



Water 2020: Regulatory framework wholesale markets and the 2019 price review consultation response

Please respond to the consultation questions by filling out the template on the following sheet. Responses will need to be received by 10th February 2016. While we would be grateful if you could use this template, responses will be accepted in other forms. Please send responses to water2020@ofwat.gsi.gov.uk.

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Water 2020: Regulatory framework for wholesale markets and the 2019 price review consultation questions

Question			Comments
Overview document	SQ1	Do you agree with our proposals for making a greater use of markets in relation to sludge and water resources?	Agree Yes, we agree that Ofwat has identified the areas with greatest scope for utilisation of market forces. We also strongly support the proposal that use of markets for water resources should be restricted to new resources.
Overview document	SQ2	Do you agree with our proposals in relation to the future form of regulation for the sector?	Agree We are generally supportive of the proposed approach. We are keen to help Ofwat ensure that the detailed implementation of its proposals is appropriate. We do have particular concerns about the pace of transition from RPI to CPI proposed in Ofwat's consultation and believe that Ofwat is right to note that it must undertake a fuller assessment of the benefits, costs and risks. We also believe it is important to develop robust approaches to cost assessment and the household retail price control which build on and improve the approaches taken at PR14.
Overview document	SQ3	Do you agree with our proposals in relation to customer engagement and outcomes?	Agree We welcome the clarification of roles of CCGs and Ofwat, and support the proposals to improve the operation of CCGs. We agree that there is scope to improve the understanding of customer priorities and to work more closely with customers. We have prepared a separate paper on these issues and submitted it to the "Marketplace for ideas." (http://corporate.unitedutilities.com/documents/Water2020-Feb16-CustomerEngagement.pdf) We welcome the additional time taken to consider the development of ODIs. Particularly important issues are whether it is possible to develop workable arrangements for long-term ODIs, the balance between rewards and penalties, and the use of comparative information in setting targets.
Overview document	SQ4	Do you agree with our proposal to extend protection of the RCV to 2020?	Agree We welcome Ofwat's commitment to extend protection of the RCV to 2020. It is important that Ofwat's proposals for sludge (e.g. the volume adjustment to allowed revenues) support, rather than undermine, confidence in Ofwat's ability to meet this commitment. We have prepared a separate paper on this issue, which has been submitted to the "Marketplace for ideas." (http://corporate.unitedutilities.com/documents/Water2020-Feb16-RCV.pdf)
Sludge treatment, transport and disposal market design	1	Do you agree with our proposal to have one separate binding price control for sludge treatment, transport and disposal?	Strongly Agree Yes, we agree with Ofwat's proposal to create a separate binding price control for sludge. We note that there are many challenges to successful separation of a wholesale sub-service, and we will support Ofwat in this through the working group that has been established. Issues yet to be resolved include detailed boundary definition (rules for inclusion and exclusion of boundary assets, cost allocation rules for shared costs, consistency in MEAV asset valuations (particularly important given Ofwat's proposal for a focused allocation of RCV), consistent measurement of sludge volumes, identification of appropriate information to facilitate trading on the trading platform, and simplification and standardisation of pricing and contractual arrangements to facilitate trading, incentives. We have sought to set out our initial views on these issues in a paper we have submitted to the "Marketplace for ideas." (http://corporate.unitedutilities.com/documents/Water2020-Feb16-SludgePriceControl.pdf) We also note the important role that waste regulations will play in the development of a successful sludge and wider waste market and look forward to contributing towards understanding the impact of these and identifying resolutions.

Question				Comments
Sludge treatment, transport and disposal market design	2a	Do you agree with our proposal to make a range of cost, capacity and location information available in order to facilitate the identification of trades?	Strongly Agree	Yes we agree with Ofwat's proposal. However, we wish to highlight the importance of creating a level playing field between companies, and hence the need for information to be reported on a consistent basis. This will require a great degree of care in designing this approach; for example, sludge volumes have historically been "back calculated" using different methodologies and assumptions. This would not be an appropriate basis to develop a new market.
Sludge treatment, transport and disposal market design	2b	Do you agree that the data should be published on a STC and STW site level?	Strongly Agree	We support the proposal to publish data on a STC and STW site level.
Sludge treatment, transport and disposal market design	2c	Do you agree that the data should be published annually?	Strongly Agree	Yes, we agree that annual publication is appropriate.
Sludge treatment, transport and disposal market design	2d	Do you agree with the categories of data that we are proposing are necessary and appropriate, as illustrated in the tables? Are any missing?	Neither agree nor disagree- N/A	<p>We will fully support Ofwat in developing the appropriate data requirements to support separation of sludge and to support future sludge trading. An initial view of the proposed data indicates:</p> <ul style="list-style-type: none"> - Treatment costs need better definition to specify what it includes / excludes, and any standard methodology requirements e.g. include depreciation and return, assumed asset life for depreciation, treatment of unused assets (exclude or allocate to other facilities?) etc. - Average transport costs seem unnecessary, as the specific transport costs between a WwTW and a sludge centre is more useful than an overall average. - no mention of specific issues (e.g. heavy metals) in sludges, and/or specific constraints/sensitivities at individual sites - there may be capacity at a site, but it may already be at the limit of acceptability of particular types of sludges (e.g. ammonia) - need to highlight any specific permitting requirements - for example any sludge centre which utilises incineration will require the WwTW providing any input sludges to have a PPC permit - each measure (average/min and max) should where possible reveal any potential variability over time. Also any known reasons for significant changes to reported volumes (e.g. expectation of major developments or closure of a major trade input) should be made available. <p>We will fully support Ofwat in this process through participation in its sludge working group and other activities as required.</p>
Sludge treatment, transport and disposal market design	3	Do you agree that the information should also contain details of 'bids' in from entrants, and that there should be guidelines for ensuring that such bids are assessed on a level playing field basis?	Disagree	<p>We would be concerned that full publication of "bids in" from entrants might stifle market development if commercial details of bids were published. It would be preferable that this information be published to Ofwat for the purpose of demonstrating compliance with level playing field requirements, and for Ofwat to indicatively report on activity and compliance levels of the incumbents.</p> <p>We believe it would be more helpful for Ofwat to publish pricing rules and standard contracts to create a trading infrastructure to facilitate trades. This is because relying on general provisions (such as RAG5) are capable of local differences in interpretation and currently present regulatory barriers to efficient trading. These rules should also address the risk that, upon switching supplier for sludge, companies would only save marginal costs, but if prices are based on average costs this would result in an overall increase in costs to be recovered from customers. Such an outcome would not be in customers' best long term interests.</p>
Sludge treatment, transport and disposal market design	4	Do you agree that the data should be made available centrally through some form of information platform? Do you have any views as to how this might best be managed?	Agree	We agree with the proposal that data should be made available centrally through some form of information platform. In the first instance, we consider this would be best provided by Ofwat.

