



Mr A R F Cooke
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14 December 2001

INTERIM DETERMINATION

You applied on 14 September 2001 for an interim determination of your company's price limits under Part IV of Condition B of your licence. Your reporter, Robin Clark, of Halcrow Management Sciences, submitted his report on your application on 18 September 2001.

Your application covers the cryptosporidium monitoring requirements placed on your company by the Drinking Water Inspectorate. We agree this is a relevant change of circumstance and that it has a material impact on your costs as defined by Condition B of your licence. We sent you our draft decisions on 8 November and corrections to the draft price limits on 20 November. You sent us your representations on 23 November and we discussed these on 27 November. Following your representations and those from others, including the Customer Service Committee, we have looked again at the costs we assumed in the draft. We have now allowed for part of your management and supervisory costs and more of your laboratory handling and administration costs associated with cryptosporidium monitoring and made some changes to our determination.

Annex A summarises your estimate of the changes to your costs, our final view of your costs and the new price limits. Our decisions are summarised in Annex B. We are sending explanatory notes expanding on Annex B separately.

These revised price limits will apply from April 2002. The effect of this change for customers is that average household bills will increase by £3 in real terms between 2001-02 and 2004-05 rather than £2 as anticipated in the final determination in 1999.

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In our draft interim determination, we included a proposed licence modification to extend the scope of the notified item to allow for both losses and gains. We discussed this when we met and you wrote to me on 7 December. Your application did not relate to optional meters and we agree that the licence modification is inappropriate.

We are placing this determination in the Ofwat library and announcing our decision to the London Stock Exchange.

This letter and its enclosures have been copied to John Ballard (DEFRA), Michael Rouse (DWI), David Jordan and Richard Cresswell (Environment Agency), Sheila Reiter (Chairman of Wessex CSC), your local members of Parliament and members of the European Parliament.

PHILIP FLETCHER

ANNEX A

BOURNEMOUTH & WEST HAMPSHIRE WATER PLC INTERIM DETERMINATION – December 2001 – SUMMARY TABLE

| Description | Company's Assessment (September 2001) | Ofwat's Assessment (December 2001) | | | | |
|---|--|--|---------|---------|---------|---------|
| Item 1 – Cryptosporidium – Additional requirements for continuous monitoring | | | | | | |
| 1.1 | Estimated net additional capital expenditure for AMP3 | £0.08m | | | | |
| 1.2 | Estimated net additional operating expenditure for AMP3 | £1.37m | | | | |
| 1.3 | Materiality amount (NPV of total net additional costs and losses) | £2.92m | | | | |
| 1.4 | Contribution towards materiality threshold | 11.0% | | | | |
| OVERALL ASSESSMENT | | | | | | |
| 2 | Materiality amount (NPV of total net additional costs and losses) | £2.92 m | | | | |
| 3 | Bournemouth & West Hampshire turnover for 2000-01 used in materiality test | £26.46m | | | | |
| 4 | Materiality test | 11.0% | | | | |
| PRICE LIMITS | | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 |
| 5 | Current price limits (as set in November 1999) | -3.0 | -1.7 | -1.7 | 0.0 | 1.7 |
| 6 | Revised price limits | -3.0 | -1.7 | 0.4 | 0.4 | 0.5 |
| Notes: | | | | | | |
| 1. The appropriate Discount Rate used is 4.95%. | | | | | | |
| 2. Materiality test – Result must be greater than $\pm 10\%$ to trigger a change in price limits. | | | | | | |
| 3. All monetary values are stated in September 2001 prices. Totals may not add due to rounding. | | | | | | |

**BOURNEMOUTH AND WEST HAMPSHIRE WATER PLC
INTERIM DETERMINATION – 14 December 2001
SUMMARY OF OFWAT'S ASSESSMENT**

1. We followed a four-stage assessment of your application in accordance with the terms of Condition B of your company's licence.
2. You included one change in your application, namely the cryptosporidium monitoring requirements placed upon your company by the Drinking Water Inspectorate (DWI).
3. Our assessment of your application is set out below.

STAGE 1 – CONFIRMATION THAT THE CHANGED REQUIREMENT IS A RELEVANT CHANGE OF CIRCUMSTANCE

Item 1 – Cryptosporidium - additional requirements for continuous monitoring

4. When we set price limits in 1999 the extent of the new requirements to deal with the risk from cryptosporidium was uncertain. Only that work which had been identified and received technical support from the DWI was included in price limits. This did not include any requirement to carry out continuous monitoring.
5. On 31 July 2000 the DWI issued a revised notice under regulation 23A of The Water Supply (Water Quality) (Amendment) Regulations 1999. This set out the steps you must take to comply with the requirements of regulation 23B. The DWI has confirmed that the work set out in your application is necessary to meet your obligations under the cryptosporidium regulations.
6. These additional cryptosporidium requirements qualify as a relevant change of circumstance. The scale of the work set out in your application is appropriate and additional to that assumed in price limits set in 1999.

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

7. You are dealing with the cryptosporidium requirements by carrying out continuous monitoring at six sites. Your reporter has commented that this is reasonable.
8. We reviewed your submitted costs for cryptosporidium monitoring and considered your reporter's report. We also looked at market prices for this type of work reported by other water companies. We used this information to develop our view of the reasonable impact of the new requirement.
9. In our initial assessment, we did not include your management and supervisory costs and half of your laboratory handling and administration

costs. We initially judged that these costs do not represent additional company expenditure. In your representations you argued that these are real costs that should be taken into account in the interim determination of your price limits.

10. We have considered your representations and have amended our assessment to include 50% of the management and supervisory costs and 75% of the laboratory handling and administration costs.
11. After making these adjustments we compared your unit operating cost for cryptosporidium monitoring with our view of the benchmark cost for a prudent and well managed company. This adjusted cost is reasonable and we have incorporated this assumption in our assessment.
12. Continuous monitoring and testing for cryptosporidium is still in its infancy. We expect decreases in the unit costs of materials and increases in efficiency for this labour intensive procedure as experience is gained. We consider that a continuing efficiency of 2.5% per annum is a reasonable expectation.
13. Your estimate of the additional capital investment associated with continuous monitoring for cryptosporidium is reasonable so we have not reduced your estimate of these costs.

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

14. Condition B of the licence sets a materiality threshold for consideration of interim determinations. A revision of price limits is triggered if the present value of the net additional 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. For the purpose of this calculation, capital costs are calculated up to the start of the next charging period and operating costs and revenue losses are calculated over 15 years.
15. The results of our analysis, based on the revised assumptions set out above, are summarised in Annex A. This shows that the materiality threshold is exceeded.

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

16. Because the materiality threshold is exceeded we are required by Condition B of your licence to review and revise your price limits. Our assessment of your company's application is that the price limits for the charging years 2002-03 to 2004-05 should be revised as set out in the table in Annex A.