

# United Utilities response to Ofwat's consultation on the Wholesale revenue forecasting incentive mechanism for AMP6

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## 1 INTRODUCTION

Uuw is pleased to respond to Ofwat's consultation on the wholesale revenue forecasting incentive mechanism for AMP6. We have provided responses to the specific questions raised in the consultation and would be pleased to discuss these in more detail if that were helpful.

## 2 CONSULTATION QUESTIONS

### Question 1: Do you agree with the need for a revenue forecasting incentive in AMP6?

As set out in the consultation document, the use of such incentive mechanisms is commonplace across other regulated activities and we agree and support the introduction of such a mechanism in the water industry.

### Question 2: Do you have any comments on our proposed approach to the wholesale revenue forecasting incentive mechanism (WRFIM)?

The mechanism as presented in the consultation document generally provides an appropriate incentive for companies to focus on robust revenue forecasting.

We have a small number of comments which we have set out in response to questions below which relate to:

- bill stability;
- the period over which any over / under recovery should take place; and,
- the opportunity to present evidence when thresholds are not complied with or the company believes there is justification to plan to not comply with them.

### Question 3: 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.

We anticipate that the flexibility threshold of +2% / -2% will in most cases provide sufficient headroom for forecast error.

However we do not have visibility at this time of the revenues incorporated into the final determination and their year on year variation. Given this, we consider that it would be appropriate for companies to have the opportunity to present evidence to Ofwat supporting the broadening of these parameters if they believe that this would be desirable in order to permit greater bill stability and less price volatility in the interests of customers. If this were not permitted, and companies were presented with a final determination which had significant year on year fluctuations in assumed revenues, then the required annual adjustments to prices required to meet the 2% threshold could be significant and disruptive.

We suggest that it would be desirable for this to be formally agreed in advance, whereby the company proposes, in the interests of smoothing annual price changes to customers, an alternative profile of income than that set out in its determination, against which to test the +2% / -2% flexibility threshold. This would be on the basis that the variation in target income was planned and justified.

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**Question 4: Do you agree with a penalty rate of 3%? Please provide supporting evidence and analysis should you wish to propose a different penalty rate.**

Setting the penalty rate at 3% provides an appropriate incentive for companies to forecast and manage their revenues. We also agree that it is appropriate that Ofwat will have the discretion in the application of any penalty when provided with convincing evidence of relevant exceptional circumstances.

**Question 5: 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?**

In agreement with Ofwat, we are also less convinced of the need for a complementary retail incentive mechanism (i.e. option 2). Of the two options presented our preference would be Option 1 whereby, as now, a true-up is made in the next price control period for any / under recovery in allowed revenue, with no penalty incentive.

**Question 6: Do you agree with the proposed cap and collar mechanism as a trigger to further investigation to provide additional safeguards to customers?**

We agree with the proposed cap and collar mechanism as a trigger to further investigation.

Where companies have exceeded these wider cap and collar thresholds in a given year, the consultation document indicates that those companies will need to commit to best endeavours to recover their allowed revenue within the control period, or otherwise face further potential enforcement actions. In deciding the most appropriate action to be taken it is important that as well as considering compliance obligations there is also consideration to the stability of customer bills and ensuring that the impact of any price shocks are minimised as far as possible.

**Question 7: Do you agree we could additionally use the WRFIM to incentivise accurate projections of revenues for 2014-15 in our final determinations?**

We have no objections to this mechanism being used for 2014-15 revenues.

**Question 8: Do you have any comments in relation to the details and mechanics of the iteration process?**

The main point of note with regards to the mechanics of the iteration process is concerning the possible impact on customer bills of any over/under revenue recovery, with the proposal that the adjustment should be completed in one year.

Dependant on the value of the over/under recovery and the profile of the final determination income, this could lead to bill fluctuations which may be disruptive to, and not be in the best interests of, customers.

We would therefore suggest that there may be instances when the over / under recovery of income is phased across a number of years. This would therefore require the adjustment to allowed revenue to be reflected across several years to reduce the possibility of a double penalty being incurred, and/or to mitigate the price volatility created by reversing a significant variation in one year by an adjustment (possibly enhanced by the penalty mechanism) in another single year. This may also require the adjustments to run into the next price review period.

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We concur, however, with the view expressed in the consultation that it is likely that the number of instances where such action is required is likely to be relatively small.