

## **DEE VALLEY WATER'S RESPONSE TO THE CONSULTATION ON THE REVENUE FORECASTING INCENTIVE MECHANISM FOR AMP6**

Thank you for the opportunity to respond to the consultation on the revenue forecasting incentive mechanism for AMP6. Whilst we would generally agree that a revenue forecasting incentive mechanism as set out in the consultation document, is an improvement on the existing Revenue Correction Mechanism (RCM), in that it limits inter-generational funding and protects customer from large changes in bills, we have concerns with the way it is being implemented and the additional regulatory burden. We have not responded to the individual questions set out in the consultation document but have discussed our concerns below.

As you know Dee Valley Water is now the smallest water only company with the lowest revenue. Our revenue is weighted heavily by our non-household customers compared to other water companies, with non-household customers providing 28% of our revenue, compared to 18% for the rest of the industry. If, as happened during the last recession, one of our larger users was to close then the impact on our revenue compared to the forecast would be significant and could likely result in the penalty rate being applied. However, for a larger water company the percentage impact due to the closure of one large customer would be less and it is unlikely that the penalty rate would apply. Ofwat needs to address this concern by taking account of company revenue, customer base and revenue from non-household customers in its assessment of the revenue adjustment. Otherwise it would seem that DVW could be unfairly penalised by virtue of its small size.

We have noted that Ofwat will not apply the penalty in a mechanistic way and will rely on companies to explain any variances. Whilst this would seem simple in theory, explaining the variance in practice in a way that would convince Ofwat is a concern. In view of this, Ofwat should set out in detail at the outset the information required to pass its penalty relaxation test. The data requirements should not be too onerous, e.g. merely demonstrating that a customer has closed should be sufficient

In terms of the forecast revenues included in the Business Plans it may benefit Ofwat to dwell on the fact that whilst the forecast revenues are consistent with the forecast consumptions from the Water Resources Management Plans (WRMP), the WRMP consumption forecasts were derived for a different purpose, i.e. to ensure availability and security of water supplies and not accuracy of revenue forecasts. It is likely therefore that the demand forecasts are conservative in order to test available headroom. Furthermore, if an adjustment had been allowed in the methodology for the Price Review 2014 to adjust revenues to take account of newer data and not used the WRMP forecasts, companies may have altered their forecasts to reduce the risk of incurring a penalty.

**Dee Valley Water**

**3 June 2014**