more than double its customers' valuation and that its water supply interruptions ODI rate is half of what its customers' values.	As we set out in our 22 June Submission to the CMA[47] our intervention to Yorkshire Water's supply interruptions ODI rate is based on it having inappropriately triangulated the results of its customer research. In particular, its ODI rate was being driven by the inclusion of an outlier piece of research which implied a rate over 100 times larger than the values derived from the company's own stated preference willingness to pay research. This outlier value which was derived from the results of only 33 respondents appeared to be driving a rate for Yorkshire which was nearly five times higher than the average of our 'reasonable range'. It was therefore appropriate for Ofwat to intervene by correcting the triangulation of the ODI rate to better align it with the results of the company's own core willingness to pay research. With respect to its leakage ODI rate we observed that the company's proposed underperformance rate was 70% less than the average of our reasonable range which was of concern given the company had failed its 2017-18 leakage performance commitment, suggesting a credible incentive to understate its ODI

[47] Ofwat, 'Reference of the PR19 final determinations: Response to Yorkshire Water's 27 May Submission to the CMA', June 2020, pp. 33-35.

Topic	Reference	Summary of issue	Response
			rates. The proposed rates also offered a lower level of customer protection than those for the 2015-20 period. Combined, these concerns justified Ofwat stepping in to better align Yorkshire's leakage ODI rate with the body of customer evidence from the rest of the sector.
ODIs - Mains Repairs	Bristol Water's hearing transcript, page 96.	The CMA states that Bristol Water is seeking a change in the mains repairs ODI underperformance rate back to the level in the company's business plan. Bristol Water also says "mains burst per se themselves are neither here nor there. The consequence for the customers are either increased leakage or interruption to supply. Those two already have strong incentives attached to them […]".	The CMA's statement (which was not challenged by Bristol Water) that the company is seeking to revert its mains repairs ODI rate back to the level in its business plan is not consistent with Bristol Water's Statement of Case in which it requests that the CMA amend its mains repairs ODI rate to £23k/repair per 1000km of mains (as opposed to £19k/repair per 1000km of mains in its business plan and our final determination rate of £40k/repair per 1000km of mains).[48] Mains repairs is an important component of our suite of common performance commitments acting as an indicator of the health of companies' assets as well as holding companies to account for past capital maintenance expenditure allowances. High levels of mains repairs can indicate problems for future customers as well as bad service for customers in the present. Furthermore, we note that in its hearing transcript (page 70) another disputing company, Northumbrian Water, references the direct disbenefit to customers of mains repairs in terms of local and traffic disruption that occur in the event of a repair.[49] The mains repairs performance commitment and ODI therefore provides a distinct incentive from water supply interruptions and leakage.
ODIs and company controllability	Bristol Water's hearing transcript, page 104, and	Bristol Water appears to imply that deadbands or reduced ODI rates could be utilised to account	The use of mitigations such as deadbands or ODI rates which vary according to company controllability is not consistent with the outcomes framework which targets the end-impacts on customers.

[48] Bristol Water, 'PR19 Redetermination Bristol Water: Statement of case', April 2020, p. 152.
[49] For an example of the disruption caused by mains repairs see https://www.bbc.co.uk/news/uk-england-bristol-53775975

Topic	Reference	Summary of issue	Response
	Anglian Water's hearing transcript, page 112	for factors outside of companies' control. In a similar vein, Anglian Water requests a deadband on its bathing water quality performance commitment to account for third party impacts that can affect the quality of bathing waters outside of its control.	In particular, the use of deadbands blunts companies' incentives to manage their own performance around the performance commitment level. Mitigations such as those described also blunt companies' incentives to manage the effectiveness to which they respond to factors outside of their control and their resilience to external events. For example, our review into the water supply issues that followed the Freeze/Thaw event of 2017-18 found that performance across companies depended to a large extent on factors within their control, such as the quality of their plans for handling major incidents.[50] Nevertheless, we have allowed for collars (and caps) to limit the extent of underperformance (and outperformance) payments on certain PCs (including, in particular, financially significant PCs). [51]
ODI Package	Anglian Water's hearing transcript, page 34, and Bristol Water's hearing transcript, page 94	Anglian Water states that it appeared that Ofwat's approach was PC by PC and that Ofwat did not step back to look at the overall position. Similarly, Bristol Water argues that Ofwat has put too much risk on mains repairs and PCC relative to customer preferences.	Contrary to the companies' assertions, Ofwat undertook a package level analysis of the balance of risk across performance commitments relative to customer preferences. This resulted in a number of interventions whereby Ofwat intervened to reduce downside risk on certain performance commitments to ensure the relative levels of exposure were consistent with customers' priority rankings. These interventions are described in further detail in our final determination policy appendix.[52] Specifically, with respect to mains repairs we identified that the ODI package implied a disproportionate level of downside risk across companies taking into account the achievability of the performance level, the size of ODI rates and customer preference rankings, and intervened to moderate ODI underperformance rates accordingly. We consider that the resulting package of incentives is consistent with customer preferences. A similar check was undertaken for all performance commitments including per capita consumption where no

