

## ANNEX A – Option 1

DWR CYMRU WELSH WATER LIMITED						
DRAFT INTERIM DETERMINATION – Autumn 2000 – SUMMARY TABLE – <i>OPTION 1 - All Obligations Confirmed</i>						
Description		Company's Assessment (September 2000)		Ofwat's Initial Assessment (November 2000)		
<b>Item 1 – Additional Meter Optants</b>						
1.1	Total <b>additional meter optants</b> in period 2000-01 to 2004-05 (AMP3) over and above the Nov 1999 assumptions.	+80,000 (water) +8,400 (sewerage)		+25,300 (water) +6,200 (sewerage)		
1.2	Estimated net additional <b>capital expenditure</b> for AMP3	£14.0m		£3.6m		
1.3	Estimated net additional <b>operating expenditure</b> for AMP3	£1.6m		£0.3m		
1.4	Estimated loss in <b>revenues</b> over the AMP3 period	£39.5m		£2.2m		
1.5	<b>Materiality Amount (NPV of total net additional costs and losses)</b>			£18.0m		
1.6	Contribution towards <b>materiality threshold</b>			3.8%		
<b>Item 2 – Cryptosporidium – Additional Requirements for Continuous Monitoring and Treatment.</b>						
2.1	Estimated net additional capital <b>expenditure</b> for AMP3	£8.7m		£7.8m		
2.2	Estimated net additional <b>operating expenditure</b> for AMP3	£5.2m		£4.0m		
2.3	<b>Materiality Amount (NPV of total net additional costs and losses)</b>			£14.4m		
2.4	Contribution towards <b>materiality threshold</b>			3.0%		
<b>Item 3 – Plumbosolvency treatment to reduce lead levels in drinking water</b>						
3.1	Estimated net additional capital <b>expenditure</b> for AMP3	£10.0m		£8.7m		
3.2	Estimated net additional <b>operating expenditure</b> for AMP3	£4.9m		£1.8m		
3.3	<b>Materiality Amount (NPV of total net additional costs and losses)</b>			£12.8m		
3.4	Contribution towards <b>materiality threshold</b>			2.8%		
<b>Item 4 – New Section 19 Undertakings given to the DWI</b>						
4.1	Estimated net additional capital <b>expenditure</b> for AMP3	£0.5m		Not a RCC		
4.2	Estimated net additional <b>operating expenditure</b> for AMP3	£0.1m				
4.3	<b>Materiality Amount (NPV of total net additional costs and losses)</b>					
4.4	Contribution towards <b>materiality threshold</b>			0%		
<b>Item 5 – Additional sewage treatment required to comply with new consents issued by the EA</b>						
5.1	Estimated net additional capital <b>expenditure</b> for AMP3	£3.3m		£2.3m		
5.2	Estimated net additional <b>operating expenditure</b> for AMP3	£0.3m		£0.2m		
5.3	<b>Materiality Amount (NPV of total net additional costs and losses)</b>			£2.6m		
5.4	Contribution towards <b>materiality threshold</b>			0.5%		
<b>OVERALL ASSESSMENT</b>						
6	<b>Materiality Amount (NPV of total net additional costs and losses)</b>			£47.7m		
7	Dwr Cymru turnover for 1999-2000 used in materiality test			£472.7m		
8	<b>Materiality Test</b> (Must be greater than +10% or less than –10% to trigger a change in price limits)			10.1% [PASS]		
<b>PRICE LIMITS</b>		2000-01	2001-02	2002-03	2003-04	2004-05
9	<b>Current Price Limits</b> (as set in November 1999)	-10.5	-0.5	0.0	1.2	1.0
10	<b>Revised Price Limits</b> – November 2000	-10.5	-0.3	1.1	1.5	1.0

**Notes:**

1. Additional costs and revenue losses shown as positive (+ve), savings and revenue gains shown as negative (-ve)
2. **Triviality criterion** – If NPV of specific change less than 1% of company turnover then normally deemed trivial and not carried forward into materiality test.
3. **Materiality Test** – Result must be greater than +10% or less than –10% to trigger a change in price limits.
4. All monetary values are stated in 2000-01 prices.

