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Finance and Networks Division
Ofwat
Centre City Tower,
7 Hill Street
Birmingham B5 4AU

By email: Stephen.stpier@ofwat.gsi.gov.uk

23rd May 2013

Dear Stephen

Setting Price Controls for 2015-20 – Business Planning Expectations Consultation

Thank you for the opportunity to respond to the latest consultation in relation to the business planning for the 2014 price review.

We are supportive of Ofwat's proposals for risk-based assessment of business plans and consider that the tests identified for assessment of plans are appropriate.

We believe further thinking is required around the process to be followed where different elements of business plans are graded differently, to ensure that the process remains effective and proportionate to the relative impacts of different sections of plans. It may be more appropriate to assess plans in the round, rather than making the judgement against the lowest scoring part of the plan. This would increase the incentive on companies to aim for an enhanced category overall, rather than just trying to avoid resubmission. The process should also take account of the relative size and impact of the wholesale plan in comparison to the retail plans and weight the assessment mechanism accordingly.

In general the proposed data tables appear to capture the information that Ofwat will require for making price determinations, however we would ask that line definitions for these tables are provided as early as possible to enable companies to begin work on them. The proposals for scenario testing should be reviewed as these appear to place a significant extra burden on companies to provide information. Ofwat should consider whether the

Bristol Water plc

Registered Office: PO Box 218, Bridgwater Road, Bristol BS99 7AU

Tel: (0117) 9665881 Fax: (0117) 9634576

Registered in England No. 2662226

www.bristolwater.co.uk



proposed scenarios are all sufficiently independent of each other to provide additional analysis, and indeed whether the variables are appropriate.

We note that the wholesale cost recovery table requires the “pay as you go” ratio to be provided on a five-year basis. We believe it would be more appropriate if this ratio could be provided by year, to take account of the variations in companies’ investment programmes over the period.

The consultation questions do not address the timetable, but given the continuing importance of this issue and the discussions at the workshop on May 7th we provide some views here.

Whilst we believe the decision to bring the submission date forward to December 2nd is manageable, it reduces the time available to companies to incorporate the outcomes of this consultation and that on the methodology into their engagement process. However, timely delivery of the methodology and reporting requirements is absolutely vital to enable delivery by this date.

We note the suggestions and discussion at the May 7th workshop regarding an extension of the Final Determination date to potentially the end of January 2015. Having already expressed our concerns regarding the delay from November to December, a further delay to January is only possible if prices for 2015/16 were not based on the final determination. This is because unmeasured bills need to be issued in mid-February. A January Determination will not allow sufficient time to prepare and test prices ahead of this billing deadline.

An additional consideration is that the tariffs process for 2015/16 will be new with separate wholesale and retail price controls. The new charges approval process places the requirement on Boards to confirm that tariffs comply with Ofwat’s principles and guidance. It is not feasible to assume that such a review and assurance could take place in the time allowed, meaning Boards would be unable to give the assurance Ofwat seeks.

We believe the overall process for PR14 would work much more effectively if Ofwat were to commit to specific dates for deliverables rather than using terms such as “early summer”. Governance processes with Boards and CCGs need to have time set aside well in advance. A flexible timetable makes this difficult and could impact negatively on overall assurance. In addition, we would expect that setting specific deadlines would help Ofwat with its own delivery process.

Companies' proposals around water resources management have already been published through draft Water Resources Management Plans, which will be updated in early 2014. Ofwat should consider how it will incorporate these into its assessment of wholesale plans when considering longer-term objectives.

We hope that Ofwat finds these suggestions helpful. We provide more details on our views in response to the specific questions set out below.

Yours sincerely,

Mike King
Regulatory Director
Bristol Water plc

Answers to Specific Questions

Q1 Do you agree with our definition of a high-quality business plan? Is anything missing? Is there anything you think we should change?

We agree that the proposed definition of high-quality business plans is appropriate.

Q2 Do you agree that our preferred package of reputational, procedural and financial incentives will incentivise high-quality business plans? If not, what do you think we should add to the package, or change?

The consultation proposes that submissions should be assessed according to the lowest grading of an element of a company's plan. This may serve to inhibit the extent to which companies can achieve enhanced assessment. We consider it would be preferable if the assessment was made at an overall plan level, taking into account differences in materiality and impact of various aspects of plans. This would also remove some constraints from companies in respect of the evidence they supply in support of some areas of their plans.