[50] Ofwat, 'Out in the Cold: Water companies' response to the 'Beast from the East', June 2018, p. 6.

[51] Ofwat, 'PR19 final determinations: Delivering outcomes for customers policy appendix', December 2019, Section 7.

[52] Ofwat, 'PR19 final determinations: Delivering outcomes for customers policy appendix', December 2019, p. 104.

Topic	Reference	Summary of issue	Response
			mismatch was identified between the strength of incentive and customer preferences.
Performance commitment levels (PCLs)	Bristol Water's hearing transcript, page 71, Yorkshire Water's hearing transcript, page 137, and Anglian Water's hearing transcript, page 34	The companies assert that we have set performance commitment levels at very stretching levels, which are unachievable, either individually or at the overall portfolio level, because we have made the assumption that most companies can be high performing on most PCs most of the time.	We consider that, in our final determinations, we set stretching but achievable performance commitment levels for each individual PC for each company – the basis of that assessment varied from PC to PC as has been described in detail elsewhere. We also recognise that over a five year period there may be adverse weather or operational events that result in a company incurring underperformance payments on some PCs in some years, but this can also go both ways. For example, benign weather can result in outperformance payments. An efficient company should earn zero net ODIs across the package as a whole, most likely from meeting the majority of its PC targets in most years. However, it is not correct to say that, when setting individual PCLs, we assumed that most companies can be high performing on most PCs most of the time. We have commented elsewhere that many companies have already met the 2020-21 or even 2024-25 performance commitment levels for some of the common PCs, or are on a clear trajectory to do so (having made an "early start" on improving performance in the final years of the previous period). In some cases companies would be close to PR19 targets if one-off events within management control were excluded (for example Anglian Water on water supply interruptions if the effect of the Leighton Buzzard failure[53] is stripped out), or if the variable impacts of management responses to more widespread events

[53] In its recent 2019-20 APR submission, Anglian attributes a large increase in its water supply interruptions performance in 2019-20 to a significant interruption to supply event in Leighton, Buckinghamshire, which affected 17,997 properties for over 24 hours, contributing 12 minutes 40 seconds to the 2019-20 score. It reports that the score without the 'one off' Leighton event would have been 5 minutes and 59 seconds for 2019-20. This compares with our target of 6 minutes and 30 seconds for 2020-21 and 5 minutes in 2024-25. The company has also publically apologised for the event saying the service fell short of what their customers should expect of them – see https://www.anglianwater.co.uk/news/open-letter-reflecting-on-leighton-linslade-and-leighton-buzzard-water-supply-recovery/

Topic	Reference	Summary of issue	Response
			such as the Beast from the East are accounted for. In other cases, companies are further away from the PR19 performance commitment levels relative to the sector because of historic under-investment or poorly targeted expenditure (for example Yorkshire Water on internal sewer flooding). Taking account of this, it is likely that companies will be able to improve performance from current levels in response to the targets and incentives that we have set in our final determinations, and supports our view that an efficient company should be able to meet the majority of its PC targets in most years. Experience from earlier price control periods, including PR14, and other sectors has also shown that companies are able to meet, or outperform, regulatory targets which they claim are challenging at the time they are set.
PCLs	Anglian Water's hearing transcript, page 102	Anglian Water states that Ofwat made no attempt to consider whether performance commitment levels (for the three performance commitments with upper quartile targets) represented realistic targets in terms of achievability.	This is not the case - we explicitly and comprehensively considered the achievability of the performance commitment levels in our determinations. While we used upper quartile performance forecasts as a starting point in our consideration of performance commitment levels for these three PCs, we also conducted further analysis – taking account of wider evidence – to calibrate the appropriate level of stretch for each performance commitment for an efficient company. We considered past performance against PR14 levels, the scale of improvement over time (both in PR14 and in previous periods where historical, comparable data was available), and the improvement required to reach the forecast upper quartile level both in the first four years of the period and in the final year 2024-25. This included looking at the 'overnight' or first year change from 2019-20 forecast levels to the forecast upper quartile level in 2020-21. At final determination we used new data on 2018-19 actual performance from shadow reporting which was not available to us at draft determination. We also considered company-specific circumstances and allowed exceptions to the common