Question		Comments
Sludge treatment, transport and disposal market design	5 Do you agree with our proposals not to make any changes to the status quo in relation to system operation activities?	Strongly Agree We note that Ofwat's proposals act as a thin / passive form of system operator. We agree that it is appropriate that companies are given the opportunity to ensure that the market is successful before Ofwat seeks to impose a more intrusive form of system operation. In the form that Ofwat is proposing, it is crucial that the framework and rules underpinning the emerging market for sludge trading is appropriately able to (a) reveal information to enable trades - and that information is consistently reported across all companies, (b) ensure that regulatory barriers are removed (such as establishing pricing rules and standard contracts), and (c) deliver sufficient incentives are in place to stimulate trading.
Sludge treatment, transport and disposal market design	6 Do you agree with our proposals not to have any specific financial incentives to support trading in relation to sludge at this time?	Strongly Disagree In the short term, we believe that it would be appropriate to provide financial incentives to stimulate trading and kick start the market. The total value of such incentives in year could be capped to ensure they are not overly generous, nor being provided where not necessary. The need for financial incentives will also depend on the required pricing rules for establishing sludge trades - e.g. financial incentives may be needed to support trades where short run marginal costs are low but average costs (hence prices) are higher.
Water resources market design	7 Do you agree with our proposal to have a separate binding price control for water resources?	Neither agree nor disagree- N/A We do not think that a separate price control is essential for promoting markets, improving availability of information, and setting incentives. However, in the form proposed in the consultation, we agree that the separate price control will be compatible with achieving key regulatory objectives. Some potential options for supply-demand planning, such as raw water storage not involving abstraction, would not be included within the water resource price control. The separate price controls have the potential to distort incentives and competition. The point at which to draw the boundary for water resource price control could be reconsidered but there is no clear appropriate dividing line.
Water resources market design	8 Do you agree with our proposal to implement an offset mechanism to ensure that entrants can recover the cost of new resources appropriately, whilst also ensuring that prices reflect average costs?	Strongly Agree We strongly support this proposal. It is essential to achieve the objectives of providing the right economic incentives for efficient entry, protecting customers and meeting the commitment on remunerating historic investment. We have contributed a further paper on this subject to the "Marketplace for ideas" (http://corporate.unitedutilities.com/documents/Water2020-Feb16-AccessPricing.pdf) setting out why we consider Ofwat's approach to be effective, proportionate and practicable.
Water resources market design	9 Do you agree with our proposals to create a market information database and bid assessment framework to allow for the 'bidding in' of third party resource options on an ongoing basis – as set out in the Deloitte report?	Agree We agree that lack of market information currently discourages investigation of trading opportunities and therefore we support the proposal to establish a market information database and bid assessment framework. Although the process should allow for bids to be submitted at any time, there needs to be some limit on the extent to which bids can be assessed between WRMP periods. The WRMP considers how sources and the network can be deployed effectively together at a resource zone level. It is an overall appraisal of needs, risks, environmental impacts and customer priorities and includes a statutory consultation process. If a new proposal is received, then a full evaluation would require assessment of how this would be incorporated into the plan, including changes to company proposed schemes and how the input would be integrated into the deployment of resources within a zone. If a bid were to be received which indicated that a change in plans could result in a significantly better solution (either in terms of cost or environmental impact) then this should normally be considered as part of the next WRMP. It may sometimes be possible to retain some flexibility in a WRMP by setting alternative pathways and trigger points for schemes. However, in general it would be better for bids to be considered as an integral part of the WRMP process.