There is an important dynamic between the approach used to assess companies and the amount of data they will feel the need to provide. If companies feel they have "one shot" there is a danger they will get the balance wrong in terms of the level of detail provided. This could make Ofwat's task of assessing plans very difficult. To facilitate a risk-based review it might be preferable to have a process that allows Ofwat to accept that their original judgement was incomplete and allow re-assessment during the process.

We note that the consultation does not currently propose for companies to move upwards between categories during the process. We feel that it ought to be possible for companies in particular to move from resubmission to standard through the provision of additional evidence or explanation that was not provided in the original business plan. It may also be the case that engagement with standard companies could move them to a position where an enhanced process could be followed if points of disagreement were resolved early. It is in the interest of companies and Ofwat to move upwards to enhanced and standard processes where possible and the framework should allow for this.

The importance of the financial incentives are not clear at this stage as we do not have visibility of how the menus will operate, but we agree that the option of enhanced menu choice and higher revenue adjustment would be appropriate.

Q3 Which of the options (elements earn procedural and financial rewards; two-category approach; two-process approach for retail; later decisions on resubmissions) do you think we should use, if any? Why?

Elements earn procedural and financial rewards:

We support the proposal that certain elements could earn procedural and financial rewards, as this would mean that the progress of the whole plan need not be held back by a lower assessment of one or some elements.

Two-category approach

The process needs to incorporate some allowance for plans which Ofwat judges not to be of the required quality and so it would be better to retain this rather than use the two-category approach. However, Ofwat could in practice use the two-category approach if all plans were judged to have met the requirements of the standard process.

Two-process approach for retail

How plans are assigned between retail, wholesale and company level proposals may vary between companies, and will be determined to some extent by company judgements. Therefore it is preferable that plans are considered as a whole, rather than fast-tracking some retail elements. We agree that retail investment proposals are likely to be less complex, so they should not cause undue delays to the process where wholesale proposals are acceptable.

Later decisions on resubmissions

The process would benefit from initial stage where Ofwat could request additional supporting evidence and/or justifications from companies. If this could be provided quickly then companies could avoid being assessed as resubmission. This would require early initial assessments from Ofwat and quick responses from companies, but would be preferable to companies being un-necessarily put into the resubmission category for the whole process.

Q4 Do you think that our proposals will be effective in meeting our objective of handing back ownership of the business plans to company Boards?

Bristol Water has always had strong ownership of its plans by our Boards, and we do not consider this will change for us. However, the proposals allow companies and their Boards greater freedom to express business plans as they choose, which we welcome.

Q5 Do you agree with the four high-level groups of tests (outcomes, costs, risk and reward, affordability and financeability) are the right ones? If not, what do you think we should

add or remove?

We agree that the four proposed tests appear appropriate. For companies, we believe that the greatest area of concern will be the test on risk and reward. This is a relatively new area which has not been subject to significant discussion during the Future Price Limits project, so we have a relatively short time to make sure this test is suitably addressed in our plan. However, we consider that through our customer engagement and Local Engagement Forum¹ processes we have the ability to develop appropriate proposals in this area.

Q6 Do you think we have set out the right tests in each group? If not, what do you think we should add or remove?

Outcomes

The CCG process has been key to our development of our Outcome proposals and we welcome the importance that is placed on their report in the assessment of our Outcomes. It is important that Ofwat can have confidence in the report provided, and we would encourage Ofwat to engage with CCGs to understand the role they are playing in review and challenge of companies' plans.

The performance commitments assessment is appropriate to the process – this is an area where Ofwat needs to be prescriptive in its requirements to ensure a suitable level of comparability across companies can be achieved.

We welcome the freedom afforded to companies in designing incentive frameworks. Clearly the balance of risk between companies and customers may be a difficult judgement but we consider it is a balance that can be achieved.

Costs

We broadly agree with the costs tests as described in the consultation, but consider that much more detail needs to be provided to companies regarding how these tests will be made in order for companies to provide the required evidence in their plans. In particular, an overview of the approach to be used is important to enable atypical costs to be identified in plans.

Risk and Rewards

¹ The Bristol Water Local Engagement Forum is our version of a Customer Challenge Group

We welcome Ofwat's new focus in this area and we look forward to seeing it develop as the methodology is finalised.

Affordability and Financeability

We agree that affordability should be considered both in the 2015-20 period and in the longer term. It is appropriate to look at the bill impacts on the majority of customers and the measures that companies put in place for those customers with affordability problems.

