

March 2020

Reference of the PR19 final determinations: Notice of reference for Bristol Water

**WATER SERVICES REGULATION AUTHORITY
WATER INDUSTRY ACT 1991, SECTION 12**

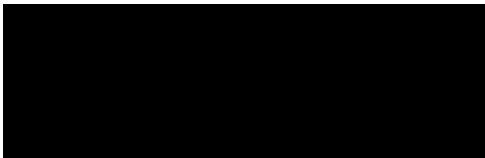
BRISTOL WATER PLC

**Notice of Reference: Determination of Price Controls
for the period from 1 April 2020**

19 March 2020

1. (a) Bristol Water plc ("the Company") holds an Appointment as a water undertaker for the purposes of Chapter I of Part II of the Water Industry Act 1991 ("the Appointment");
- (b) on 15 December 2019, the Water Services Regulation Authority ("Ofwat") gave notice to the Company of a determination under Condition B of the Appointment of the Price Controls for the period from 1 April 2020 ("the Disputed Determination"). The terms of the Disputed Determination are set out in Schedule 1 hereto;
- (c) the Company has required Ofwat to refer the Disputed Determination to the Competition and Markets Authority ("CMA"). The terms of the Company's notice are set out in Schedule 2 hereto.
2. Ofwat, as required by section 12(3)(a) of the Water Industry Act 1991 and the Appointment, refers the Disputed Determination to the CMA.
3. The CMA shall report on and determine the Disputed Determination within a period of six months beginning with the date of this reference.

**Signed for and on behalf of the
Water Services Regulation Authority**



**Rachel Fletcher
Chief Executive**

December 2019

PR19 final determinations

**Notification of the PR19 final determination
of Price Controls for Bristol Water**

ofwat

www.ofwat.gov.uk

Mel Karam
Chief Executive
Bristol Water plc
Bridgwater Road,
Bristol,
BS13 7AT

16 December 2019

Dear Mel

Final determination of price controls

I enclose the formal notification of the determination by the Water Services Regulation Authority (Ofwat) of Price Controls for the period from 1 April 2020 to 31 March 2025. This sets out:

- the designation of Water Resources Activities;
- the Price Control for Network Plus Water Activities;
- the Price Control for Water Resources Activities;
- the Price Control for Retail Activities; and
- (in annex 1) the Notified Item and Land sales assumptions;
- (in annex 2) the Performance Commitments in relation to which Price Controls may be adjusted in-period; and
- (in annex 3) the Revenue Forecasting Incentive formula.

This final determination letter has been published on our website. We are also publishing details on the outcomes and performance commitments for the company to deliver, together with information on our general approach and the reasons for our decisions.

We will publish information about the annual regulatory reporting, assurance requirements and our approach to PR19 reconciliations early in 2020.

You have two months to decide whether to refer the determination to the Competition and Markets Authority. If you wish Ofwat to refer the determination you must let us know in writing no later than 15 February 2020.

Yours sincerely,



David Black

Senior Director, Water 2020

Notification by the Water Services Regulation Authority of its determination of Price Controls for Bristol Water plc (“the Determination”)

This is the Determination by the Water Services Regulation Authority (“Ofwat”) of the Price Controls for Retail Activities, Network Plus Water Activities and Water Resources Activities. It is made by Ofwat in accordance with Part III of Condition B (Charges) of the company’s Appointment as a water undertaker:

- after having had regard to all the circumstances which are relevant in the light of the principles which apply by virtue of Part I of the Water Industry Act 1991 in relation to Ofwat’s determinations, including, without limitation, any change in circumstance which has occurred since the last Periodic Review or which is to occur; and
- in accordance with the statement setting out strategic priorities and objectives for Ofwat published by the Secretary of State for Environment, Food and Rural Affairs.

The Price Controls will all apply for the five consecutive Charging Years starting on 1 April 2020.

You must levy charges in a way best calculated to comply with the Price Controls.

Unless the contrary intention appears, words and expressions used in the Determination and the accompanying annexes, shall have the same meaning as in the Conditions of the Appointment. Common terms used in the formulae in the Determination and the annexes are defined in the Glossary set out in Annex 4.