**ANNEX A – Option 2**

<b>DWR CYMRU WELSH WATER LIMITED</b>			
<b>DRAFT INTERIM DETERMINATION – Autumn 2000 – SUMMARY TABLE – <u>OPTION 2 - Some Obligations Confirmed</u></b>			
Description		Company's Assessment (September 2000)	Ofwat's Initial Assessment (November 2000)
<b>Item 1 – Additional Meter Optants</b>			
1.1	Total <b>additional meter optants</b> in period 2000-01 to 2004-05 (AMP3) over and above the Nov 1999 assumptions.	+80,000 (water) +8,400 (sewerage)	+25,300 (water) +6,200 (sewerage)
1.2	Estimated net additional <b>capital expenditure</b> for AMP3	£14.0m	£3.6m
1.3	Estimated net additional <b>operating expenditure</b> for AMP3	£1.6m	£0.3m
1.4	Estimated loss in <b>revenues</b> over the AMP3 period	£39.5m	£2.2m
1.5	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		£18.0m
1.6	Contribution towards <b>materiality threshold</b>		3.8%
<b>Item 2 – Cryptosporidium – Additional Requirements for Continuous Monitoring and Treatment.</b>			
2.1	Estimated net additional capital <b>expenditure</b> for AMP3	£8.7m	£7.8m
2.2	Estimated net additional <b>operating expenditure</b> for AMP3	£5.2m	£4.0m
2.3	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		£14.4m
2.4	Contribution towards <b>materiality threshold</b>		3.0%
<b>Item 3 – Plumbosolvency treatment to reduce lead levels in drinking water</b>			
3.1	Estimated net additional capital <b>expenditure</b> for AMP3	£10.0m	No additional
3.2	Estimated net additional <b>operating expenditure</b> for AMP3	£4.9m	Obligation
3.3	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		Confirmed [4]
3.4	Contribution towards <b>materiality threshold</b>		0%
<b>Item 4 – New Section 19 Undertakings given to the DWI</b>			
4.1	Estimated net additional capital <b>expenditure</b> for AMP3	£0.5m	Not a RCC
4.2	Estimated net additional <b>operating expenditure</b> for AMP3	£0.1m	
4.3	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		
4.4	Contribution towards <b>materiality threshold</b>		0%
<b>Item 5 – Additional sewage treatment required to comply with new consents issued by the EA</b>			
5.1	Estimated net additional capital <b>expenditure</b> for AMP3	£3.3m	Confirmation of
5.2	Estimated net additional <b>operating expenditure</b> for AMP3	£0.3m	Scheme not
5.3	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		Received by FD
5.4	Contribution towards <b>materiality threshold</b>		0%
<b>OVERALL ASSESSMENT</b>			
6	<b>Materiality Amount</b> (NPV of total net additional costs and losses)		£32.4m
7	Dwr Cymru turnover for 1999-2000 used in materiality test		£472.7m

8	<b>Materiality Test</b> (Must be greater than +10% or less than –10% to trigger a change in price limits)						6.8% [FAIL]
<b>PRICE LIMITS</b>		2000-01	2001-02	2002-03	2003-04	2004-05	
9	<b>Current Price Limits</b> (as set in November 1999)	-10.5	-0.5	0.0	1.2	1.0	
10	<b>Revised Price Limits</b> – November 2000	No Change					
<b>Notes:</b> <ol style="list-style-type: none"> <li>1. Additional costs and revenue losses shown as positive (+ve), savings and revenue gains shown as negative (-ve)</li> <li>2. <b>Triviality criterion</b> – If NPV of specific change less than 1% of company turnover then normally deemed trivial and not carried forward into materiality test.</li> <li>3. All monetary values are stated in 2000-01 prices</li> <li>4. Lead programme – This is the lower bound of the lead programme, the confirmed programme may be between Option 1 and 2</li> </ol>							

**DWR CYMRU WELSH WATER LTD**

**DRAFT INTERIM DETERMINATION – Autumn 2000**

**SUMMARY OF OFWAT'S INITIAL ASSESSMENT**

1. Ofwat has followed a four stage assessment of the application in accordance with the terms of Condition B of the company's licence.
2. The company cited five changes in its application: (1) greater numbers of customers taking up the free meter option (additional meter optants); (2) the continuous monitoring requirements for Cryptosporidium required by the DWI; (3) a re-appraisal of the methods of controlling lead in the water supply; (4) improvements to comply with new undertakings at two water treatment works, and (5) legal requirements to make sewage treatment improvements at three works.
3. Ofwat's initial assessment of the application is set out in summary terms below for each of the stages and items.

