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Dear Regina,

Thank you for your letter of 26 October 2012 in which you proposed changes to our licence under Section 13 of the Water Industry Act 1991.

Severn Trent Water continues to be supportive of the principles of reform of the water industry. The current approach to regulating the industry through the RCV and linkage to RPI has served customers and investors well.

Whilst Severn Trent Water is minded to accept Ofwat's proposed change to our licence, we believe it would be better if the current proposals were modified.

Ofwat's information note published earlier this week contained much useful clarification for the industry. It also contained an invitation to make constructive suggestions about how to overcome any remaining difficulties whilst maintaining the fundamentals of the reform agenda.

We believe that there are two key issues that are preventing acceptance of sector reform proposals being agreed with the wider industry: the prospect of losing 40 per cent of revenue from wholesale controls; and the lack of clarity about how future prices would be controlled.

We believe these concerns could be overcome, whilst maintaining the integrity of the reforms being sought, in the following way:

- The new licence could (a) limit regulatory flexibility to removing only retail operations, sewage sludge processing and water resources management from wholesale controls, (b) limit the maximum transfer of revenue out of the wholesale controls to 20 per cent, as opposed to the 40 per cent currently proposed.
- The new licence retaining a formula controlling future annual price increases each year – for example, through a weighted average approach.

We believe that these changes would still give Ofwat the flexibility required to drive the significant reform of the industry that we are supportive of. Critically, they may also allow companies in the industry to reach an accommodation with Ofwat that will be so vital for maintaining investor confidence and the protection of customer interests.

Yours sincerely,

Tony Wray  
CEO Severn Trent