1. Designation of activities

The sets of activities that will be covered by the relevant Price Controls are set out below.

1.1 Network Plus Water Activities

All activities carried out by the Appointee in performance of its functions as a water undertaker that are not designated as Water Resources Activities or Retail Activities will be Network Plus Water Activities.

1.2 Water Resources Activities

Ofwat designates as Water Resources Activities under sub-paragraph 8.9 of Condition B the activities carried out as part of the Appointed Business that fall within the definitions of the following services in [RAG 4.08 – Guideline for the table definitions in the annual performance report](#) (March 2019):

- Water resources – Abstraction licences; and
- Water resources – Raw water abstraction.

1.3 Retail Activities

Ofwat is not changing the activities that are currently designated as Retail Activities (these activities were designated as part of the 2014 Periodic Review).

1.4 Wholesale activities not covered by wholesale price controls

The Price Controls in respect of Water Resources Activities and Network Plus Water Activities will not apply to those activities for which there are Excluded Charges. Excluded Charges (as defined in Condition B) include:

- charges for a supply of water in bulk to another water undertaker;
- amounts payable in respect of an unmeasured supply of water by means of stand-pipes or water tanks and in respect of the erection or maintenance of stand-pipes or water tanks;
- amounts payable in relation to the alteration or removal of any relevant pipe (as defined in section 158 of the Water Industry Act 1991) or other apparatus that the Appointee is required to carry out under the New Roads and Streets Works Act 1991 or any other statutory provision except a provision of the Water Industry Act 1991;
- charges for a supply of water provided by the Appointee under section 59 (Supplies for other public purposes) of the Water Industry Act 1991;
- charges for unmeasured supplies of water to cattle troughs;
- charges for unmeasured building water supplies;
- amounts payable in respect of an unmeasured supply of water by means of bowsers or water tankers;
- charges for unmeasured supplies of water to farm taps and other agricultural water points;

- amounts payable under any such agreement as is described in section 20(1)(b) of the Water Resources Act 1991; and
- charges payable under any agreement for any unmeasured supply of water which are calculated by reference to the rateable value of hereditaments, occupied by the person to whom the supply or services are provided, fixed in accordance with section 32, 33 or, as the case may be, 34 of the General Rate Act 1967 or, as the case may be, fixed in accordance with section 54 of the Local Government Finance Act 1988.

2. Price Controls for Network Plus Water Activities

In respect of the Appointed Business's Network Plus Water Activities, except those activities for which there are Excluded Charges, there will be one single Price Control in respect of the Appointed Business's Network Plus Water Activities.

Such Price Control will consist of in each Charging Year:

- the percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for the immediately preceding November; and
- a number, "**K**", which may be a positive number or a negative number or zero

which together shall be expressed as a percentage, and which shall limit the change in the revenue allowed to the Appointed Business in each Charging Year in respect of the Network Plus Water Activities concerned.

For each Charging Year starting on or after 1 April 2021 the revenue allowed to the Appointed Business in respect of the Network Plus Water Activities concerned will be the product of the following formula:

$$R_t = R_{t-1} \times \left[1 + \left(\frac{CPIH_t + K_t}{100} \right) \right]$$

For the Charging Year starting on 1 April 2020 the revenue allowed to the Appointed Business in respect of the Network Plus Water Activities concerned is the product of the same formula except that R_{t-1} = the relevant revenue allowance (as set out below). This is because (as the form of Price Controls has since changed) at the last

Periodic Review no revenue allowance in respect of Network Plus Water Activities was set for the Charging Year that started on 1 April 2019.

In respect of the Appointed Business's Network Plus Water Activities, the starting point for the calculation of the change in the revenue allowed to the Appointed Business in the Charging Year starting on 1 April 2020 (the revenue allowance for Network Plus Water Activities) is **£87.662** million, which shall constitute the value of R_{t-1} in respect of that Charging Year.

The “K” numbers for each Charging Year are set out in Table 1.

Table 1: Price Control for Network Plus Water Activities “K” numbers

Charging Year beginning 1 April	2020	2021	2022	2023	2024
K number	0.00	-0.77	-0.84	-0.96	-0.85

3. Price Control for Water Resources Activities

The Price Control shall consist of, in each Charging Year:

- the percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for the immediately preceding November; and
- a number, “K”, which may be a positive number or a negative number or zero

which together shall be expressed as a percentage, and which shall limit the change in the revenue allowed to the Appointed Business in each Charging Year.