Q7 Do you think our proposals for business plan assurance will be effective in meeting our objective of handing back ownership of business plans to company Boards?

We consider that these proposals transfer the ownership of the assurance process from Ofwat to Boards, rather than ownership of business plans. Our opinion is that the assurance provided by the Reporters provided an important check on companies' proposals and the confidence that Boards could place on business plans.

Q8 Our objective in specifying the data tables (and the August submission) is to ask for all of the information we need, but no more than we need. Do you think that we have achieved this? Is there any information that you think we might not need? Is there any information that you think we will need but we have not included in the data tables?

We believe that the data requested in the August data submission is appropriate.

We would make the point that we are able to provide the information required for 2011-12 because we made the internal decision to continue to collect this data that used to form part of the June Return. Had we not done so then it would have been significantly more onerous. We believe it would be appropriate if Ofwat continues to collect the data requested in the August submission on an annual basis to ensure that all the data it requires is available for future price reviews.

Q9 We aim to collect data on a consistent basis from all companies. Are the data tables clear and well specified? Are there any areas where we need to look again at the way we have asked for the data to remove any ambiguities in the request?

August Data Submission

We have no concerns regarding the proposed data to be submitted in August, but would

request that Ofwat needs to provide as soon as possible the date by which this submission is required and the outstanding line definitions.

Appointee-level Data Tables

We have some specific comments on some of these tables as follows:

Table A3:

- Line 3: Require confirmation that this ratio on total capital related deductions includes allowable depreciation
- Line 3: Require confirmation that this ratio on total capital related deductions excludes opex IRE
- Line 4: Suggest that this is a calculated cell (A10 row 4/A14 row 11)
- Other: In A3 section D and E May be useful to have the add back line for depreciation on the A3 schedule (linked to A10 row 4)

Table A4: We do not believe that it is necessary for this table to be included in the business plan; this data should be collected after the conclusion of the PR14 process. If it is to be required then further definitions and guidance are required regarding the requirements for this table.

Table A5: analysis of pensions accounting charge over the various headings will be an estimate, as this information is not analysed over the headings retail household, retail non-household and wholesale. The analysis of the cash contributions over these headings will be in proportion to the contributions, as there is no other suitable basis.

Table A12: the measured income accrual, line 6, is probably required to be analysed between Household and Non-Household, not in total as asked for here.

Scenario tables

There is a considerable degree of overlap between the proposed scenarios. For example input costs and industrial demand scenarios are driven to a significant degree by the economic position. We believe there may be scope for some rationalisation in these tables.

If in its scenarios Ofwat is using rainfall totals as a proxy for climate change, we would suggest that this would be better represented by a scenario that compared the impacts of changes in deployable output.

Wholesale Data Tables

Table W7: This table appears to require provision of information on all abstractions. We believe that the table should only require information on band 3 “at-risk” abstractions.

Table W10: We note that the PAYG ratio is only required on a five-year basis. We believe it would be more appropriate if this ratio could be provided by year, to take account of the variations in companies’ investment programmes over the period.

Retail Data Tables

No comments.

Q10 Do you agree with our proposal to continue to set price limits for new appointees using a relative price control? If not, what alternative do you prefer?

No comment

Q11 Do you agree that we should set Cholderton & District Water its own simplified price control?

No comment

Q12 Do you think that we should develop a new small company service incentive? If so, what form do you think this incentive should take?

No comment

Q13 Do you agree with our proposal that small water companies should not be subject to separate wholesale and retail price limits?

Whilst these companies remain small then the separation of wholesale and retail price limits would appear disproportionate, although not doing so would create a discrepancy for customers in those areas. It may be counter to future developments in market opening if some customers were not able to choose retail supplier because of the size of their wholesale supplier. It would be preferable if Ofwat could find a solution which provided for separate wholesale and retail price limits for these small companies, whilst maintaining proportionality in the associated regulatory burden. Where small companies are supplying non-household customers then a separate price control is required, as if this is not in place then a future competitive market may be distorted.

Q14 New appointees are growing in size. In the future do you think that we might need to adopt a different approach to regulating their prices and service? If so, what circumstances should prompt a change of approach?

As new appointees continue to grow in terms of numbers of appointments and customers served, the regulatory model that is applied to them should more closely resemble that applied to the current incumbent companies, to the extent that those models are the same once a new appointee reaches the size of the smallest Water Only Companies.