Question			Comments
Water resources market design	10	Do you agree that a third party organisation may be best placed to manage the information database?	<p>Agree</p> <p>We agree that contracting with a third party organisation could be a suitable approach, provided the appointed organisation has sufficient technical knowledge to ensure consistency of data, consistency of approaches to issues such as reliability of sources, and to review reliability of information. The decision on whether to use a third party organisation should, however, be subject to a transparent assessment of the costs involved and whether these are likely to be exceeded by the benefits.</p> <p>We support the decision not to introduce a separate system operator role. The proposals for encouraging bidding in of resources will help to encourage a wider approach to optimisation. The planning and operation of water resource inputs is an integral part of a water company's functions and separating them into a different organisation would increase costs and potentially reduce deployable output and affect other aspects of service, in particular resilience.</p>
Water resources market design	11	Do you agree that measures should be introduced to increase transparency and certainty around security of supply for water trading? How can this objective best be achieved?	<p>Agree</p> <p>We consider that certainty around security of supply is achievable through long-term contracts. This will give the company receiving the water confidence in planning future supply and the company providing the water confidence that returns will be earned for a sufficient period. Water resource projects are often capital-intensive, with long-life assets, so contracts of at least 25 years will generally be necessary where investment is required to supply additional water. We agree that concerns about security of supply may to some extent deter water trading but we do not consider that this is one of the main reasons for lack of trading. However, additional information on the database about new source risk and reliability, as well as deployable output, could be helpful in appraising options and giving confidence in using new sources.</p> <p>Lack of certainty about future long-term needs is a deterrent both for potential suppliers and for companies potentially requiring new sources of water. The proposed database will contribute to improving this but we consider that this is an area where increasing the extent to which outputs are agreed beyond a five-year period would help.</p>
Allocation of the RCV	12	Do you agree with our rationale for allocating the RCV?	<p>Agree</p> <p>We do not consider that a split of the RCV is necessary for water resources. It adds complexity and the proposed water resources price control is unrelated to pricing for competition, either through access to the network or through bidding in to WRMPs. If, however, the RCV is to be split, then we support an unfocused approach. A focused approach would not result in efficient competition and the RCV allocated to the network business would in many cases be too low. A focused approach is suitable where this results in appropriate price signals and is not problematic in relation to the level of RCV which would remain in the rest of the wholesale business.</p>
Allocation of the RCV	13	Do you agree with our proposed approach for allocating the RCV for sludge?	<p>Agree</p> <p>We agree that a focused approach is appropriate for sludge, because this may be compatible with efficient competition and would not be problematic in relation to allocation of the RCV to the rest of the business. However, getting a consistent and accurate approach to the valuation of assets will be key to promoting efficient competition.</p>

Question		Comments	
Allocation of the RCV	14	Do you agree with our proposed approach for allocating the RCV for water resources?	<p>Agree</p> <p>We do not consider that a split of the RCV is necessary for water resources. It adds complexity and the proposed water resources price control is unrelated to pricing for competition, either through access to the network or through bidding in to WRMPs.</p> <p>Some potential bids, e.g. options for raw water storage not involving abstraction, would not be included within the water resource price control and the separate price controls have the potential to distort incentives and competition.</p> <p>If, however, the RCV is to be split, then we support an unfocused approach. A focused approach would not result in efficient competition and the RCV allocated to the network business would in many cases be too low. A focused approach is suitable where this results in appropriate price signals and is not problematic in relation to the level of RCV which would remain in the rest of the wholesale business.</p>
Protection and treatment of the RCV: managing transition and our approach to new investment	15	Do you agree with our proposal to address stranded asset risks by extending our commitment to protect efficient investment included in the RCV to 31 March 2020?	<p>Strongly Agree</p> <p>Yes, we strongly support Ofwat's commitment to protect investment included in the RCV to 31 March 2020. However, we are keen to understand how this commitment will be met for sludge, given the volume adjustment to revenues that Ofwat is proposing for the separate sludge price control. We have provided a paper to the "Marketplace for ideas" which explores this issue in more detail (http://corporate.unitedutilities.com/documents/Water2020-Feb16-RCV.pdf).</p>
Protection and treatment of the RCV: managing transition and our approach to new investment	16	Do you agree with our assessment that there is no prospect for stranded assets due to the proposed form of control for sludge and water resources for the 2020-25 period?	<p>Agree</p> <p>Sludge: We do not believe the risk of stranding sludge assets is as small as is presumed in Ofwat's December consultation. Whilst each individual sludge asset's risk of stranding is possibly small, there are a large number of diverse assets across England. As such we think it likely that some assets will be stranded if or when sludge markets become more open, especially if incumbents start competing to deliver sludge services to each other. The approach to gate pricing is key to this. It seems that a revenue adjustment mechanism seems likely to strand RCV unless either (a) the revenue adjustment only reflects avoidance of short run marginal costs, or (b) there is a mechanism to transfer RCV from sludge to wastewater Network+ following loss of volume to sludge trading.</p> <p>Water Resources: We agree that, for water resources, the proposed approach protects companies from any financial impact of asset stranding. In addition, given the proposed approach to access prices and the time it takes to implement new resource schemes, the risk of any assets being stranded up to 2025 is low.</p>
Protection and treatment of the RCV: managing transition and our approach to new investment	17	Do you agree with our proposed approach of an income guarantee recovered through the network plus control for protection against the risk of stranding, if a mechanism is required? How do you consider that such a mechanism could be designed to provide a simple, transparent, largely ex ante mechanism that preserves incentives for efficiency?	<p>Neither agree nor disagree- N/A</p> <p>In principle we support this approach. As noted in response to Q16, the key risk area to Ofwat's commitment to the RCV as at 31 March 2020 is sludge, given Ofwat's proposed volume adjustment to sludge revenues. As noted above, the need for an income guarantee on network+ depends on the nature of the revenue at risk within the sludge control. If it is based on marginal costs then an income guarantee may not be necessary. However if it is based on total costs, then the risk of asset stranding seems likely to be high and an income guarantee would become necessary. It is also difficult to see how this could operate ex ante, given that it would be to respond (ex post) to actual changes in volume, and hence revenue foregone.</p>
Our approach to access pricing	18	In relation to water resources, do you agree with our proposals to implement an approach based on the average cost of providing 'network plus' activities?	<p>Agree</p> <p>We agree, providing that this is combined with the proposed mechanism for an adjustment for the difference between LRIC and average cost of resources.</p>
Our approach to access pricing	19a	In relation to access prices for water resources, do you agree with our proposal that companies should be responsible for calculating and publishing these?	<p>Agree</p> <p>We agree that companies should be responsible for publication. There will need to be some standard guidance to ensure consistency, in particular in relation to the calculation of incremental costs.</p>

