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10 August 2015

BY EMAIL – PR14reconciliation@ofwat.gsi.gov.uk

Dear Ofwat

Consultation on WRFIM mechanism

Thank you for the opportunity to comment on Ofwat's proposals in relation to the operation of the WRFIM mechanism.

Subsequent to final determinations being accepted, Ofwat has identified that the proposed operation of the WRFIM would be in conflict with Condition B of company licences. In response to this, Ofwat initially consulted on replacing the WRFIM – which allowed for symmetric correction of under or over recovery of income – with a revised mechanism operating on a non-symmetric basis during AMP6. This is because it would only allow for bills to be lowered in subsequent years - correcting for any over-recovery - but would not allow bills to rise in order to correct for any under-recovery. The intention would be that any under-recovery would be corrected for in the next AMP.

As we stated in our response to Ofwat's informal consultation on this proposal, our view is that this did not seem appropriate. It was inconsistent with the final determination and tended to "store up" potential bill increases for AMP7. This would lead to greater volatility in bills, contrary to customers' stated preferences.

In its PR14 Reconciliation Rulebook, Ofwat has suggested three alternative approaches.

1. Use the revised WRFIM formula for all companies;
2. Allow companies to choose between a licence amendment (and the original WRFIM formula) or no change to the licence (and the use of a revised WRFIM formula); and
3. Only introduce a sector-wide licence modification if all companies agree to the proposed change.

Cont'd

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Ofwat

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It is our view that option 2 is the only appropriate option. This is because it is the only solution which facilitates the operation of the WRFIM as was envisaged at the time that final determinations were accepted, without making this conditional upon the individual decisions taken by other companies.

Options 1 and 3 appear to amount to imposing a change in the operation of WRFIM – versus what was anticipated in final determinations – without company consent.

Decisions on whether to accept changes to the company's licence is a matter reserved to the Board. The Board's view on such changes will depend upon the specific proposals put before it and, therefore, we cannot bind the Board to a specific decision at this point in time, particularly in view of the limited time available for consultation.

However, in principle, we consider that a change to Condition B to allow companies to recover additional revenues as envisaged under the WRFIM would represent the most simple solution and would resolve the WFRIM issue in a way that is consistent with the operation of the mechanism as envisaged in the final determination. This is therefore our preferred solution.

We consider that option 2 is the only option that enables such a licence amendment to be made available to all company boards for their consideration and allows scope for the WRFIM to operate in the way envisaged when accepting final determinations. Those companies that elect not to accept such an amendment would, in effect, have agreed to a variation in the operation of the WRFIM by accepting the alternative, asymmetric approach with a true-up in AMP7.

Yours sincerely



James Bullock
Director of Economic Regulation