For each Charging Year starting on or after 1 April 2021 the revenue allowed to the Appointed Business in respect of the Water Resources Activities concerned will be the product of the following formula:

$$R_t = R_{t-1} \times \left[1 + \left(\frac{CPIH_t + K_t}{100} \right) \right]$$

For the Charging Year starting on 1 April 2020 the revenue allowed to the Appointed Business in respect of Water Resources Activities is the product of the same formula except that R_{t-1} = the relevant revenue allowance (as set out below). This is because (as the form of Price Controls has since changed) at the last Periodic Review no revenue allowance in respect of Water Resources Activities was set for the Charging Year that started on 1 April 2019.

In respect of the Appointed Business’s Water Resources Activities, the starting point for the calculation of the change in the revenue allowed to the Appointed Business in the Charging Year starting on 1 April 2020 (the revenue allowance for Water Resources Activities) is **£18.390** million, which shall constitute the value of R_{t-1} in respect of that Charging Year.

The “**K**” numbers for each Charging Year are set out in Table 3.

Table 3: Price Control for Water Resources Activities “K” numbers

Charging Year beginning 1 April	2020	2021	2022	2023	2024
K number	0.00	0.57	1.19	0.91	0.24

Note:

There is no Table 2 in this determination. This is a deliberate omission that is intended to ensure consistency in Table numbers between different companies.

4. Price Control for Residential Retail Activities

In respect of the Appointed Businesses’ Retail Activities, there shall be one single Price Control for the Appointed Business’s Retail Activities relating to the supply of water to household premises (as defined in section 17C of the Water Industry Act 1991) (“**Residential Retail Activities**”).

The Price Control for Residential Retail Activities:

- shall consist of a limit on the total revenue allowed to the Appointed Business in each Charging Year in respect of the Retail Activities concerned; and
- is set for a period of five consecutive Charging Years starting on 1 April 2020.

The total unadjusted revenue, **TR**, allowed to the Appointed Business in each Charging Year in respect of Residential Retail Activities shall be the relevant amount set out in Table 6 as modified in accordance with the following formula:

$$R_t = TR_t + (AC_t - FC_t) \times M_t \times 1000$$

Where:

TR_t Total Revenue The total unadjusted allowed revenue expressed in outturn prices as set out in table 6;

AC_t Actual Customers Actual customer numbers (meaning the average number of individual household premises (as defined in section 17C of the Water Industry Act 1991) supplied or served by the Appointed Business in a Charging Year) expressed in thousands;

FC_t Forecast Customers. Forecast customer numbers in thousands set out in table 6;

M_t Modification Factor. The modification factors expressed in outturn prices set out in table 6.

Table 6: Price Control for Residential Retail Activities numbers

Charging year beginning 1 April	2020	2021	2022	2023	2024	2020-25
TR (£million, outturn)	10.919	11.103	11.273	11.449	11.616	N/A
M (£, outturn)	21.49	21.60	21.70	21.81	21.91	N/A
FC (thousands)	508.069	514.020	519.486	524.860	530.110	N/A

Note:

There is no Table 4 or 5 in this determination. This is a deliberate omission that is intended to ensure consistency in Table numbers between different companies.

5. Demonstrating Compliance with the Price Controls

The Appointee shall provide such information as Ofwat may reasonably require in relation to annual regulatory reporting to demonstrate how the Appointee is complying, or has complied, with its obligation to levy charges in a way best calculated to comply with each Price Control applicable to it.

Annex 1: Notified Items and Land Sales

Notified Items

Ofwat gives notice that, to the extent specified, the following items have not been allowed for at all when making the final determination of Price Controls:

1. Charges for water abstracted from the Gloucester and Sharpness Canal

Any change (whether an increase or decrease) to the Annual Charge and the Volumetric Charge for a supply of water from the Gloucester and Sharpness Canal under the Agreement that is payable by the Appointee to Canal & River Trust (“CRT”):

- (a) in relation to Charging Years beginning on or after 1 April 2020; and
- (b) as a result of the Review of CRT Charges.