		Question		Comments
Our approach to access pricing	19b	Do you agree they should be published by water resource zone, with network distribution and treatment costs separately identified?	Agree	We agree that prices should be published by zone, with standard company-wide costs for treatment and distribution and a zone-specific adjustment for the difference between company-wide average costs for resources and zone incremental water resource costs. This will encourage efficient entry while being consistent with maintaining company-wide average pricing for final customers.
Our approach to access pricing	20	In relation to water resources, do you agree with our proposals to implement a mechanism that offsets the difference between the LRIC (or potentially the AIC in the absence of LRIC data) of new resource and the prevailing average cost of resource?	Strongly Agree	We strongly support the proposal. This is essential to achieve the objectives of providing the right economic incentives for efficient entry, protecting customers and meeting the commitment on remunerating historic investment. We have submitted a paper to the "Marketplace of ideas" which explores this issue further (http://corporate.unitedutilities.com/documents/Water2020-Feb16-AccessPricing.pdf).
Our approach to access pricing	21	Do you further agree that it is the incumbent's, rather than the entrant's LRIC, that should form the basis of the payment, in order to provide a stronger incentive for entry?	Disagree	The LRIC for the incumbent should be the benchmark price but there should be some gain to the incumbent's customers from lower-cost sources being made available through trading. This is considered further in our separate paper on upstream pricing.
Our approach to access pricing	22	In relation to sludge, do you agree that price and non-price terms should be the outcome of commercial negotiation, supported by the cost or price and capacity information previously set out?	Agree	Whilst we believe this is one possible approach, we believe it should be supplemented by the presence of standard contracts to help facilitate the negotiation process. Over-reliance on bespoke arrangements could result in negotiations being delayed and frustrated. Also, we note that this only refers to pricing between parties. Currently, a RAG5 compliance transfer price is also required for appointed entity sludge assets to be used for (non-appointed) sludge trading. It will be necessary for Ofwat to clarify simple and consistent pricing rules for companies to account for the internal cost of providing a (non-appointed) sludge trading service, or to amend company licences to enable traded sludge to be an appointed activity (and hence avoid the need for a transfer price)
Our approach to access pricing	23	Do you support our proposals to develop high level guidelines as to how rival offers in relation to sludge treatment, transport and disposal should be evaluated?	Agree	We would support Ofwat in developing guidelines, but note that (ultimately), companies will need to consider how best to meet their statutory duties when assessing rival offers, based on many factors including risk. It would be helpful to establish a method for assuring that bids will provide an appropriate level of service to companies. One way to achieve this could be for any alternative suppliers to inherit accountability for the incumbent's duty for satisfactory sludge disposal, as that would no longer be in direct control of the incumbent. We also believe that Ofwat should provide standard trading contracts, which would help ease the process for negotiating and entering into trades.
Making greater use of direct procurement for customers	24	Do you agree with our proposals relating to the use of direct procurement on behalf of customers?	Agree	We agree that there may be benefit from applying a different approach to procurement for very large, discrete enhancement projects. However, as noted in the consultation appendix, some large projects may not be sufficiently discrete to enable effective procurement. In addition, some projects which might be separable in terms of construction may need to be operated as part of an integrated system so could only be stand-alone in terms of the construction element. As the consultation notes, companies already operate tendering processes and the existing framework provides strong incentives for efficiency. Therefore it is uncertain whether this approach will generally lead to lower costs. We consider that use of direct procurement should be considered an experimental area for PR19.
Making greater use of direct procurement for customers	25	Do you have any views on our specific proposal to set a £100 million threshold above which point we would expect companies to procure at market on a standalone basis?	Agree	In view of the uncertainty about the benefits from this approach, applying it initially to a limited number of projects is sensible. Therefore we support the proposed threshold, provided that it is limited to discrete enhancement projects.
The implications of making more use of markets	26	Do you agree that our proposal for four binding wholesale price controls should apply to companies whose area is wholly or mainly in Wales, as well as to companies whose area is wholly or mainly in England?	Agree	Yes, we support that the same approach should be adopted for companies wholly or mainly operating in Wales as is applied to companies operating wholly or mainly in England. .

		Question		Comments
The implications of making more use of markets	27	Do you agree with our initial view that the network plus controls for water and wastewater and the water resources controls should be total revenue controls?	Strongly Agree	Yes, we support the proposal that these controls should be total revenue controls.
The implications of making more use of markets	28	Do you agree that future investment in relation to sludge treatment, transport and disposal should be exposed to volume risk and, accordingly, what are your views regarding the appropriate form of control in this area?	Agree	We do not object in principle but note that the interaction between this proposal and Ofwat's commitment to the RCV as at 31 March 2020 is unclear. It may (depending on the design of the control) also affect prices that sludge business units will be able to provide into the market. It is important the Ofwat's methodology is able balance the need to maintain its commitment to the RCV, set appropriate levels of allowed revenues for sludge, and also to enable companies to provide efficient and appropriate pricing signals into the emerging sludge market. We have submitted a paper which considers this issue to the "Marketplace for ideas." (http://corporate.unitedutilities.com/documents/Water2020-Feb16-RCV.pdf)
The implications of making more use of markets	29	In your view, how should new investments be remunerated in the sludge and water resources controls from 2020?	Strongly Agree	<p>We agree that continuation of an RCV-based approach is appropriate for water resources. Otherwise, new investment to provide additional resources for dry years or to provide for future population growth would not be made, as the return would not be sufficient for the risk of an asset being under used.</p> <p>We agree that post-2020 investment in the sludge business should be exposed to some volume risk. However, returns must be sufficient to ensure that necessary investment to meet future capacity needs is made. A price cap approach, with exposure to volume risk until the next price review, would limit the risk to returns, although there would still need to be some increase in the cost of capital. We think that it is unlikely to be practical to separate volume changes due to competition from volume changes due to other factors such as demand fluctuations.</p>
The implications of making more use of markets	30	How can we best ensure that long-term contracting arrangements are not dis-incentivised – and that any continued application of a return on RCV approach for incumbents is on a level playing field with third party providers?		<p>Ofwat has proposed that there should be focused RCV allocation to sludge - this step alone should assure new entrants that they are able to compete on a level playing field with incumbents. As noted in response to q29, the expectation that sludge volumes will be at risk to competition together with the application of volume risk, would tend to indicate some level of increase to the cost of capital which should be reflected in price controls.</p> <p>Regarding long term contracts, Ofwat would need to set out some expectations for how prices and bids from third parties should be dealt with on an ongoing basis. By way of example, one might consider what would happen where a company is providing (say) sludge services to a site under a long term contract, but then another third party bids a lower price for the provision of the same service. If there are penalties or sanctions for not taking the lowest price (due to a long term contract being in place), or if revenues are based purely on market prices, then this would act to discourage long term contracts, which would also likely deter entry and investment into that market.</p>
Incentivising monopolies to discover and reveal information on efficient costs	31	Do you agree with our proposal to retain our RBR approach for PR19?	Strongly Agree	Yes, we support Ofwat's RBR approach to reviewing business plans. However it is important that companies are able to enter into that process with a reasonable understanding of the tests that will be applied, and therefore be able to reflect those in the evidence provided in business plans. In particular companies should have access to Ofwat's proposed cost assessment models (for wholesale totex and household retail cost to serve). Absent this information, companies would be subjected to unequal treatment depending on whether cost assessments favourably or unfavourably represented company specific circumstances. It is essential for those requiring higher costs than indicated by cost assessment models that they are able to provide appropriate evidence to explain and justify the cost proposals in business plans - this will only be possible if any models are shared prior to company business plan submission.