Topic	Reference	Summary of issue	Response
			performance levels of these performance commitments if well justified. On the basis of this analysis, considering representations from stakeholders about achievability, we decided to moderate the performance commitment level for water supply interruptions for 2024-25 (increasing it to 5 minutes) and to amend the glide path to this level over the earlier years of the period.
PCLs - Water Quality Contacts	Anglian Water's hearing transcript, page 99	Anglian Water states that its customers did not support an improvement in its Water Quality Contacts performance commitment over the 2020-25 period. Instead it argues that the performance commitment level should have a flat profile over the period and that Ofwat's intervention to set improving performance levels is contrary to its customers' preferences.	Our final determination base expenditure allowances provide funding for an efficient company to improve performance on this metric over the period. If the company considered that improving performance over the 2020-25 period was not consistent with its customers' preferences it could have continued to propose a flat performance commitment level while proposing to return the associated funding from base expenditure allowances. Instead Anglian Water appears to be proposing to keep the full base funding allowance but not deliver the associated performance improvement.
PCLs - Water supply interruptions	Bristol Water's hearing transcript, page 70	Bristol Water states that water supply interruptions is too volatile a metric upon which to undertake trend analysis, due to factors such as weather.	We consider analysis of past and forecast performance does provide meaningful insight into the achievability of the performance commitment level for water supply interruptions because despite the impact of extreme weather events such as the 2017-18 "Freeze/thaw" a clear downward trend is apparent in the historic data at a sector average level. Furthermore, we do not accept that extreme events are wholly outside management control. Some companies perform better than others in response to significant national weather events precisely due to the speed and efficiency of management actions taken to mitigate the risk of a loss of supply to customers. Even where there are significant external factors that can influence performance, companies are able to reduce volatility by taking steps to make themselves more resilient to such events. For

Topic	Reference	Summary of issue	Response
			example, this includes the use of remotely operated actuated valves which can close down burst mains and re-zone areas quicker, limiting losses on larger incidents. For smaller incidents companies can make use of quick to assemble temporary tank systems.[54] Further, we set out in our final methodology our expectations for companies in relation to resilience. We consider resilience as the ability to cope with, and recover from, disruption. A resilient company should anticipate trends and variability in order to maintain services for people and protect the natural environment, now and in the future. The resilience of critical infrastructure and essential services can be secured through incorporating resistance, reliability, redundancy and fast and effective response to, and recovery from, disruptive events. Just because a metric can be impacted by weather does not mean that companies should not consider it as part of their resilience planning. Finally, we note that Bristol Water itself forecast in its September 2018 business plan performance of less than 2 minutes by 2024-25 (compared to our final determination performance commitment level of 5 minutes).
Unplanned outage	Northumbrian Water's hearing transcript, page 75	The company reiterates that the "unplanned outage measure is too new and insufficiently well established …to be applied to it at this point" and refers back to previous evidence it submitted in its statement of case as evidence to substantiate this.	The main evidence that the company refers to is based on a review before the measure was first reported by companies in 2017-18. There has been significant year on year improvement in reporting compliance.[55]. New evidence from the 2019-20 APRs show the improvements in reporting have continued in 2019-20 and twelve companies are fully compliant with the reporting requirements, including all the disputing companies. The remaining companies have reported unplanned outage without any deviation from the reporting

[54] For example see https://www.emergencywater.co.uk/always-in-supply.
[55] Ofwat, Reference of the PR19 final determinations: Response to Northumbrian Water's statement of case, May 2020, p. 91.