Definitions

Words and expressions used in this Notified Item have the same meaning as in the Conditions of the Appointment, unless the contrary intention appears. In addition, the following words have the following meaning for the purposes of this Notified Item:

“**Agreement**” means the agreement dated 10 July 2000 between CRT and the Appointee for the supply of untreated water from the Gloucester and Sharpness Canal together with the associated agreement between CRT and the Appointee dated 28 November 2007;

“**Annual Charge**” means the annual charge in pounds referred to in clause 5.1 of the Agreement;

“**Appointment**” means the appointment of Bristol Water plc as a water undertaker for the purposes of Chapter I of Part II of the Water Industry Act 1991;

“**Charging Year**” has the meaning given in Condition A of the Appointment;

“**Notified Item**” has the meaning given in paragraph 12.1 of Condition B of the Appointment;

“**Review of CRT Charges**” means the review of the annual and volumetric charges payable by the Appointee under clause 5 of the Agreement with effect from 1 April 2018 that has been called for by CRT under the process set out in clause 16 of the Agreement; and

“**Volumetric Charge**” means the charge in pounds per megalitre referred to in clause 5.2 of the Agreement.

Additional notes:

1. In the event of an Interim Determination, no account will be taken of any costs to the extent that they would have been, or would be, avoided by prudent management action (and for this purpose what constitutes “prudent management action” shall be assessed by reference to the circumstances which were known or which ought reasonably to have been known to the Appointee at the relevant time). In relation to this Notified Item, Ofwat will consider, in particular, whether the Appointee has engaged actively and effectively in any discussions and arbitration proceedings, taking account of all relevant factors. But nothing in this paragraph means that the Appointee is under an obligation to instigate discussion or arbitration proceedings.
2. For the avoidance of doubt, legal costs, including those associated with arbitration in respect of the Annual Charge and the Volumetric Charge, are not included in, or attributable to, this Notified Item.
3. Any adjustment to the level of a Price Control or Price Controls in an Interim Determination that is attributable to this Notified Item would be dealt with outside the standard totex cost sharing mechanism at the 2024 Periodic Review. Instead, the approach is that attributable costs or savings would be shared between customers and the Appointee on a 75% (customers) / 25% (the Appointee) basis.

2. Second Cheddar reservoir

Any increase in costs in the period from 1 April 2020, beyond those that Ofwat allowed for when making the final determination of Price Controls, that is reasonably attributable to the Project in circumstances where the Appointee demonstrates to the reasonable satisfaction of Ofwat that:

- (a) the procurement of another person to design, build, finance and, where appropriate, operate and maintain the Project is, for reasons outside the reasonable control of the Appointee, no longer in the best interests of customers;
- (b) the Project is still required to enable the Appointee to properly carry out its functions as a relevant undertaker; and
- (c) such costs are not reasonably recoverable otherwise than through charges or revenue in respect of which Price Controls are set.

Definitions

Words and expressions used in this Notified Item have the same meaning as in the Conditions of the Appointment, unless the contrary intention appears. In addition, the following words have the following meaning for the purposes of this Notified Item:

“Appointment” means the appointment of Bristol Water plc as a water undertaker for the purposes of Chapter I of Part II of the Water Industry Act 1991;

“customers” includes, as well any person who is provided with water by the Appointee either directly or indirectly via a Licensee, any other water undertaker to whom the Appointee is providing, or may provide, a supply of water in bulk; and

“the Project” means the development of a new (second) reservoir at Cheddar and works to connect the reservoir to the water supply system of Wessex Water Services Limited for the purpose of enabling a supply of water in bulk to Southern Water Services Limited.

Additional notes:

1. In the event of an Interim Determination, no account will be taken of any costs to the extent that they would have been, or would be, avoided by prudent management action (and for this purpose what constitutes “prudent management action” shall be assessed by reference to the circumstances which were known or which ought reasonably to have been known to the Appointee at the relevant time).
2. In order to demonstrate that the procurement of another person to design, build, finance and, where appropriate, operate and maintain the Project is no longer in the best interests of customers, we would expect the Appointee to provide a well-evidenced and well-reasoned business case following the HM Treasury Five Case model (as described in The Green Book published by HM Treasury) or an equivalent robust and iterative business case.
3. Even where an initial procurement process has not resulted in the award of a contract, it may be in the best interests of customers for the Appointee to undertake a further procurement exercise.