**STAGE 1 – CONFIRMATION THAT THE CHANGED REQUIREMENTS ARE RELEVANT CHANGES IN CIRCUMSTANCE OR ARE COVERED BY SPECIFIC NOTIFIED ITEMS**

**Item 1 – Additional Meter Optants**

4. A special notified item was set out in the 1999 price limit determination to protect the company from some of the implications of a greater number of customers taking up the free meter option than had been assumed by Ofwat.

**Item 2 – Cryptosporidium – Additional Requirements for Continuous Monitoring and Treatment.**

5. In 1999 the extent of the new requirements to deal with the risk from Cryptosporidium was uncertain. Provision was only made for that work which had been identified and received technical support from DWI for the purposes of the Periodic Review. The outcome of risk assessments was not known, and hence no provision was made in price limits for these requirements.
6. Ofwat has sought confirmation from the Drinking Water Inspectorate (DWI) that the company's assessment of the requirements under regulation 23B of The Water Supply (Water Quality) (Amendments) Regulations 1999 was appropriate and necessary. The Chief Inspector, Michael Rouse, issued a revised notice under Regulation 23A(7) dated 31 July 2000, in which he set out the need for the company to carry out the work, citing the appropriate regulations. In the light of this notice Ofwat is able to confirm that this item is a Relevant Change in Circumstances that complies with the definitions set out in Condition B for interim determinations.

7. Ofwat has reviewed the work set out by the company as necessary to meet this new requirement and taken into account the findings of the Reporter following his review of the company submission. Ofwat is content that the scale of the work set out in the application is appropriate and additional to what has been assumed in price limits set in 1999.

8. The company has chosen to deal with the requirements at 40 sites by abandoning or providing new sources at 14 sites, carrying out continuous monitoring at 12 sites and installing additional treatment at 14 sites. The Reporter has commented that the decisions made by the company are reasonable.

9. Ofwat confirms that the *Cryptosporidium* requirements do qualify as a Relevant Change of Circumstance.

### **Item 3 – Plumbosolvency treatment to reduce lead levels in drinking water**

10. Provision was made in price limits set in 1999 for a work programme to deal with the new lead parameters. This was funded as a lead communication pipe replacement programme, but during the process DWI made it clear that after it received further information from each company, it would review the most effective means of delivering compliance. Plumbosolvency control is now the preferred initial approach.

11. In your application you explain that you are finalising a programme of work to deal with lead levels initially by plumbosolvency control. This indicates that your company will need to install first time treatment at 16 works and optimise existing treatment at a further 16 sites, as well as some ancillary work.

12. This plumbosolvency control work will need to be carried out before it is possible to decide what more needs to be done to achieve full compliance with the lead parameter. This could involve a strategic programme for replacing lead communication pipes. However, you have indicated that it may be necessary to carry out some lead communication pipe replacement before March 2005.

13. For this draft interim determination, we have assumed that DWI will issue a formal Statement of Intent setting out the programme you have described in time for this to be considered in the final interim determination. To address your point on the need to carry out lead communication pipe replacement within this pricing period, we have assumed a rephasing of the work you planned into the last two years of the period, by which time the efficacy of the plumbosolvency control will be clearer. If further information from DWI indicates that this level of work is unlikely to be needed in the final two years, the provision will be appropriately adjusted in the final interim determination. If the provision remains, and the strategic pipe replacement programme confirmed by DWI sets out different levels of pipe replacement from our assumptions, then the appropriate adjustments will be made at future price settings.

14. Ofwat confirms that if there are significant differences between the extent of the programme assumed at the 1999 price setting for dealing with lead and the formal statements of intent issued by DWI, then this will be considered as a Relevant Change of Circumstance.

#### **Item 4 – New Section 19 Undertakings given to the DWI**

15. Both of these undertakings were given by the company to comply with water quality standards in the current Water Quality regulations. Ofwat has not been persuaded that either of these undertakings was necessary because of matters beyond the control of the company, such as a deterioration in the quality of the raw water available to the company. We assume that companies will continue to comply with the current water quality standards within current price limits. These new undertakings are not a Relevant Change of Circumstance. No additional provision has been made in the draft interim determination for customers to pay for this work.

16. Ofwat does not consider that this work qualifies as a Relevant Change of Circumstance.

#### **Item 5 – Additional sewage treatment required to comply with new consents issued by the EA**

17. Your application to deal with sewage treatment falls into two parts, that concerned with the additional work to Llangefni not included in the 1999 price limits and subject to review by the National Assembly for Wales (NAfW), and secondly small changes to the assumed programme of work at Garnswilt and Porthmadog.