Topic	Reference	Summary of issue	Response
		The company also claim that unplanned outage has a limited impact on consumers because the impacts are mitigated because of redundant network capacity and its interconnected network.	requirements that they consider would lead to a material impact on the reported number. Apart from Northumbrian Water and Southern Water, all companies either delivered the 2020-21 PCL in 2018-19 or are on the right trajectory to deliver it taking 2019-20 performance into account as well. Southern Water raises no concern with meeting the PCLs. We note that nine companies have already performed below (better than) the 2024-25 PCL in 2019-20. Moreover, we explicitly took account of the fact that the metric was new and set a less challenging PCL because of this. [56] We note the company's argument with regard to the lower benefits to consumers of an unplanned outage on its network but it has not suggested that it should have a lower base cost allowance to reflect the lower level of asset health that it is proposing to provide compared to other companies.

[56] Ofwat, 'PR19 final determinations: Delivering outcomes for customers policy appendix', December 2019, p. 63.

Table 2.3: Summary of response to issues raised – risk and return

Topic	Reference	Summary of issue	Response
WRFIM	Yorkshire Water's hearing transcript, page 131	Yorkshire Water suggests that there would be less need for accelerated revenues if the company had been able to recover the revenue claimed in respect of WRFIM.	Reconciliation adjustments have no impact on our assessment of financeability. In line with the published methodology, we assess financeability on the basis of the notional capital structure excluding reconciliation adjustments for previous control periods. This ensures that customers do not pay more to address financeability constraints arising either from poor performance, or as a result of an adjustment being made to allowed revenue as a result of the company's performance in the previous period. Similarly, it ensures that the value of outperformance payments earned through regulator incentive mechanisms is not eroded as a result of adjustments made following the financeability assessment. We set out our reasoning for excluding reconciliation adjustments in our reference of the determination of price controls: Cross-cutting issues document.[57]
Gearing outperformance sharing mechanism	Bristol Water's hearing transcript, page 50	Bristol Water states that gearing increases as a result of the final determination if it pays dividends out to shareholders, potentially taking gearing above the 70 per cent threshold for the gearing sharing mechanism.	The increase in gearing is in relation to Bristol Water's actual capital structure. This is a matter for Bristol Water and its shareholders. We set out in the final determination for Bristol Water that we assessed financeability with a dividend yield assumption of 3.00% with dividend growth of 1.18%.[58] Table 5.2 shows that average gearing for the notional company is below 60%.
Gearing outperformance sharing mechanism	Anglian Water's hearing transcript, page 77	Anglian Water states that it has to put £40 million aside for the gearing outperformance mechanism reducing the equity buffer to deal with risks.	This is a matter for Anglian Water and its shareholders. As set out in Table 5.2, of the final determination for Anglian Water, the average gearing for the notional company is around 60%.[59] Therefore the gearing outperformance sharing mechanism will not be activated for the notional company.

[57] Ofwat, 'Reference of the PR19 final determinations: Cross-cutting issues', March 2020, paragraphs 6.65-6.69, pp. 71-72.
[58] Ofwat, 'PR19 final determinations: Bristol Water final determination', December 2019, pp. 72-73.
[59] Ofwat, 'PR19 final determinations: Anglian Water final determination', December 2019, p. 82.

Topic	Reference	Summary of issue	Response
Retail margin	Yorkshire Water's hearing transcript, pages 33-34.	Yorkshire Water misleadingly suggests that Covid-19 liquidity support in business retail is a 'pass through' of retail risk to the wholesale controls, and so that the retail controls are no more risky than wholesale.	The issue of liquidity support is a business retail control issue – it does not concern the household retail control, and so there is no risk transfer between household retail and wholesale due to this measure. This issue is therefore of limited relevance to establishing the relatively higher exposure to systematic risk of the household retail control versus the wholesale controls (which is what the retail margin adjustment adjusts for). Liquidity support is not in any case a total pass-through of risk: while time-bounded liquidity support is being provided to business retailers, they will ultimately pay for this support, at a nominal interest rate capped at 5.98%. The exposure of wholesalers to bad debt from this measure is furthermore limited to the average monthly wholesaler charge for each failed business retailer.
Embedded debt	Yorkshire Water's hearing transcript, page 15 Anglian Water's post-hearing follow-up submission, 12 August, page 1	Yorkshire Water argues its all-in debt costs including swaps should be reflected in the overall allowance. It has previously stated this is 4.93% in nominal terms. Anglian Water's follow-up submission suggests the CMA should set its allowance based on the following datapoints: • 4.94% - based on the iBoxx A/BBB 'corrected' to 20 years from 15. • 4.95% 'balance sheet cross-check' including swaps for WaSCs and large WoCs.	The allowances requested by both Anglian and Yorkshire Water companies are much higher than the March 2020 nominal cost of debt they report in their recently-published Annual Performance Reports (evidence which was submitted in July and so not previously available to share with the CMA). In the below table, we set out the published figure from the Annual Performance Reports (reflecting March 2020 RPI of 2.6%), and restate it using our final determinations assumption of 3.0% RPI. This latter figure is to aid comparability with our final determinations embedded debt allowance of 4.47% nominal. **Company-reported March 2020 cost of embedded debt from Annual Performance Reports (Table 1e):**