Question			Comments
Incentivising monopolies to discover and reveal information on efficient costs	32	Do you agree with our proposal to reflect current performance in our RBR assessment (and for CCGs to consider this as part of their report?)	Agree In principle we agree with this approach. However, it should be recognised that simplistic indicators of company performance do not provide a full representation of company performance over a period. There may be events that affect performance which fall outside of company control (for example the recent floods). In this case, it is important that Ofwat assesses performance over the period as a whole, rather than focusing on individual events, particularly events outside of company control. A company with a good track record of performance that has not suffered any extreme weather events has not necessarily performed better than one that has. It is also important that Ofwat takes account of qualitative evidence for how companies have addressed any apparent performance issues - companies should feel that "going the extra mile" in the event of (say) an operational incident will be recognised.
Incentivising monopolies to discover and reveal information on efficient costs	33	Do you agree that the RBR assessment should consider the extent to which the business plans are part of a longer term plan?	Strongly Agree We agree that there should be more emphasis on long-term planning to ensure that services are resilient in the face of future pressures on water and waste water systems. Preparation of long-term plans similar to Strategic Direction Statements would be appropriate but with a clearer link to the five-year plan.
Assessing cost efficiency	34	Do you agree that the consideration of disaggregated cost models is appropriate given the price control structure proposed?	Agree It is appropriate that Ofwat examines such evidence (e.g. as part of overall triangulation), but it is important that this alone should not be used to assess required costs. Historically companies will have taken individual decisions on investments to meet local and regional requirements on an efficient basis. This has undoubtedly resulted in differences between companies in how requirements have been met. For example, depending on local supply demand requirements and the cost of new sources, one company may have elected universal metering, whereas another company may have had more options to develop new water resources. This will naturally result in an imbalance between newly separated elements of wholesale (in this case water resources and water network+). An over reliance on disaggregated models by Ofwat could result in an "infeasible frontier" whereby the former (high metering) company sets the cost benchmark for water resources, but the latter (higher water resources) company sets the cost benchmark for network+. This would only reflect an infeasible mix of management actions and an overall cost assumption than companies could not reasonably be expected to achieve. We consider that overreliance on modelled outputs should be avoided, recognising the limitations of such models that was identified at PR14.
Assessing cost efficiency	35	Do you agree that the development of detailed cost allocation guidelines is appropriate?	Strongly Agree Yes, we strongly agree that the development of detailed cost allocation guidelines is a necessary component of ensuring a level playing field for those elements of wholesale that will be subject to market forces. The proper setting of such guidelines is a difficult task which will require considerable effort and resources and this should be recognised at the outset. However, without detailed cost allocation guidelines, we do not believe that an effective market can operate in the best long term interests of customers. This is because the market will yield absurd results.