##### **a) Llangefni**

18. At the 1999 Periodic Review the First Secretary excluded the River Quality Objectives (RQO) element of the Llangefni scheme as it did not appear to offer good value for money for either the environment or customers. No provision was made in price limits for the scheme submitted by Dwr Cymru in its business plan. In its Interim Determination Referral Notice the company has submitted a new scheme in response to a new consent set by the Environment Agency Wales. The costs are considerably less than the costs in the original submission.

19. Ofwat has sought confirmation from the Environment Agency (EA) that the completion date for this scheme is the same as that assumed by the company. At the same time Ofwat is seeking confirmation from the NAfW that the scheme has been appropriately re-appraised and now offers benefits both to customers and the environment, and should therefore be completed to the specification of the current price limits (2000-2005).

20. Ofwat has reviewed the work set out by the company as necessary to meet the legal requirements and taken into account the findings of the Reporter following his review of the company's submission.

21. The scheme has been included in this draft interim determination, however the situation may have to be reviewed for the final interim determination when the formal view of the NAfW has been received. This may also change the timescale for completion, which would also be reflected in the final interim determination.

22. Ofwat confirms that if all the necessary stages in verifying this scheme have been carried out in time for the final interim determination this will qualify as a Relevant Change of Circumstance.

### **b) Garnswllt and Porthmadog**

23. At the 1999 Periodic Review both these schemes were addressed with respect to the costing details submitted by Dwr Cymru in its Business Plan and as such were included in the process of Ofwat's final determination. However, the costs submitted by Dwr Cymru for both the schemes did not impact on price limits, as they did not then fall completely within the price setting period (April 2000 to March 2005).

24. Additional provision has not been made in this assessment. We consider that the company may need to accommodate its costing error by some fine-tuning on the delivery of the environmental programme.

25. Ofwat does not consider that this work qualifies as a Relevant Change of Circumstance.

## **STAGE 2 – ASSESSING THE APPROPRIATE NET ADDITIONAL COSTS / REVENUE LOSSES ATTRIBUTABLE TO EACH CHANGE**

### **Item 1 – Additional Meter Optants**

26. Ofwat has carefully assessed the information contained in your application and, where appropriate, we have requested further clarification from you and the Reporter.

#### *Numbers of Optants*

27. In assessing the evidence most weight has been attached to confirmed outturn information and the extent to which this indicates a divergence from the assumptions made in the final determination.

28. The final determination assumed that 10% of unmeasured customers would choose to change to measured charging between April 2000 and March 2005. Furthermore it was assumed that switching would follow a pattern whereby a constant proportion of the remaining unmeasured customer base took up the free meter option each year.

29. The final determination also contained assumptions about the number of optants among unmeasured sewerage customers who receive water supplies from other water suppliers.

30. Your application presents evidence relating to confirmed free meter requests received in the period 1 February 2000 to 24 September 2000. In addition, your submission presents evidence to support your forecast of meter optants up to March 2005.

31. For the purpose of this interim determination Ofwat is required to take a forward-looking view of the likely uptake of optional metering for the remainder of the quinquennium. In doing so we have had regard to the sensitivity of calculations to alternative extrapolations, and to the limited quantity of outturn data

32. Ofwat considers that it is appropriate to adjust assumptions about the uptake of optional metering during the quinquennium as indicated in Annex A. We consider that it is still appropriate to assume that a constant proportion of the remaining unmeasured customers will take up the free meter option each year.

33. Licence condition B 14.2(3)(i)(D) requires that no account to be taken of

*“... any amounts attributable to matters allowed for in making a Relevant Determination, except to the extent that such amounts otherwise fall to be taken into account as amounts reasonably attributable to, or connected with, the Relevant Item.....;”*

34. Ofwat’s approach has recognised this by revising assumptions adopted at the final determination for variations between the assumed level of meter optants for 1998-99 and 1999-2000 and the outturn numbers of meter optants during that period.

#### *Meter Optant Characteristics*

35. You estimate that the characteristics of meter optants will be different to those assumed in the final determination.

36. However, Ofwat considers that the assumptions adopted at the final determination remain valid. In reaching this judgement, account has been taken of the robustness of the data you have presented, the short time period for which data is available and of the likelihood that the average characteristics of optant cohorts will change over the period of the quinquennium. Ofwat considers that there are good reasons to assume that, on average, those customers that stand to make the largest savings will be among the first cohorts to opt for measured charging and therefore, will not be representative of optants over the five year period.

