Southern Water

Your Ref:

By e-mail

Our Ref:

Date:
4 June 2014

Contact:
01903 272383

Dear Sir/Madam,

Revenue forecasting incentive mechanism for AMP6 consultation

Thank you for the opportunity to respond to your consultation on a new revenue forecasting incentive for AMP6.

We welcome and support the proposed annual revenue correction. Our own experience of a substantial revenue shortfall in the current AMP highlights the need for a more responsive correction mechanism. This is particularly relevant as more companies follow Southern Water in embarking on major metering programmes, which make revenue forecasting inherently more challenging due to the unpredictability of customer behaviour in response to the switchover.

In the research we carried out in 2011, in the context of a potential interim determination application, our customers were strongly supportive of tackling such issues sooner, so that the impact on bills is smoothed, rather than allowing forecast variances to build up over time. Equally in the context of an over-recovery of revenues it is right that customers should not have to wait for a number of years before this is corrected.

We also think it is right that companies have an incentive to accurately forecast revenues when setting wholesale tariffs each year. However, the existence of the annual correction mechanism itself provides strong incentives to do so, such that the application of an additional penalty is unnecessary. We are also concerned more generally that changes such as the introduction of a penalty regime change the risk-reward balance for the sector and potentially have implications for the cost of capital, after this has effectively been determined.

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While we do not believe there is a need for a penalty regime, if it were to be implemented, then we believe that the proposed tolerance level of 2% pa is too narrow, in particular for a company like us where around 95% of our AMP6 household water revenues will be directly related to consumption.

To identify the typical level of year-on-year variations in consumption, we have examined our own consumption data back to 1989. Over this period there were 11 years in which the year-on-year variation exceeded 2%, with a maximum variance of over 5% and a standard deviation of 2.7%. There is also evidence to suggest that this variance may be increasing with three of the last five years seeing year-on-year variances of greater than 2%. A higher percentage threshold for metered customers would therefore be essential to avoid penalising companies with high meter penetration.

Yours sincerely,

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Simon Oates
Director of Strategy and Communications