<table>
<tr><th>Topic</th><th>Reference</th><th>Summary of issue</th><th>Response</th></tr>
<tr><td></td><td></td><td>4.97% ‘actual’ cost of Anglian water debt which has been ‘efficiently incurred’.</td><td>
<table>
<tr><td>Company</td><td>Weighted average nominal cost of debt (2.6% RPI)</td><td>Weighted average nominal cost of debt (3.0% RPI)[60]</td></tr>
<tr><td>Anglian</td><td>4.29%</td><td>4.49%</td></tr>
<tr><td>Bristol</td><td>4.60%</td><td>4.80%</td></tr>
<tr><td>Northumbrian</td><td>4.18%</td><td>4.34%</td></tr>
<tr><td>Yorkshire</td><td>4.66%</td><td>4.79%</td></tr>
</table>
The corresponding figures for the sector stated at 3.0% RPI (relevant to a notional approach) are as follows:
Average of companies: 4.55%
Issuance-weighted average: 4.16%
These APR figures include the impact of swaps – which we have not hitherto made allowances for in past price reviews. We do not consider it appropriate to reflect swap costs, as their bespoke nature and time variation of interest costs degrade their usefulness as datapoints to inform the efficient cost of debt. In addition, swaps may reflect company risk management relating to features of the actual structure (e.g. high gearing) – it would not be appropriate for customers to fund this.
</td></tr>
</table>

[60] We have adjusted the published Annual Performance Report data by multiplying the difference between 3.0% and 2.6% (0.4%) by the share of index-linked debt in total borrowings for each company and adding the resulting figure to the published APR interest cost.

Topic	Reference	Summary of issue	Response
			Anglian Water's proposed 20 year iBoxx A/BBB-based trailing average would effectively see 2005 iBoxx data reflected in its allowance up to 2025– i.e. covering 25 years of iBoxx data, not 20 years. In addition to grossly overcompensating the company (based on its latest APR submission), its 20 year trailing average would be a radical departure from the 10 year trailing average used at PR14, and is also much longer than Ofgem's proposed iBoxx-based 10-14 year extending trailing average for its RIIO-2 draft determinations. We submit more generally that the CMA should consider the incentive properties and impacts on customers of allowing interest costs stemming from companies' actual structure decisions around gearing and shareholder distributions. For instance, Anglian Water's cost of embedded debt is distorted by the large increase in gearing to fund its atypically large shareholder distribution in 2002. Funding such costs would mean that customers bear the downside when they materialise, while shareholders enjoy the upside from outperformance in previous periods.
Benefits test	Bristol Water's hearing transcript, p45	Bristol Water suggest that customer willingness to pay (without any confirmation of wider customer benefits) is a sufficient decision-making criterion to assure an outcome analogous to that which would obtain in a competitive setting.	Customers have limited information on the consequences of funding (or not funding) an uplift to their supplier's allowed return on capital. This makes confirmation of customer benefits an important safeguard against informational failures such as customers making a willingness to pay decision based on illusory benefits. Bristol Water's customer research submitted in September 2018 showed that customer support for an uplift is contingent on customer benefits. Even accepting its point at face value, Bristol Water have been unable to provide convincing evidence throughout the appeals process that their customers support the £6.08 per household per year cost of funding its requested uplifts to the cost of debt and equity. This figure is over three times the last bill impact figure - £1.80 – which the company tested with its customers.