#### *Meter Unit Costs*

37. The company has presented evidence to support its assessment that the unit capital costs of metering are higher than those allowed for in the final determination. We consider that there is no reason not to expect further efficiencies, and that the unit cost assumptions used in the final determination remain appropriate.

#### *Meter Location*

38. We have also considered evidence presented relating to meter location, in particular Dwr Cymru’s view that external metering carries a range of advantages. Ofwat accepts that the regulatory regime should provide incentives to companies to adopt the most appropriate and cost effective approach to meter location. We intend, therefore, to ensure that where companies present a robust case for a

different mix of meter locations than that assumed for the final determination they will not be disadvantaged at the next periodic review. For example, companies may be able to demonstrate opex savings arising from external meter location. Where these have been achieved Ofwat will ensure that the periodic review methodology does not penalise efficiency.

39. Ofwat does not, therefore, consider it appropriate to use the interim determination mechanism to provide for different assumptions about meter location.

## **Item 2 – Cryptosporidium — Additional Requirements for Continuous Monitoring and Treatment.**

40. Your company is dealing with the requirement of the Notice in two ways, by continuous monitoring and by installing additional treatment. To ascertain the appropriate costs to assume in the draft interim determination, these were dealt with separately.

### *Continuous Monitoring Requirements*

41. Ofwat has reviewed the company's projected costs for meeting this requirement and considered the Reporter's report. Ofwat has also looked more widely at experience elsewhere and in particular at market prices for this type of work already included in price limits for other companies. Ofwat considers that the company has over-estimated the initial additional operating costs of carrying out the continuous monitoring. Therefore Ofwat's assessment has been based on the initial benchmark established elsewhere.

42. Continuous monitoring and testing for Cryptosporidium is in its infancy. As the level of this monitoring increases it is reasonable to assume there will be a decrease in the costs of materials as the development of this assay progresses and an increase in efficiency for this labour intensive procedure. This is a new area of technology and routine high levels of work have yet to be carried out in commercial laboratories. Analogies can be drawn with other developments where unit costs have shown the existence of steep learning curves. In the light of these considerations Ofwat has concluded that unit costs for this work should decline reasonably rapidly. Ofwat has assumed progressive improvements in efficiency to be 2.5% per annum until 2005 and from 2005 onwards 5% per annum. These projections will provide a reasonable balance both in terms of a continuing stimulus to the company to seek cheaper ways of delivering the obligation and an incentive to go even further, which will benefit the company and the customers in the longer term.

43. For the additional capital investment associated with the sites requiring continuous monitoring, the same assumptions were employed as for the capital associated with additional treatment set out below.

### *Additional treatment*

44. Other work to deal with Cryptosporidium involved the company decision to fit additional treatment to works rather than carry out monitoring. This was deemed to be cost-effective and has been confirmed by the Reporter.

45. Insufficient information was available on other projects employing this control measure to allow the cost put forward by your company to be compared with the costs of carrying out this work elsewhere in the industry. We considered your methodology and procurement practice and propose to reduce your company estimate for costs by 10% for both the operating and capital costs to reflect our view that the proposals have not been sufficiently market-tested by full tendering.

46. For the capital cost for this work future efficiencies were assumed from 2001-02. In view of the pressing time constraints on carrying out this work and the lack of flexibility within this relatively homogenous programme, we have made a conservative estimate of 1.4% per year future efficiency gains.

47. Uncertainty surrounds the net additional operating costs of such work. In the past companies have been able to deliver much greater efficiencies in dealing with such new standards than they originally expected or forecast. Accordingly Ofwat proposes to assume an efficiency gain of 2.8% a year. Ofwat considers this rate of improvement provides a reasonable balance between the incentives on the company to achieve these efficiencies and the scope to go even further, which would in time be to the benefit of customers.

#### *Ofwat view of the likely costs*

48. The company assessed the net present value over 15 years of the operating and capital costs of complying with the new requirement as £18.4m at 2000-01 prices, with £5.2m net additional operating costs and £8.7m net additional capital costs incurred over the period to March 2005.

