

21 November 2012

Regina Finn
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Ofwat
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Dear Regina,

Section 13 proposal to modify licences

I am writing in response to the Ofwat section 13 proposal to modify the licences of water companies that was published on 26 October 2012. My colleague Adrian Page has discussed the proposals with Keith Mason and we welcome the changes that have been made to the original consultation including the inclusion of RPI within the licence and the protection surrounding RCV at March 2015. We also welcome the confirmation that you have made in respect to the safeguards that remain in place, in particular:

- the requirement under the Water Industry Act for Ofwat to enable an efficient company to finance the functions of the whole business, and
- the allocation of all the existing RCV to wholesale and for the price controls for wholesale continuing to be index linked by RPI

We reiterate that the allocation of the cost of historic and future metering to the wholesale function is also important to us.

Given the changes made to the original consultation, Cambridge Water accepts your proposal to amend the Company's licence. There are, however, a number of areas where we feel that greater clarity could be provided either in the licence or in statements from Ofwat. These are consistent with the meeting between Adrian Page and Keith Mason on 14 November and are as follows:

- 1) The clarity around the areas that may be transferred out of the price control for wholesale could be made clearer than being specified as 20% and 40% of wholesale revenues. We welcome, and would prefer, the suggestion made by Jonson Cox that this could be specified as being retail activities and resources, plus sludge for the water and sewerage companies, rather than as a percentage.
- 2) For asset intensive areas that are moved outside of the wholesale price control for future price controls, there will be a need to remunerate the asset base of these activities with an appropriate return on this invested capital. We

would hope that this can be set out more clearly in order for us to understand how the existing RCV will be protected in this circumstance as well as how remuneration on these asset intensive areas will be protected from rising prices.

- 3) Our understanding is that any transfers between price controls in the middle of a price control period will be small in nature compared to the maximum allowed in the licence and will be in order to refine the existing price controls. In these circumstances, there will be consultation, but it will not be possible to appeal to the Competition Commission in respect to the transfer. However, there will be a true up of revenue at the next price review, which will be appealable. It would be useful if you could confirm that our understanding is correct and to clarify this in the licence or in other documents that Ofwat will produce.
- 4) The document explaining the licence changes is quite clear that there will be consultation on any future changes to the wholesale control. However, the licence (for instance in sections 8.10 and 14A3) does not include this commitment to consult on changes. We would welcome this being included in the licence.

Given the Water White Paper published by Defra which sets out the Government's policy priorities for the water and sewage sector, it is clear that there will need to be modest and evolutionary change. However, we also want to reiterate our view that the pace of change introducing new competition mechanisms into the water industry should be gradual with a sufficient amount of time for all stakeholders including customers, companies, debt and equity investors to consider further proposals for change. In this way, we believe, the risk of regulatory uncertainty can be avoided and the introduction of competition can occur without unintended adverse impacts.

We remain concerned as to whether the good intentioned proposal in the Government White Paper of introducing competition in water retail will lead to lower costs and better service. There may be administrative benefits for a small number of large multisite customers, but for the majority of domestic and small non-domestic customers there is a risk of customer confusion on delivery of service and escalation of costs as retailers add their margin into the overall cost of delivering water.

These positions are supported by our shareholder, Alinda Infrastructure Fund I.

We trust that the above points are clear and helpful as you consider the responses that you receive. If you would like to discuss any of the above then please do not hesitate to contact me.

Yours sincerely,



Stephen Kay
Managing Director

CC: Keith Mason
CC: Alex Black