

Please find below the NWL response to the consultation on the WRFIM as set out in the PR14 reconciliation rulebook policy document page 94, published on 23/07/15.

Our preference is for all revenue adjustments to be made at PR19, but, if this is not the final methodology, that Ofwat introduce a licence modification to allow symmetrical adjustments to revenue in line with the original WRFIM formula.

We also believe that the current Licence Condition B should be applied symmetrically in period, and since the current Licence Condition B does not allow for adjustments to make up revenue under recovery in previous years, there should be an expectation for adjustments to revenue for over recovery to be symmetrical. This is particularly important as water companies must obviously consider the impact of revenue changes on bill stability, as set out in the Defra charging principles for the water industry.

On page 46 of Ofwat's response to the PR14 Reconciliation Rulebook it states that "The purpose of the mechanism is to reduce the impact of deviations on customer bills arising from revenue forecasting deviations". The Defra charging principle of bill stability is also an incentive to forecast accurately, as poor forecasting will generate volatility. Adjusting revenues in period will have a knock on impact on bill increases year on year, and the more in period adjustments that are created, the higher the likelihood that bills will begin to increase or decrease to reflect the changing adjusted allowed revenue.

The primary benefit for customers of the WRFIM adjustment being applied symmetrically at PR19, rather than adjusting revenues in period, is that it significantly helps with maintaining bill stability and predictability.

At the very least the decisions on revenue under recovery in period to make up for previous over recovery should be left to companies so that they have the most flexibility available to manage bill stability, rather than creating a reputational expectation being set that all over recovery must be returned as soon as possible and that all under recovery is a risk that would have to be borne by the water companies until the next price control.

We agree that the revised WRFIM calculation spreadsheet should be applied so that companies are not penalised for revenue variances that cannot be corrected due to the way the current Licence Condition B is drafted. It should be noted that there are still some errors in the WRFIM spreadsheet which must be corrected. We list the errors we have found at the end of this response, and would be happy to discuss these in detail.

If a Licence Condition B modification is to be applied then we feel that it will be necessary to consult with all companies and that all companies should be treated on a consistent basis, as it would clearly be difficult to make comparisons on revenue performance otherwise.

We believe that the WRFIM formula under the current position does not impact on the Licence, with respect to over or under recovery. The WRFIM will be applied at PR19 and not in period, and therefore companies can work within the Licence requirements to manage their compliance with other charging rules, such as bills stability.

WRFIM spreadsheet errors:

- Cells L27 and L28 on the 'Data' tab are in the 2015-16 column, and therefore the calculation sheets do not pick the data up because they are looking for 2014-15 data. These two cells should be in column K we believe.
- Also on the 'WRFIM – Water' tab cell L28 is referencing 2014-15 column, instead of the 2015-16 column. This is different to the 'WRFIM – Sewerage' sheet and the other calculations on this row.
- We feel that the revenue variance used to calculate any penalty should be the annual difference between the allowed and recovered revenue, not the adjusted and recovered revenue. This is causing a cumulative effect on the penalty once year 5 is reached.