49. Ofwat considers that the appropriate net additional costs of meeting this change are £4.0m operating costs and £7.8m capital costs over the period to March 2005. Ofwat assesses the net present value of these costs to be £14.4m

### **Item 3 – Plumbosolvency treatment to reduce lead levels in drinking water**

50. Your company submitted an outline estimate of the shape of the programme for controlling plumbosolvency. This had a number of components including conventional orthophosphate dosing, and further optimisation using lime or CO<sub>2</sub> dosing.

51. The Reporter has indicated that the capital costs assumed for this programme were site specific. The costs had been estimated from a desk study, and on three site visits made by the Reporter only one of these site solutions was satisfactory. Although the estimates have now been revised, Ofwat considers that this indicates a significant level of uncertainty about these costs. In view of this and the contingency built into the estimates, Ofwat proposes to reduce your original company estimate for capital costs by 10%.

52. For this capital work, future efficiencies were assumed from 2001-02. In view of the pressing time constraints on carrying out this work and the lack of flexibility within the programme, a conservative estimate of 1.4% per year future efficiency was assumed.

53. On operating costs, sufficient information is available to be able to compare your company's estimate of costs for orthophosphate treatment with those of other companies who have established a benchmark. Ofwat proposes to use an estimate for this work that is 75% of the way from your figures to the benchmark costs together with future efficiency gains at a rate of 1.4% a year. Your approach to the estimates for lime and CO<sub>2</sub> dosing was similar to that above and so the same percentage adjustments have been applied.

*Ofwat view of the likely costs*

54. The company assessed the net present value over 15 years of the operating and capital costs of complying with the new requirement as £23.6m at 2000-01 prices, with £4.9m net additional operating costs and £10.0m net additional capital costs being incurred over the period to March 2005.

55. Ofwat considers that the appropriate net additional costs of meeting this change are £1.8m operating costs and £8.7m capital costs the period to March 2005. Ofwat assesses the net present value of these costs to be £12.8m

**Item 5 – Additional sewage treatment required to comply with new consents issued by the EA**

**a) Llangefni**

56. Ofwat has reviewed the company's projected costs for meeting this requirement and considered the Reporter's report. It is assumed that the company has used the same methodology for estimating costs as that used for the rest of the environmental programme in 1999. The costs of the additional work at Llangefni have been challenged in the same way as comparable improvements in the sewerage quality programme at the 1999 final determination. However, no future efficiency assumptions have been applied to Year 1 (2000-01) estimates.

*Ofwat view of the likely costs*

57. The company assessed the net present value over 15 years of the operating and capital costs of complying with all the sewage treatment schemes as £4.1m at 2000-01 prices, with £0.3m net additional operating costs and £3.3m net additional capital costs being incurred over the period to March 2005.

58. Ofwat considers that the appropriate net additional costs of dealing with additional treatment at Llangefni are £0.2m operating costs and £2.3m capital costs over the period to March 2005. Ofwat assesses the net present value of these costs to be £2.6m.

59. This would normally be considered trivial. Since the scheme was omitted from the 1999 price limits to allow reappraisal, Ofwat proposes to include it in the interim determination if the National Assembly approves it.

### **STAGE 3 – MATERIALITY TEST – IN AGGREGATE DOES THE SUM OF ALL THE CHANGES EXCEED THE MATERIALITY THRESHOLD SET DOWN IN THE LICENCE?**

60. Condition B of the licence sets a materiality threshold for consideration of interim determinations. If the present value of the net additional costs and revenue losses (calculated up to the start of the next charging period for capital costs and over 15 years for operating costs and revenue losses) arising from the changes is greater than 10% of the turnover of the Appointed Business in the latest financial year for which accounting statements have been delivered to Ofwat, then a revision of price limits is triggered.

61. The results of Ofwat's analysis, based on the revised assumptions set out above, are summarised in Annex A. This indicates that the materiality threshold has been satisfied for Option 1 – *All Obligations Confirmed*, but not for Option 2 – *Some Obligations Confirmed*.

### **STAGE 4 – IMPLICATIONS FOR PRICE LIMITS IF THE MATERIALITY THRESHOLD IS EXCEEDED**

62. For Option 1 – *All Obligations Confirmed* there would be a change in price limits calculated using the approach set out in Condition B of your licence. Ofwat's provisional assessment of the company's application is that the price limits for the charging years 2001-02 to 2004-05 should be revised as set out in the table in Annex A if the conditions set out as Option 1 prevail.

63. We propose to adopt the symmetrical notified item model used by the Competition Commission, together with the new projections of meter optants as amended by the numbers set out in Annex A.