Question		Comments
Encouraging a longer-term approach	36 Do you agree with our proposal to retain the current timings of our price controls, that is not change the duration of wholesale price controls, not to stagger wholesale water and wastewater price controls and not seek to further align the timing of controls with other planning processes?	Agree We agree that the wholesale price control duration should continue to be five years. If there is to be any change in future, it should be linked with a change to the water resource management plan duration. This is currently fixed by legislation at no more than five years. Because of the links between supply-demand planning and maintenance and resilience programmes, it would be undesirable to set different durations for price controls and WRMPs. Staggering wholesale water and waste water controls would not be desirable. There are advantages in giving the opportunity for customers and stakeholders to weigh up priorities for water service improvements relative to waste water. In addition, as noted in the consultation, there are economies of scope in managing the two processes together. Since it is highly desirable to align WRMP and price review timings it would not be possible to align the price review with River Basin Management Plan timing. However, the RBMP and price review timing will be more out of line than at PR14 so there is a need to give further consideration to how changes in requirements after PR19 will be dealt with. It may be possible to define for PR19 some projects which are clearly cost-beneficial and cost-effective for the water industry to address, but it is likely that there will be significant issues to resolve. Options to deal with this need to be considered, such as ODIs to allow for variations in the size of programme, or provision for the price review to be reopened in these limited areas. Companies are expected to integrate the development of their WRMPs into their mainstream business planning. However, there is a misalignment in that companies will be consulting on their draft WRMPs (published in March 2018) when the Business Plan is submitted in July/August 2018. The customer and stakeholder consultation and investment planning processes need to be aligned. If this is not possible then the impact of this in terms of limiting the integration of business plans and WRMPs needs to be recognised. We consider that a workable option would be for both timetables to be adjusted to align them, with Business Plan submission deferred to October, and the WRMP cycle brought forward.
Encouraging a longer-term approach	37 Are there any other measures, not considered above that could help to encourage a longer term approach?	Agree Greater certainty on the future environmental programme would encourage long-term planning. We do, however, recognise that this may be easier to aspire to than achieve.
A more responsive regulatory framework	38 Do you agree that we should amend the licence to allow for in period adjustments for some or all of the following: outcome delivery incentives, revenues and cost sharing?	Neither agree nor disagree- N/A We agree that licence amendments would be necessary to enable in period adjustments. One of the benefits of inter-period adjustments is that overall impacts can be netted off in total and smoothed over a five year period. One of the risks of having in period adjustments for outcomes, revenues and costs is that revenues (and hence customer bills) would be less stable over time. It would be helpful to consider how in period adjustments are applied to minimise the risk of large swings in customer bills, which the evidence suggests that customers would not support. An example of this evidence is the research conducted by Uuw as part of the PR14 process. In the specific case of cost sharing, any in period mechanism for totex needs to avoid disincentivising changes to phasing of spend, which might otherwise be interpreted as efficiency/inefficiency which results in some in period sharing which may not be appropriate - this could inefficiently incentivise companies to meet annual spend assumptions, not necessarily to deliver efficient programmes
Indexation of future price controls (RPI versus CPI)	39 Do you agree with our proposal to move to CPI (subject to the UKSA's final recommendations)?	Agree We agree that, in the long term, Ofwat will need to move away from RPI as the main inflation basis for regulating the industry. We have contributed a paper to the "Marketplace for ideas" which examines some of the key issues which need to be resolved in order to ensure that the transition delivers the best possible outcome for customers (http://corporate.unitedutilities.com/documents/Water2020-Feb16-PriceControlIndexation.pdf).

Question		Comments		
Indexation of future price controls (RPI versus CPI)	40	Do you agree with our proposal to implement a CPI based approach, for both revenues (prices) and the RCV, subject to a transition process?	Disagree	<p>We agree that it is appropriate for Ofwat to start planning how to transition away from RPI. However we consider that to do so before the development of a fully functioning CPI-linked debt market is likely to be suboptimal for customers as it could increase financing costs. We have submitted a paper to the "Marketplace for ideas" which sets out these considerations in more detail (http://corporate.unitedutilities.com/documents/Water2020-Feb16-PriceControlIndexation.pdf).</p>
Indexation of future price controls (RPI versus CPI)	41	Do you agree with our proposal to transition to CPI over time, both in terms of the overall method and the specific proportions of the RCV we are suggesting would remain indexed by RPI?	Neither agree nor disagree- N/A	<p>Ofwat should recognise that any transition away from RPI will necessarily increase costs (to be recovered from customers) until an equivalently efficient CPI linked debt market has developed - Ofwat's impact assessment incorrectly assumed that the cost of CPI debt would be no higher than RPI debt</p> <p>Ofwat's transition mechanism should provide maximum mitigation against these additional costs, whilst still meeting its requirement to commence the transition. To this end, we have commissioned work from KPMG to help better inform the assessment of transition mechanisms, and how quickly it would be appropriate to implement CPI.</p> <p>We recognise that Ofwat is undertaking further work to establish the costs, benefits and risks of a transition. We believe it is very important that this is undertaken in a way which allows all stakeholders to have confidence in the process and provides an opportunity to reflect on this evidence and what it implies for the most appropriate method for transition.</p>
Indexation of future price controls (RPI versus CPI)	42	Do you agree with our commitment to ensuring that any such change is value and bill neutral in NPV terms over time in nominal terms? What steps could be taken to make this commitment as credible as possible?	Strongly Agree	<p>Ofwat has committed that "choice of indexation method should not impact on the total (nominal) level of returns earned by investors" (section 5.7.2 of main Water 2020 report). However, Ofwat should recognise that any transition away from RPI will necessarily increase costs (to be recovered from customers) until an equivalently efficient CPI linked debt market has developed. Therefore it is important that Ofwat recognises that it is not possible to implement a CPI based approach in a way that is NPV neutral for revenues whilst maintaining a commitment to the nominal level of returns to investors - bills will need to increase to recover the additional costs/risk. Ofwat's impact assessment incorrectly assumed that the cost of CPI debt would be no higher than RPI debt.</p> <p>It is essential that Ofwat recognises this and seeks to design a transition mechanism that provides greatest mitigation against these additional costs, whilst still meeting its requirement to commence the transition. To this end, we have commissioned work from KPMG to help better inform assessment of transition mechanisms.</p> <p>It is also important that Ofwat recognises that assurance will be required over totex assessments following a transition to CPI. Given the reduction in value of the index (CPI compared with RPI), it is essential that Ofwat do not inadvertently impose this change in a way that imposes an additional, unjustified, efficiency expectation on companies.</p>
Indexation of future price controls (RPI versus CPI)	43	Do you agree that we should calculate the RPI linked element of the RCV based on forecast RPI with a true up at the end of the period to protect companies from changes in the difference between RPI and CPI over the control period?	Strongly Agree	<p>We strongly support this approach, which is fundamental to delivering revenue and value neutrality. However, as set out in our paper on this subject in the "Marketplace for ideas" we believe the details of this approach must be fully exposed (http://corporate.unitedutilities.com/documents/Water2020-Feb16-PriceControlIndexation.pdf).</p>
Impact of the balance of risk and reward on the cost of capital	44	To what extent does the current balance of risk and opportunities vary across the proposed wholesale controls and how does this impact on the cost of capital?	Neither agree nor disagree-	<p>Whilst we broadly agree with the analysis set out in the PwC paper on the balance of risk, an area which needs further analysis is the impact of asymmetric ODIs on risk. Any detailed analysis of this issue is missing from the paper. Penalty-only ODIs or ODIs based on upper quartile performance would need an upward adjustment to returns if, on average, companies are to earn a return equal to the cost of capital. The effect of these ODIs means that network activities are riskier than the paper suggests, as a number of these are at least partly network-related - pollution incidents, sewer flooding, water supply interruptions and water quality contacts. This should be considered as part of the further discussion of the ODI framework during 2016.</p>