Land sales

For the purposes of the Determination, Ofwat gives notice that for each of the five consecutive Charging Years starting on or after 1 April 2020:

- the value attributable to Relevant Disposals of Land allowed for in making the determination is zero; and
- variations in value received or expected to be received from Relevant Disposals of Land shall constitute a Relevant Change of Circumstance.

Annex 2: In-period Outcome Delivery Incentives (ODIs)

Ofwat notifies the Appointee in accordance with Part 3A of Condition B that the Price Controls determined in respect of the Appointee's Retail Activities, Water Resources Activities and Network Plus Water Activities may be adjusted to reflect the Appointee's performance in relation to the following Performance Commitments:

Table A2.1: In-period financial performance commitments - Common PCs

Name of Common Performance Commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Water quality compliance (CRI) [PR19BRL_PC01]	Financial - Under; In-period	Water network plus
Water supply interruptions [PR19BRL_PC02]	Financial - Out & under; In-period	Water network plus
Leakage [PR19BRL_PC18]	Financial - Out & under; In-period	Water network plus
Per capita consumption [PR19BRL_PC19]	Financial - Out & under; In-period	Water network plus; Residential retail
Mains repairs [PR19BRL_PC03]	Financial - Under; In-period	Water network plus
Unplanned outage [PR19BRL_PC04]	Financial - Under; In-period	Water network plus
C-MeX: Customer measure of experience [PR19BRL_PC12]	Financial - Out & under; In-period	Residential retail
D-MeX: Developer services measure of experience [PR19BRL_PC13]	Financial - Out & under; In-period	Water network plus

Note:

The listed Performance Commitments are set out in the document named **PR19 final determinations: Bristol Water – Outcomes performance commitment appendix**.

Table A2.2: In-period financial performance commitments - Bespoke PCs

Name of Bespoke Performance Commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Customer contacts about water quality – appearance [PR19BRL_PC06]	Financial - Out & under; In-period	Water network plus
Customer contacts about water quality – taste and smell [PR19BRL_PC07]	Financial - Out & under; In-period	Water network plus
Properties at risk of receiving low pressure [PR19BRL_PC08]	Financial - Out & under; In-period	Water network plus
Turbidity performance at treatment works [PR19BRL_PC09]	Financial - Under; In-period	Water network plus
Unplanned maintenance – non-infrastructure [PR19BRL_PC10]	Financial - Under; In-period	Water network plus
Void properties [PR19BRL_PC17]	Financial - Out & under; In-period	Residential retail
Raw Water Quality of Sources [PR19BRL_PC21]	Financial - Out & under; In-period	Water resource control
Biodiversity Index [PR19BRL_PC22]	Financial - Out & under; In-period	Water resources; Water network plus

Name of Bespoke Performance Commitment	Type of Outcome Delivery Incentive (ODI)	Price controls ODIs will apply to
Waste disposal compliance [PR19BRL_PC23]	Financial - Under; In-period	Water network plus
Water Industry National Environment Programme Compliance [PR19BRL_PC24]	Financial - Under; In-period	Water resources
Local community satisfaction [PR19BRL_PC25]	Financial - Out & under; In-period	Water resources; Water network plus
Abstraction Incentive Mechanism (AIM) [PR19BRL_PC26]	Financial - Out & under; In-period	Water resources

Note:

The listed Performance Commitments are set out in the document named **PR19 final determinations: Bristol Water – Outcomes performance commitment appendix**.

