

To: Regulatory Directors
By email

12 August 2014

Dear Regulatory Director

PR14 outcomes and delivery incentives

I would like to start by thanking you for all of the assistance we have been receiving from you and your team as we make our price determinations. Across the 14 companies we are making good progress in making our recommendations to the Ofwat Board and are on schedule to issue our draft determinations on 29 August 2014.

We have been engaging with you and your team on outcomes for some time. The dialogue that took place after your submissions on 27 June was helpful in clarifying some aspects of your proposals and again we are appreciative of the generally positive response that we have had to our queries across the sector.

In support of our 'bottom up' analysis of your individual company proposals, we have also undertaken a number of checks to ensure that our approach on outcomes is consistent with information from the assessment results on other aspects of your proposals including those on wholesale costs. In addition, now that we have proposals for outcome delivery incentives (ODIs) across all 18 companies, we have also undertaken a limited number of horizontal comparisons across key outcomes which lend themselves to this form of analysis. The purpose of this comparison was to ensure that where you gain rewards, you do so as a result of performance at an upper quartile or equivalent level – and also to check that there were appropriate incentives in place for companies to catch up with such performance levels during the next five years.

The areas where we consider that a reasonably complete horizontal comparison can be undertaken are:

- interruptions to supply;
- water quality contacts;
- drinking water quality compliance;
- leakage; and

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- additionally for water and sewerage companies:
 - internal sewer flooding; and
 - pollution incidents.

This letter is to signal to you that there may be some potential for changes to ODIs following the additional checks and horizontal comparisons and that these may have consequent implications for your return on regulated equity (RoRE) range. It will also mean that you may have areas where you wish to re-engage with your customer challenge group in early September. We hope that this advance notification is helpful to you and them in making any necessary plans for additional engagement and further analysis.

If you have any questions regarding this letter please do not hesitate to contact me – or alternatively please contact your portfolio lead.

Yours sincerely



Giles Stevens
Delivery Director