Topic	Reference	Summary of issue	Response
Financial headroom	Bristol Water's submission on 6 July, p11, paragraph 47	Bristol Water states that Ofwat did not respond to its 'Annex 4' of the company's reply in our June submission. Annex 4 relates to the role and financeability impact of the different types of scenario testing.	We did not consider this to be new evidence. We responded to issues raised in relation to the financial headroom under the final determinations in our response to the statements of case[61].
Financial resilience testing for low inflation and deflation scenarios	Northumbrian Water's submission on 6 July, p16	Northumbrian Water argues that inflation affects the interest rate on index-linked debt in two ways: 1) through the real interest rate applied to the notional balance; and 2) the inflation accretion from the inflation element applied to the notional amount. In its assessment, Northumbrian Water states that, in its assessment, the company reflected the change in inflation in both elements.	Our financial modelling assumes that a proportion of embedded debt is index linked debt. There is no assumption of further index linked debt in new debt. Therefore, it is correct to assume that there is no impact on the real interest rate for index linked debt for changes to inflation.
	Yorkshire Water's response to CMA request for information (RFI012A) dated 4 August 2020, page 4. Yorkshire Water's response to CMA request for information (RFI012A) dated 4 August 2020, pages 1 and 5	Yorkshire Water states that "Standstill works in a very similar way to Special Administration in that it allows the company a breathing space before any enforcement, whilst a recovery plan or transfer can be put in place. YWS believes that this is not only in the long-term interests of its secured lenders but also its customers as it seeks to minimise disruption to operations and to	Standstill and Special Administration are different in very many ways. The Standstill arrangements are primarily for the benefit of the company's secured lenders. We consider there is a significant risk during a period of Standstill of disruption to customer service as management's attention is diverted and future investment is constrained. Whilst the Standstill arrangements may provide a period of time during which it cannot be placed into administration by its secured creditors, it would not prevent us, with the consent of the Secretary of State, or the Secretary of State alone, from applying to a court asking for it to make a special administration order.

[61] Ofwat, 'Reference of the PR19 final determinations: Risk and return – response to common issues in companies' statements of case', May 2020, paragraphs 4.74-4.92, pp.118-123.

Topic	Reference	Summary of issue	Response
		avoid unnecessary acceleration of debts." The company also sets out that "…, we would observe that a company with RPI-linked debt and a portfolio of RPI-linked swaps will have greater flexibility to manage future changes (e.g. significant WACC changes) in a more efficient manner than a company without such swaps and only RPI-linked debt. This reflects the greater liquidity in swap markets and the ability to amend the terms of an RPI-linked swap during its life." Yorkshire Water later states that "This new approach has allowed YWS to adapt to changing financial markets and to secure cost-efficient solutions to meet its objectives for restructurings"	Yorkshire Water's response to the CMA request for information focuses on the RPI-linked swaps. We have not examined the actual swap agreements so we cannot comment on the detailed terms of individual arrangements. However, we note the following: Yorkshire Water sets out a number of actions it has taken in relation to the RPI-linked swaps including removing or extending mandatory breaks, and to reduce interest costs.[62] But Yorkshire Water does not point out that there is likely to be a (perhaps significant) cost to it, either as a cash payment or an increase in swap coupon, of amending the terms of the agreements. Whether or not any changes are done in a manner that is 'cost efficient', as the company claims, they will almost certainly not be cost neutral. Yorkshire Water states that "The CMA does not need be concerned that YWS faces additional cost risk in comparison to other companies in the sector (i.e. there is no "hand grenade" as alighted on in our Main Party Hearing); on the contrary, our use of swaps provides us with flexibilities that companies with only conventional index-linked debt would not have." We note however Moody's recent rating action, sets out that "The downgrade of the Class A notes reflects the persistently high and growing mark-to-market loss (MTM) on Yorkshire Water's derivative portfolio, …"[63]

[62] Yorkshire Water, 'Yorkshire Water's response to CMA request for information (FRI012A) dated 4 August 2020', August 2020, p. 5, Section 4.
[63] Moody's Investors Service, 'Rating action: Moody's downgrades Yorkshire Water's Class A notes to Baa2 and changes outlook to negative', March 2020, p. 1.