Reconciliation for 2019-20 financial performance commitments

Ofwat further notifies the Appointee in accordance with Part 3A of Condition B that the Price Controls determined in respect of the Appointee’s Retail Activities and Network Plus Water Activities may be adjusted to reflect the Appointee’s performance in the Charging Year beginning on 1 April 2019 (“2019-20 Charging Year”) in relation to all the Performance Commitments set out in the company-specific appendix (read together with any corrigenda published by Ofwat) to the determination of Price Controls by Ofwat pursuant to the 2014 Periodic Review. The adjustment to the relevant Price Control in relation to each such Performance Commitment would be the difference between:

(a) either:

- (i) the adjustment(s) to the revenue allowed to the Appointed Business that Ofwat made to reflect the Appointee’s forecast performance in the 2019-20

- Charging Year in relation to that Performance Commitment when determining, pursuant to the 2019 Periodic Review, the Price Controls for the five consecutive Charging Years beginning on 1 April 2020; or
- (ii) if there was no such adjustment, zero;

AND

- (b) the adjustment(s) to revenue that Ofwat would have made when determining Price Controls pursuant to the 2019 Periodic Review if the Appointee's actual performance in the 2019-20 Charging Year in relation to that Performance Commitment had been known.

Annex 3: Revenue Forecasting Incentive formula

Ofwat notifies the Appointee for the purposes of sub-paragraph 8.1A of Condition B that sub-paragraph 8.1 of Condition B will not prevent the Appointee from levying charges to recover a Relevant Shortfall in the Charging Years beginning 1 April 2021, 1 April 2022, 1 April 2023 and 1 April 2024 (each of which will be a “Relevant Charging Year” for these purposes) where the “Relevant Shortfall” means any positive amount calculated for a Relevant Charging Year in accordance with the following formula:

Revenue Forecasting Incentive: Price Control for Network Plus Water Activities

The RFI for network plus water activities will be determined according to the following formula:

$$\begin{aligned} \mathbf{RFI}_t = & - (\mathbf{RR}_{t-2} - \mathbf{AR}_{t-2}) \times \left(\mathbf{1} + \frac{\mathbf{D}}{100} \right)^2 \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \\ & - \mathbf{PS}_{i,t} \times \frac{\mathbf{PR}}{100} \times | \mathbf{RR}_{t-2}^* - \mathbf{AR}_{t-2}^* | \times \left(\mathbf{1} + \frac{\mathbf{D}}{100} \right) \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \end{aligned}$$

The RFI for network plus water activities, \mathbf{RFI}_t , and any blind year adjustment, \mathbf{BYA}_t , is added to allowed revenues for network plus water activities, \mathbf{R}_t , to calculate adjusted allowed revenues for network plus water activities, according to the following formula:

$$\mathbf{AR}_t = \mathbf{R}_t + \mathbf{BYA}_t + \mathbf{RFI}_t$$

Revenue Forecasting Incentive: Price Control for Water Resources Activities

The RFI for water resources activities will be determined according to the following formula:

$$\begin{aligned} \mathbf{RFI}_t = & - (\mathbf{RR}_{t-2} - \mathbf{AR}_{t-2}) \times \left(\mathbf{1} + \frac{\mathbf{D}}{100} \right)^2 \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \\ & - \mathbf{PS}_{i,t} \times \frac{\mathbf{PR}}{100} \times | \mathbf{RR}_{t-2}^* - \mathbf{AR}_{t-2}^* | \times \left(\mathbf{1} + \frac{\mathbf{D}}{100} \right) \times (\mathbf{1} + \mathbf{CPIH}_{t-1}) \times (\mathbf{1} + \mathbf{CPIH}_t) \end{aligned}$$

The RFI for water resources, \mathbf{RFI}_t and any blind year adjustment, \mathbf{BYA}_t , is added to allowed revenues for water resources, \mathbf{R}_t , to calculate adjusted allowed revenues for water resources, according to the following formula:

$$\mathbf{AR}_t = \mathbf{R}_t + \mathbf{BYA}_t + \mathbf{RFI}_t$$

Where for each of controls to which the RFI relates:

$$\mathbf{BYA}_t = \mathbf{TBYA} \times \mathbf{Y}_t \times \left(1 + \frac{\mathbf{D}}{100}\right)^{\mathbf{T} - 2019} \times \mathbf{CPIH \text{ adjustment factor}}_t$$

\mathbf{AR}_{t-2} The adjusted allowed revenue stated in £ millions in charging year t-2 with the first year starting on 1 April 2020.

\mathbf{RR}_{t-2}^* This has the same meaning as \mathbf{RR}_{t-2} , except in this case this applies to the sum of both the network plus water and water resources controls.