Question		Comments
Impact of the balance of risk and reward on the cost of capital	45 To what extent would our proposed market and incentive reforms impact on the balance of risk and opportunities and the cost of capital and whether this would vary across the proposed wholesale controls?	Agree We agree with the analysis in the PwC paper that, on the basis of the Ofwat proposals, there would be very little impact on the cost of capital for existing water resources, but that there would be some impact for sludge. The report notes the sludge impact could be mitigated by investor perception of potential upside, but this could be very limited until more evidence is available of these upside opportunities being realised. The cost of capital for new investment would depend on the approach to remuneration of new investment, which is discussed further in our separate paper on upstream pricing.
Customer engagement	46a What does good customer engagement look like?	Neither agree nor disagree- We have submitted a paper to the "Marketplace of ideas" which sets out our perspective on the best customer engagement framework for PR19 (http://corporate.unitedutilities.com/documents/Water2020-Feb16-CustomerEngagement.pdf). In summary, we consider that good customer engagement includes: - continuous engagement, rather than just involving customers at price reviews - making use of all interactions, rather than just willingness to pay surveys - establishing the value that customers place on aspects of service, rather than just priorities, so that costs and benefits can be assessed - involving customers in service delivery, particularly where they can contribute to more effective delivery - comparing approaches and results with other companies and other sectors - ensuring that the needs and priorities of all groups of customers are considered - providing clear information about service performance and comparative data - engaging customers on long-term issues
Customer engagement	46b What are your views on the principles outlined above?	Agree The principles set out above are broadly in line with those outlined in the consultation. However, we consider that there needs to be emphasis on establishing the value which customers place on the different aspects of service, which enables trade-offs to be made.
Customer engagement	46c How could companies draw on good practice from within and outside the sector?	Neither agree nor disagree- N/A We think that there should be earlier sharing of values from willingness to pay surveys, so that decisions on the use of results and on whether further research is needed can be made in the context of whether the results are outliers compared with other companies. At PR14 sharing was done informally among some companies at a late stage. The UKWIR project on post-PR14 customer engagement, communications and education highlights a number of innovative approaches which could be implemented more widely at PR19.
Customer engagement	46d How can companies make use of revealed preference techniques and information obtained in their day-to-day interactions with customers to develop a richer set of evidence of customers' needs and requirements?	Neither agree nor disagree- N/A We agree that revealed preference techniques and information from day-to-day interactions should be a part of the information used to understand customer priorities. There will also be a continuing use for willingness to pay surveys. Our approach to making use of the various approaches available is set out in our separate paper on customer research.
Customer engagement	47a What are your views in relation to our proposals on future CCG remit; scope; timetable; governance arrangements; and membership?	Strongly Agree We support the proposals for future CCG arrangements.
Customer engagement	47b In relation to the quality of a company's customer engagement, do you agree with the above list of issues that should be covered by the CCG report?	Strongly Agree We agree with the list of issues which should be covered in the CCG report.

Question			Comments
Customer engagement	47c	What are your views on the division of responsibilities between CCGs and Ofwat?	Agree We agree that clarification of roles was needed and that the division of responsibilities proposed is reasonable. We also agree that it would not be appropriate to task CCGs with the remit of representing customers or negotiating all or part of the regulatory settlement with companies. However, there could be some strengthening of the CCG role by, for example, a statement of intent that Ofwat would normally accept customer preferences if a CCG endorses a company's engagement process as reflecting its customers' views.
Customer engagement	48a	What are your views on our proposal to facilitate more collaboration between CCGs?	Agree We agree that there are potential benefits from more collaboration between CCGs and we support the proposals.
Customer engagement	48b	What are your views on our aspiration to publish information on the WACC and outcome RoRE ranges early?	Strongly Agree We support the proposals to publish information on the WACC and outcome RoRE ranges earlier in the process and believe this will enhance the quality of customer engagement.
Customer engagement	48c	Without inserting ourselves between companies and their customers, what else could we do to incentivise and encourage good quality customer engagement?	Neither agree nor disagree- N/A Effective engagement could be incentivised through an ODI or ODIs based on customer perception of companies, either as an extension of SIM or separate measures. A number of companies had performance measures of this sort, e.g. based on surveys of community perception, customer trust and keeping customers informed.
Outcomes	49	How can the outcomes framework encourage a longer-term approach? Should we encourage, or even mandate, that certain measures - for example asset health – span more than a single regulatory control period?	Disagree We recognise the advantages of commitments that span more than one regulatory period. Expenditure in one period may often not deliver its full benefits until a subsequent period, so incentives which only relate to performance in the current period may discourage investment with long-term benefits. However, there are difficulties in making commitments unless there is also a commitment to the future expenditure associated with delivering these commitments. We think it is appropriate to encourage long-term measures but do not consider that they should be mandated, at least until there has been some experience of how they can work in practice. There is also scope to encourage measures which are based on forward-looking indicators. For example, catchment management measures may take a long time to show an impact on water quality but it is possible to measure their impact within a five-year period through assessing the impact on farmer behaviour.
Customer engagement and outcomes in the face of change	50	What are your views on the proposed contents of our November 2016 consultation on outcomes (balance of bespoke versus comparative measures, and role of comparative information)?	Strongly Agree We welcome the further consultation on outcomes and support the proposed contents. The current UKWIR project in this area will contribute to the analysis of the issues in these areas. The issue of the impact of ODIs on the risk-reward balance, and the effect of setting comparative targets, will need to be considered as part of this consultation.
Customer engagement and outcomes in the face of change	51	What are your views on our proposal that companies submit the definitions – but not the targets or any associated incentives - for their performance commitments to us in early 2018 before they submit their business plans?	Agree We agree that there is a need for some common measures on key aspects of service, so that it is possible to enable overall industry performance to be measured and for comparisons of current performance to be made. Therefore it would be sensible to submit definitions early. There would, however, need to be some flexibility to make changes to proposed measures if justified by the outcome of customer and stakeholder engagement.

