

7 November 2013

Mr Andrew Chesworth
Ofwat
Centre City Tower
7 Hill St
BIRMINGHAM
B6 4UA

Dear Andrew

Thank you for the opportunity to comment on your informal consultation on a possible notice to determine Thames Water's price limits for 2014-15.

As you will appreciate Affinity Water is not in a position to comment on the specifics related to Thames Water's business. However, your consultation raises a number of general points of principle on which we would like to contribute. In doing so, Affinity Water welcomes the fact that Ofwat is committed to the principles of best regulatory practice. For the reasons set out below we do not believe Ofwat has made the case that reopening Thames Water's price limits would be consistent with these principles.

Q1. Do you agree that the basis of RPI in the current control period may have resulted in significant revenue gains not anticipated when the price limits were set?

We encourage Ofwat to consider the impact on investor confidence of appearing to undermine the stability and predictability of the link between RCV and the RPI index. The importance of this link is something that Ofwat itself has recently concluded for its PR14 final methodology. It is important to note that there is not a 'one way' bias to changes in the RPI index. Changes are a matter for the ONS, an independent statutory body, and methodological changes can result in positive as well as negative impacts on the index. We also note that companies' licences give Ofwat the ability to propose a change to the index used if there is a material change in the index, but your consultation acknowledges that the change in question is not material in this context. We therefore struggle to see how re-opening the Thames Water price control can be seen as consistent with the principles of best regulatory practice in that it would neither be proportionate nor targeted.

Q2. Do you agree that the impact of sustained monetary interventions on the market costs of finance may have had significant favourable effects on the market costs of finance for an efficiently financed company, relevant to a review of Thames Water's price limits for 2014-15?

We caution Ofwat against being seen effectively to reopen the weighted average cost of capital during a price review period. This would not be in step with the principles of regulatory best practice and risks sending contradictory messages to the investor community compared to Ofwat's PR14 final methodology. We note that Ofwat has not accepted a move to debt indexation in setting the cost of capital, preferring to set a fixed cost of debt. This approach creates an incentive effect for companies to outperform the fixed cost of debt settlement. If Ofwat sends the message that there is now a penalty for seeking efficient financing, this would run counter to the principles of best regulatory practice. Ofwat will also be aware that the ability of individual companies to take advantage of lower finance costs depends on a number of factors such as their capital requirements, terms of embedded fixed debt, etc.

Please do not hesitate to contact me if you would like to discuss any points we have made.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Richard Moriarty".

Richard Moriarty
Director of Regulation