A1 Appendix – additional tables and figures to accompany our response

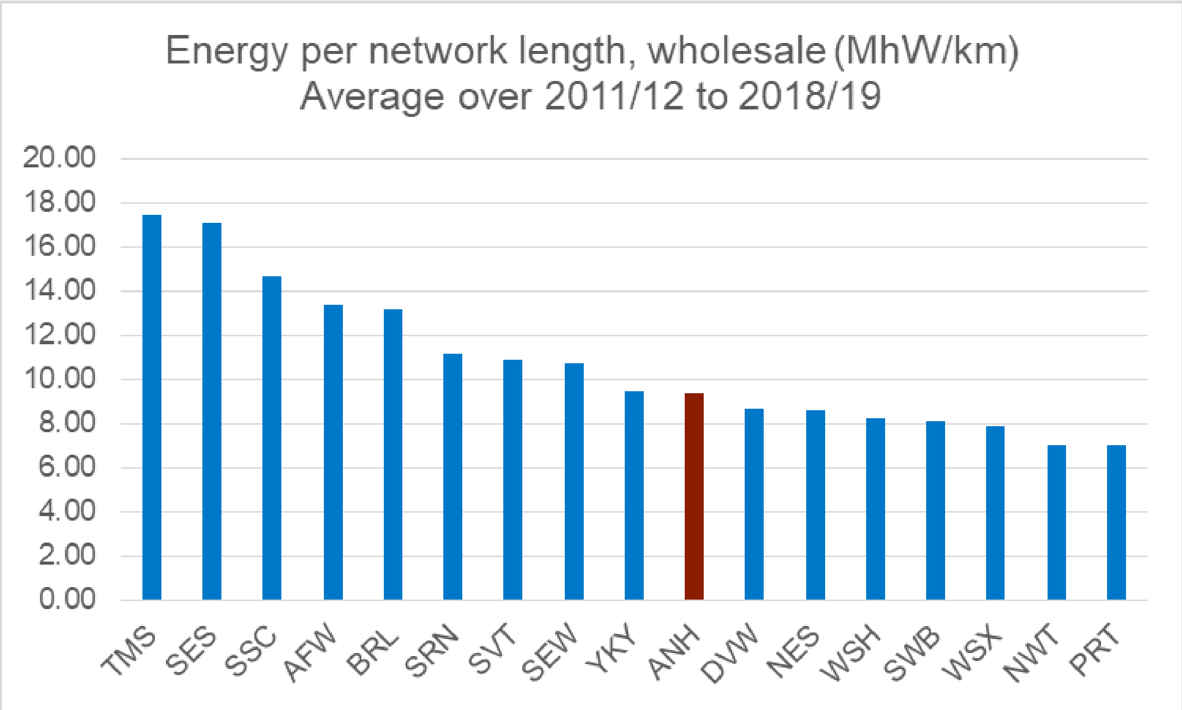
Figure 1. Confidence grades for average pumping head and booster pumping stations as reported by companies

Company	Average pumping head				Number of booster pumping stations
	Water resources	Raw water distribution	Water treatment	Treated water distribution	
Anglian Water	C4	C4	D5	C3	B2
Northumbrian Water	A2	A2	A2	A2	B2
United Utilities	B4	BX	B4	B4	B2
Southern Water	B4	B4	C4	B4	B2
Severn Trent Water Ltd	C3	C3	C3	C3	A2
South West	A2	A2	B3	B3	B2
Thames Water	B2	B2	B2	B2	A4
Dŵr Cymru	B3	B3	B3	B3	B3
Wessex Water	C2	C2	C2	C2	A1
Yorkshire Water	B3	B3	B3	B3	A1
Affinity Water	B3	B3	C5	B2	A2
Bournemouth Water	A2	A2	B3	B3	A3
Bristol Water	C3	C3	C3	C3	B4
Dee Valley Water	B3	B3	B3	B3	A1
Portsmouth Water	A2	A1	A2	A2	A1
SES Water	B2	B2	B2	B2	A1
South East Water	B2	B2	B2	B2	A2
South Staffs Water	A2	A2	A2	A2	A1

Notes: The confidence grade is an alphanumeric code that companies assign to each data in their annual performance review submissions. The letter refers to reliability and the number to accuracy. A refers to the most reliable and 1 refers to the most accurate.[64] Companies reported confidence grades per each financial year. The grades presented in this table are based on the data covering the period 2011/12 to 2016/17.

