

# **SETTING PRICE CONTROLS FOR 2015-20 – BUSINESS PLANNING EXPECTATIONS**

## **RESPONSE FROM DEE VALLEY WATER**

### **1. INTRODUCTION**

We welcome the opportunity to respond to Ofwat's consultation on the business planning expectations for the next periodic review.

On a general point regarding business planning expectations we suggest that Ofwat should continue to engage with companies throughout the process, particularly after the business plan submission. We are concerned that Ofwat could assign a business plan to the resubmission category and therefore penalise a company for what could be a genuine misunderstanding rather than a deliberate attempt to "bid" the process.

For the previous price review we felt that our individual company meetings with Ofwat were vital for us to explain the company specific characteristics. For example, it is clear that due to the relatively small size of Dee Valley Water we do not always fit neatly in to models that Ofwat uses, such as the econometric models. We would therefore suggest that if we are shown to be an outlier it may be as a consequence of inappropriate use of models rather than an efficiency and we would welcome the opportunity to explain this through further dialogue and engagement.

In line with our responses to previous consultations, we fully support the principle that companies should take ownership of their plans and be responsible for delivering the outcomes that customers value. However, given the uncertainty and lack of detail surrounding how business plans will be assessed and how prices will be determined for customers it is not clear whether this principle will truly be met.

It is worth noting that based on the feedback that we have already received during our customer engagement activities we have a good understanding of our customers wants and how we can deliver these for them. What does not feel to be entirely within our control, and hence preventing us from taking full ownership of the plan, is the ability to set prices to enable us to provide the investment required to deliver the outcomes that customers support. Until we arrive at this point we will not have confidence that we do have full ownership of our plan.

We have responded to the majority of the questions in the consultation document and our responses are provided below.

## 2. DVW RESPONSES TO CONSULTATION QUESTIONS

### **An incentives-based price review process**

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

Defining high level criteria which precisely set out what a high-quality business plan should contain is complex and difficult. We generally agree with Ofwat's definition of high-quality but would add that there should be some measure of good customer engagement added to the overall definition. Without this extra dimension how will it be possible to demonstrate that the plan is delivering what customers value and want?

Affordability should consider absolute prices rather than simply the change proposed at this periodic review. Just considering any proposed increase would be short-sighted by ignoring companies' contributions to affordability by previously having kept bills low.

#### **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 use, if any? Why?**

In our view, we are surprised it is thought that high-quality business plans need to be incentivised. The importance of the Determination to a water company is so great that it should be incentive enough for individuals and companies to deliver high-quality business plans. We are naturally inclined to deliver what we consider to be a high quality business plan so that we can minimise the distraction and the regulatory burden and apply our focus to delivering outcomes that customers actually want delivered.

We would be disappointed if Ofwat considered that all companies "game" or "bid". Our aim is solely to be allowed the level of investment that we believe we need to ensure that the service to customers is not put at risk.

Any assessment method Ofwat adopts should be able to identify the necessary requirements. Whether the new proposals will do this any more effectively than refinements of previous methods (eg econometric models and AMA/CIS) is not clear without more detail. It is particularly important that the new method makes due allowance for company-specific issues. For example because of our small size, we may submit a business plan at a greater level of resolution than other companies and would hope not to be disadvantaged by generic or high-level assessment approaches.

**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?**

Our view is that a two-category approach is appropriate for this periodic review. Whilst, academically, it may be useful to have three categories to incentivise the submission of high-quality plans, we believe that Ofwat should adopt a mature approach to assessing business plans and have open dialogue with companies throughout the process and have a policy of full engagement especially when there are significant differences between Ofwat and companies. For example, if there are omissions or errors in a business plan it would seem reasonable for Ofwat to work with a company to obtain clarity or more information which should result in the best outcome for all stakeholders. Long and protracted disputes between Ofwat and companies due to poor understanding of the issues or poor communication between the parties should be avoided at all costs.

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

The proposals set out in the consultation will go some way to handing back ownership of business plans to company Boards but Ofwat will also need to clarify or reduce the economic complexity of some of the proposed measures in order for this objective to be fully achieved and address the point we made in Section 1.

#### **The risk-based review in detail**

**Q5 – Do you agree that 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?**

The risk-based review using just four high-level groups is a significant move away from the detailed assessment criteria used for the previous periodic review of prices and is supported in principle. The details will be important to its success.

**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 tests proposed for the outcomes element refer to being consistent with Ofwat's methodology including in relation to leakage. We understand that Ofwat will be consulting on water efficiency and leakage and look forward to receiving this document in due course.

## **Retail costs**

The consultation does not make reference to the handling of retail capex. For Dee Valley Water, a new billing system is envisaged in AMP6 and the cost will be borne by the retail business. It is therefore essential for Ofwat to clarify how capex costs will be dealt with in the retail business.

## **Non-household SIM**

We are aware that Ofwat is considering including non-household SIM scores for companies in Wales in the overall SIM ranking. We have made it clear that we do not generate enough non-household contacts to ensure the sample size will be statistically robust. We are concerned that we will be disadvantaged by having to undertake additional surveys to gauge customer satisfaction and would welcome clarity on this point.

**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?**

See response to Q4.

## **Delivering focused information requirements**

**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?**

**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?**

The data tables appear to be a comprehensive list of information that Ofwat may require to set prices. However, without knowing how the information is going to be used to set prices (i.e. in the absence of a financial model) and without precise line definitions it is difficult to confidently state whether the data tables are complete.

**Dee Valley Water  
19 May 2015**