



Our Ref. NCH/YMO

Regina Finn
Chief Executive
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

VIA EMAIL

23 November 2012

Dear Regina

SECTION 13 PROPOSALS TO MODIFY COMPANY LICENCES

On 26 October 2012, you sent us notice of revised proposals to modify Conditions B and C of our appointment licence. You requested our consent to these modifications in accordance with Section 13 of the Water Industry Act 1991.

After careful consideration, the Board of Dee Valley Water has decided to consent to the modifications proposed in your Section 13 notice.

Although we have serious misgivings about the effect of the modifications as drafted, we cannot withhold our consent; this is because of the risk to Dee Valley Water of a reference to the Competition Commission. We are unable to justify the investment in external advice and management time that would be required for a referral on this particular issue.

Keith Mason addressed our Board on 20 November, and Jonson Cox has met both our Chairman, Graham Scott, and our senior non-executive director, David Weir, in the last two weeks. We are grateful for these opportunities to discuss our issues and concerns and Ofwat's latest thinking. From these meetings, we understand that even at this late stage you are still prepared to consider constructive comments on how to proceed so that all parties can meet their objectives. We trust that the comments that follow will be read in that spirit.

Despite the existing safeguards you have highlighted and the limits on flexibility that you have introduced into the proposed modifications since the December 2011 proposals, we still consider that there is too much uncertainty about returns for investors in the future. We have consulted our major investors, both equity and debt, within the last few weeks and this is the clear message they are giving us. Whilst they acknowledge that meetings have been held with Ofwat on this issue, they consider that their views have not been heard and have not been given proper consideration.

The modifications are intended to prepare the sector for future challenges such as climate change, population growth etc. We do not consider that the case has yet been made satisfactorily that the sorts of structural changes within the industry enabled by the licence modifications will be any better at addressing these challenges. On the contrary, we have a real concern that they could divert attention away from achieving strategic objectives and could also inhibit long-term planning generally, which is vital for the future security of water supply. More justification and evidence that the risks have been considered would be helpful.

We also have concerns about the potential for an adverse impact of competition on customers generally in terms of higher prices, and possibly even service and water quality due to increased interface risks. We feel that these issues are not being recognised sufficiently.

If we had been in a position to withhold our consent to the licence modifications as proposed, we would have recommended instead the adoption of the alternative version of Condition B proposed by the industry to ensure that PR14 can proceed whilst further modifications could be examined more widely and in more detail. In the circumstances, we remain willing to co-operate with you in any further discussions about changes to company licences which allow prudent evolution of regulation in the water industry in line with the governments' policies, both Welsh and Westminster, and a successful PR14 process.

I would be pleased to clarify any of the points raised in this response.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'N Holladay', written in a cursive style.

Norman Holladay
Managing Director