[64] We explain the boundaries between different confidence grades in reporting requirements, for example in our PR19 reporting guidance for mains repairs, pp. 4-5.

Figure 2. Average Annual Energy consumption per network length, wholesale water (MhW/km in 2011-12 to 2018-19)



A2 Approach to PR19 blind year adjustments for 2019-20 performance

Background

A2.1 Our December 2019 final determinations of price controls used forecast performance for 2019-20 in relation to the reconciliation of the 2015-20 incentive mechanisms. We are currently undertaking a blind year adjustment process that will confirm the revenue and regulatory capital value ("RCV") adjustments to account for differences between the forecast performance for 2019-20 and the actual performance reported for 2019-20. We intend to run a short consultation on our proposed blind year adjustments towards the end of September and finalise details by 15 November 2020.

A2.2 This process applies to all companies, including the four disputing companies. How and when the blind year adjustments are applied for the four disputing companies will depend on the decisions the CMA makes and the extent to which, if at all, it decides to reflect the adjustments in the price controls it determines.

A2.3 Our current intention is to run this process in the same way, and to the same timetable, for all companies. However, given the interactions with the redetermination process we wanted to identify this issue now. We consider it would be helpful to further discuss this issue later in the CMA's process. We will share any published material from the blind year process.

Areas of interaction

A2.4 We plan to apply some of the blind year adjustments (including the RCV adjustments and revenue adjustments related to the PR14 residential retail reconciliation model) at the next price review (PR24). But we intend to apply other adjustments during the 2020-25 period through two separate mechanisms, both of which could, for the four disputing companies, be affected by decisions made by the CMA:

A2.5 **Revenue forecasting incentive (RFI) formula**: Annex 3 to the notification of the final determination of price controls for each water company sets out the formula notified to that company for the purposes of (depending on the company) either sub-paragraph 8.1A or 9.1A Condition B. This allows water companies to recover shortfalls in revenue in previous charging years that are calculated in accordance with the formula. The formula also includes a blind year adjustment term (TBYA) whose value for each company we intend to announce later this year.[65] The definition of TBYA includes blind year revenue adjustments related to the PR14 wholesale revenue forecasting incentive (WRFIM) and water trading incentives. We also propose to consult formally in September on a licence modification that would amend the definition to include blind year revenue adjustments related to the PR14 totex menu and any unambiguous revenue errors that Ofwat may have made in making its final determinations.

A2.6 The RFI formula for the four disputing companies forms part of the disputed determination for the purposes of the references to the CMA. The extent to which Ofwat can set the value of a blind year adjustment term for the purposes of the RFI formula, and whether or not a licence modification is necessary or appropriate, will therefore depend on the determinations made by the CMA. We propose that the CMA either includes the blind year adjustments in the price controls that it determines (we can provide the relevant adjustments at a later stage) or confirms that the scope of the RFI formula is wide enough to enable Ofwat to apply the relevant adjustments in-period.

A2.7 **In-period ODI determinations**: Annex 2 to the notification of the final determination of price controls for each water company sets out the performance commitments in relation to which price controls may be adjusted during the 2020-25 period. These adjustments will be made through in-period ODI determinations in accordance with Part 3A of Condition B. All PR14 performance commitments were designated as in-period for the purposes of the blind year adjustment for 2019-20. We need to make in-period ODI determinations by 15 November 2020 to apply adjustments, in whole or in part, to the 2021-22 charging year.

A2.8 The performance commitments notified to the four disputing companies for the purposes of Part 3A of Condition B form part of the disputed determination for the purposes of the references to the CMA. We propose that the CMA either includes the blind year adjustments in the price controls that it determines (we can provide the relevant adjustments at a later stage) or confirms the designation of all PR14 performance commitments of the disputing companies as in-period ODIs for the purposes of the blind year

[65] The notified formula does not apply to price controls for bioresources activities (it only applies to price controls for network plus activities and water resources activities), but relevant blind year revenue adjustments related to the PR14 wholesale revenue forecasting incentive and the PR14 totex menu will be applied to price controls for network plus wastewater activities.

adjustment for 2019-20 so that Ofwat can apply the relevant adjustments in-period.

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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