Question		Comments
Customer engagement and outcomes in the face of change	52	<p>What are your views on our proposal for a licence modification to allow for the in-period payment of outcome delivery rewards and penalties?</p> <p>Neither agree nor disagree- N/A</p> <p>We consider that the case for this is in balance. One of the benefits of inter-period adjustments is that overall impacts can be netted off in total and smoothed over a five year period. One of the risks of having in period adjustments for outcomes, revenues and costs is that revenues (and hence customer bills) would be less stable over time. It would be helpful to consider how in period adjustments are applied to minimise the risk of large swings in customer bills, which the evidence suggests that customers would not support. An example of this evidence is the research conducted by U UW as part of the PR14 process.</p>
Implementing our proposals: licensing and next steps	53	<p>Do you agree with our summary of potential licence changes and the process for achieving these outlined in section 9.1 above?</p> <p>Agree</p> <p>We agree with Ofwat's goal of ensuring licence amendments are undertaken in a collaborative way. We are committed to working constructively with Ofwat in this area.</p>
Implementing our proposals: licensing and next steps	54	<p>Do you agree with the next steps for establishing the necessary data for the 2019 price review outlined in section 9.2?</p> <p>Agree</p> <p>We agree with the need for an asset revaluation in advance of the next price control. Ofwat's proposal to separate sludge using a focused RCV basis places a particular emphasis on the need for appropriate and consistent bases of assessing an MEAV for sludge - for example whether all companies value assets on the same basis (e.g. including or excluding mothballed assets). Any inconsistencies could undermine the development of the market.</p> <p>We also propose that Ofwat should (a) consult on information requirements for PR19, and (b) set out more clearly the timetable for publishing information and assurance requirements to help companies to better plan for substantial exercises such as asset valuations.</p>
Implementing our proposals: licensing and next steps	55	<p>Do you agree with our indicative timetable for the Water 2020 programme?</p> <p>Neither agree nor disagree-</p> <p>The indicative timetable does not include information on the timing of a number of key price review publications, in particular:</p> <ul style="list-style-type: none"> - Publication of cost assessment models for wholesale totex and household retail cost to serve - Publication of business plan reporting requirements <p>As noted above, we consider that there needs to be more integration with the WRMP timetable.</p> <p>We also note that it would be beneficial for Ofwat to timetable engagement with companies prior to publication of RBRs, to ensure that company business [plans have been fully understood and appropriately assessed within the RBR.</p> <p>Finally, as previously raised during PR14, Ofwat could create more time towards the end of the process by publishing determinations earlier.</p>
Impact Assessment	IA1	<p>Do you agree with the benefit and cost impact categories we have identified?</p> <p>Agree</p> <p>We agree that Ofwat has identified the most relevant categories.</p>
Impact Assessment	IA2	<p>Are there any impact categories you think we have not included that are relevant, or any we have included that should be omitted?</p> <p>Agree</p> <p>We do not propose to add or remove any other categories.</p>

		Question		Comments
Impact Assessment	IA3	What are your views on the indicative scale of the impacts we have identified?	Disagree	<p>The scale of impacts are (necessarily) qualitative and relative - it is not clear what size of benefit is implied by "very high". However, it is possible to comment on relativities between scale ratings.</p> <p>We are surprised to see water resources having a higher scale rating than sludge - although individual trades may be of higher value for water resources, we consider the potential for trading to be greater for sludge. Therefore we wouldn't consider the potential for one area to be any greater than the other.</p> <p>We strongly disagree with Ofwat's proposed assessment for the change in indexation. Work we have undertaken with KMPG and work undertaken by Nera for Water UK indicate the likelihood of additional cost and risk being incurred by the industry (which will inevitably be passed to customers) to meet Ofwat's desire to improve the legitimacy of how price controls are indexed. These additional cost are exacerbated by the rapid rate of transition that has been proposed by Ofwat. The current consensus of evidence would suggest that the impact of this proposal would be negative, and not insignificant in scale.</p>
Impact Assessment	IA4	Are you able to provide any evidence on any of the impacts in relation to our proposals?	Disagree	<p>Regarding the assessment of the change in indexation, Ofwat makes three points in its detailed assessment. We have reviewed these and provided comments below. The evidence supporting our responses to 1 and 3 (below) is provided in our report commissioned from KPMG. The evidence supporting our response to point 2 is provided in Nera's report for Water UK and in other reports such as Moody's recent report on "Redefining real".</p> <p>1. "CPI indexation should better reflect water companies' costs" Any such benefit will be offset by increased beta estimates in the WACC, as CPI better correlates to the market as a whole, so beta estimates should be higher.</p> <p>2. "More robust measure of inflation, increasing customer legitimacy" Alongside an assessment of customer legitimacy there should also be an assessment of investor legitimacy (or maintaining investor confidence.) We are not aware of any customers or customer groups specifically lobbying to move away from RPI – however, many investors are clearly voicing concerns, which appear not to be recognised in Ofwat's impact assessment.</p> <p>3. "There is no evidence that CPI linked debt should be more expensive than RPI linked debt" Conversely, there is no evidence to support an assertion that the costs of each are equal. The absence of experience of a market cannot, in this case, provide positive support for a conclusion. Commentators suggest to us that the absence of a basis of pricing (ie: a yield curve for a liquid market) would tend to suggest that costs will, if anything, be higher.</p>