\mathbf{AR}_{t-2}^* This has the same meaning as \mathbf{AR}_{t-2} , except in this case this applies to the sum of both the network plus water and water resource controls.

\mathbf{PR} The penalty rate. Denoting the forecast error $(\mathbf{RR}^{*t-2} - \mathbf{AR}^{*t-2}) / \mathbf{AR}^{*t-2} = x\%$, the penalty rate is:

- 3% for all variations if $|x\%| > 3\%$;
- $3\% * (|x\%| - 2\%) / (3\% - 2\%)$ if $2\% < |x\%| \leq 3\%$;
- zero if $|x\%| \leq 2\%$.

The result enters the above formulas as a number. For example, for a penalty rate of 3%, \mathbf{PR} enters the formula as number 3.

$\mathbf{PS}_{i,t}$ is the share of the penalty that the Appointee chooses to allocate to the control in charging year t,

- where i = network plus water or water resources control; and
- the \mathbf{PS}_i values must sum to one¹ for each charging year.

¹ That is, $\mathbf{PS}_{\text{water resources}} + \mathbf{PS}_{\text{water network plus}} = 1$

BYA_t The blind-year adjustment, stated in £ millions, to the allowed revenue of the network plus water or water resources control in each year over the charging years 2021/22 to 2024/25, inclusive.

TBYA = Blind year adjustment stated by Ofwat in 2017-18 year average prices. The blind year adjustment will be announced by Ofwat at a future date. The adjustment will be based on the difference between the Appointee's forecast and actual performance for the 2019-20 Charging Year in relation to the Wholesale Revenue Forecasting Incentive Mechanism and the Water Trading Incentive applied in relation to the 2015 to 2020 price control period. It will be a correction to the revenue allowed by Ofwat when determining, pursuant to the 2019 Periodic Review, the Price Controls for water resources, network plus water and network plus wastewater activities for the five consecutive Charging Years beginning on 1 April 2020. The adjustment will not include the 2019-20 performance commitments referred to in Annex 2.

Y_t is the share of the blind year adjustment that the company has elected to receive in period t of the AMP. This allows the company to spread the impact of the blind year adjustment over the relevant years. The Y_t values across all of the charging years for each relevant price control must

- sum to one, if the blind year adjustment is negative;
- sum to one or less, if the blind year adjustment is positive; and
- be greater than or equal to zero.

T = the year in which the relevant charging year begins – for example

- for the charging year 2022-23 then T = 2022;
- for the charging year 2023-24 then T = 2023; and
- for the charging year 2024-25 then T = 2024.

Annex 4: Glossary

Common terms used in formulae in the Determination and the annexes are defined below.

Term	Where used	Definition
t	All	A suffix added to a term to indicate the Charging Year.
t-1	All	A suffix added to a term to indicate the Prior Year. For example, R_{t-1} refers to the Charging Year starting one year before the start of relevant Charging Year.
t-2	All	A suffix added to a term to indicate the Charging Year commencing on 1 April immediately prior to the Prior Year. For example, R_{t-2} refers to the Charging Year starting two years before the start of the relevant Charging Year.
R_t	Network plus water, water resources	Revenue stated in £ millions allowed to the Appointed Business in a Charging Year by a Price Control in respect of the activities concerned
RR_t	RFI	The revenue stated in £ millions recovered by the Appointed Business in a Charging Year in outturn prices. In both RFI the first year, t, starts on 1 April 2022 so that year t -2 starts on 1 April 2020.
$CPIH_t$	Network plus water, water	The percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the Consumer Prices Index (H)

	resources, RFI	between that published for the month of November in the Prior Year and that published for the immediately preceding November.
FYA CPIH	Water resources	The percentage change (expressed, in the case of an increase, as a positive number, in the case of a decrease, as a negative number, and, in the case of no change, as zero) in the average level of the Consumer Prices Index (H) across the twelve months of the Charging Year compared to the average level of the Consumer Prices Index (H) across the twelve months of the Prior Year.
K_t	Network plus water, water resources	A specified number for the relevant Charging Year which may be a positive number or a negative number or zero.
D	Water resources, RFI	The specified discount rate, based on the weighted average cost of capital of 2.92
CPIH adjustment factor_t	Water resources, RFI	One plus the percentage change in the Consumer Prices Index (H) between that published for the month of November in the Prior Year and that published for November 2016.

