



**Revenue forecasting incentive mechanism for AMP6
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Portsmouth Water response to the consultation on Revenue Forecasting incentive mechanism for AMP6

Thank you for the opportunity to review and comment upon your consultation on the Revenue forecasting incentive mechanism for AMP6. We give our consent that this response is made publically available via your website.

Q1 Do you agree with the need for a revenue forecasting incentive in AMP6?

We believe that the need to introduce an incentive, or more appropriately a penalty, to improve revenue forecasting is disappointing. We believe at Portsmouth Water we aim to do the right thing for our customers and should not need such a mechanism to ensure this occurs.

That said we are a Company which has experienced a significant variation between expected and actual revenue in this current review period, AMP5. This has arisen primarily because of the difference in timings in submission and compliance with guidance between the Water Resources Management Plan and the Final Business Plan. During the time between these two submissions we saw a reduction in new connections as the macroeconomic downturn impacted in our area and the guidance for the Business Plan at PR09 required consistency with the WRMP.

Q2 Do you have any comments on our proposed approach to the wholesale revenue forecasting incentive mechanism (WRFIM)?

We concur with views expressed in the consultation that to adjust price limits in subsequent AMP periods is not desirable or informative for customers. If price signals are to be used to inform customers then the closer the change is to the event the better.

The best solution would be that prices are used to signal a change in advance which in turn allows customers to make more informed decisions and choices in the period

in question. That opportunity is not realistic at this time and thus the process proposed in the paper of effectively a two year lag appears pragmatic.

Q3 Do you agree with a revenue flexibility threshold of +2%/-2% of adjusted allowed revenue for the wholesale water and wastewater controls? Please provide supporting evidence and analysis should you wish to propose a different level of flexibility.

The analysis presented in Figure 1 is very helpful in demonstrating the variation between plans and actual performance in AMP5.

Whilst we have already highlighted the impact of the significant variance between expected and actual housing growth, the proposal to require a forecast one year in advance should significantly enhance our forecast accuracy given our confidence in the starting position. Indeed taking this one issue, we note that for large housing developments we would know the profile of new build over the project with a large degree of certainty.

Further we note the 2% threshold is the same as most other regulatory sectors.

Q4 Do you agree with a penalty rate of 3%? Please provide supporting evidence and analysis should you wish to propose a different penalty rate.

Again the analysis presented in Figure 3 demonstrates the impact of the 3% penalty when applied to the 2% threshold. We note you have examined the trade-offs between penalties and thresholds and you conclude that the proposal given the impact on the Regulatory Return on Equity is “modest but meaningful”.

Further we note the RoRE range in other regulatory sectors. Without undertaking similarly analysis for us as a company we would support the proposal given the description of the penalty being “modest but meaningful”, as desirable.

Q5 Do you agree with the use of a separate revenue forecasting incentive mechanism in the retail control? If so, do you agree with the use of an equivalent mechanism as in the wholesale control, with the same parameters?

The balance of the arguments put forward in the paper suggests there is not the same need to introduce such a mechanism for retail. We would support this position more from a practical point of view of keeping things (relatively) simple.

Further, as we have seen with the revenue correction mechanism there can be some significant consequences of such mechanisms and it may be better to introduce into include retail when we have an understanding of how it is operating for wholesale.

Q6 Do you agree with the proposed cap and collar mechanism as a trigger to further investigation to provide additional safeguards to customers?

Again focusing on Fig 1 there appears significant justification for regulatory investigation into significant variations between expected and actual revenue. The impact on future customers appears significant for the three companies highlighted.

Q7 Do you agree we could additionally use the WRFIM to incentivise accurate projections of revenues for 2014-15 in our final determinations?

We would not support the use of WRFIM in 2014/15 given we already have the revenue correction mechanism in place for this year.

Q8 Do you have any comments in relation to the details and mechanics of the iteration process?

We note the expectation that information required to forecast and reconcile revenue will not be significant, which is welcomed.

Whilst the discussion in this consultation have focused on variations of demand stemming from weather patterns and new connections we also note the impact water efficiency initiatives by non-households in particular, meter optants, voids and diversions has on Company revenue. These should not be over looked in the analysis.

If you have questions on this paper please contact s.morley@portsmouthwater.co.uk

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