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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It's what we're made of.

Rachel Fletcher
Chief Executive
Ofwat
21 Bloomsbury Street
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WC1B 3HF

13 February 2020

Dear Rachel

Ofwat PR19 Final Determination: Reference to the Competition & Markets Authority

This letter is a formal notice, on behalf of the Board of Bristol Water plc, requiring Ofwat to refer the PR19 Final Determination to the Competition & Markets Authority (CMA), in accordance with section 12 of the Water Industry Act 1991 and our Instrument of Appointment.

As you will be aware from our response to the PR19 Draft Determination and subsequent representation meeting, we had serious concerns at that time that the outcome of PR19 would not be financeable for a small water only company such as Bristol Water. Unfortunately, the Final Determination has not remedied our concerns.

The Board of Bristol Water has reached the decision to require a reference to the CMA after comprehensive and careful consideration of the causes and consequences of such referral. We are fully aware, following two previous referrals at PR14 and PR09, of the potential disruption and uncertainty that this could impose on Bristol Water's plans. We have gone to significant lengths to avoid a third consecutive reference to the CMA, and it is of grave concern and disappointment that it cannot be avoided.

I hope you would agree that Bristol Water has changed significantly from the organisation it was at the previous two references. With new ownership, new Board structure, new management team and a clear social purpose we feel we are closely aligned with Ofwat's vision and strategy, as well as the governance principles and customer-centric operational objectives that Ofwat has set out under your leadership. I would like to emphasise that our transformation will continue.

Even as we considered the technical detail of the PR19 Final Determination, it was clear that there is much we agree on. The residential retail price control is not disputed. The ambitious outcomes and scope of what we proposed for our customers and stakeholders, our local communities and for the environment in our business plan are very similar to those in the Final Determination. There have also been discussions during the testing of plans carried out by the Ofwat team, such as on outcome delivery incentives and resilience investment.

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The risk mitigations we proposed were accepted as clearly in customers' interests and, in the case of the annual ODI bill smoothing cap, standardised as an industry-wide measure at the Final Determination.

However, there remain fundamental issues we could not resolve in the price review process that, in combination, mean we cannot find any alternative other than to seek re-determination by the CMA. These issues mainly include, but are not limited to, the following:

- Despite the clear precedent set by the CMA in 2010 and 2015, Ofwat's Final Determination allowed **cost of capital** is too low for an efficiently financed small water only company such as Bristol Water. The overall allowed cost of capital is insufficient to service debt and equity returns and allow investors a reasonable expectation that they will receive a return commensurate with the risks they face. This issue is the combined result of the industry allowed weighted average cost of capital and the Bristol Water requirement for a company specific adjustment to the industry cost of capital.
- The **wholesale totex allowance** for Bristol Water is insufficient to deliver the ambitious outcomes and performance levels set in the Final Determination and supported by our customers. The application of the modelling for the circumstances faced by Bristol Water, rather than the fundamental approach, means we cannot agree with the Final Determination allowance as an efficient cost of delivery.
- The **balance of risk and reward** in the Final Determination is biased asymmetrically towards high risks, in outcome delivery penalties, sharing mechanisms, and restrictions in the financing of the business, to the extent that overall levels of risks are unacceptable to the future of Bristol Water and our ability to serve our customers.
- Ultimately, and as a result of the above, there is not adequate headroom in the **financeability** assessments to demonstrate resilience in the financing of the company over the price review period.

These issues will not come as a surprise as they are the same as those we raised in our response to Ofwat's Draft Determination.

We recognise the burden that a CMA reference will place on both of our teams, but have confidence that the professional and positive approach we have seen throughout the PR19 process will continue. I am determined that this reference will not distract us from our transformation and, in particular, delivery of the social purpose commitments the Board has made through our social contract and our strong support for the non-household market improvements. We will also continue to play our role in helping Ofwat shape its strategy and the future of the water sector during the reference period.

Yours sincerely



Mel Karam
CEO

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