



2014 price review investor conference call on final determinations

12 December 2014

Jonson Cox

Thank you and good morning everybody. As you know, it's a big day today for Ofwat, and for all the water and wastewater companies. This morning we published the final determinations for 18 companies. In a moment Sonia, our Chief Regulation Officer, will take you through the details of this morning's announcement. I am going to make a few short brief comments.

I am also sorry that our Chief Executive Cathryn Ross is not on the call with us today and she sends her apologies – but she is currently in the BBC Studios in interviews.

I am pleased that Ofwat has achieved what we set out to do. That was to conduct the review, on schedule and also to run the review differently from previous ones. We wanted to push water companies to own their business plans and to engage in a meaningful relationship with their customers. For the first time, requiring companies to develop their plans in line with needs and priorities for customers, this price review has seen an unprecedented level of customer engagement. There have been over a quarter of a million individual customer contacts. So, as a result, the business plans are better aligned with the needs and interests of customers, society and the environment as well as investors.

Throughout the price review, we at Ofwat had wanted to bring the company focus back to taking their businesses to the frontier of efficiency and customer service. We have been worried that financial outperformance derived from capital structures more highly leveraged than our notional structure may, over recent years, have blunted the incentive to improve operating efficiency.

So, we pushed all companies to reach the 2013 upper quartile standard of performance by setting outcome incentives and penalties. These will allow up to a 2% gain on regulated equity for the best performing companies. There are some 500

performance commitments across the sector – that's the total number for all companies – and two thirds of those have strong financial incentives and penalties that will help companies really want to move the frontier forward.

We also believe that companies who produce exemplary business plans, making tough choices themselves, should be fast tracked under our 'enhanced' status. South West Water and Affinity Water have been held harmless against our reduction in WACC (weighted average cost of capital). I know that few industry commentators expected those companies to reach enhanced status. The fact that they did, and others who may have been predicted by commentators didn't, introduces some of the disruptive changes that happen in competitive markets. As an economic regulator, our job is to promote some of this competitiveness.

So those are a few opening comments from me and I'd like to hand over to Sonia who will take you through the detail of today's FD (final determination) announcement.

Sonia Brown

Thanks very much, Jonson.

PR14 (the 2014 price review) is all about companies being challenged to deliver more for less.

Over the 2015-20 period, average bills for water and wastewater customers in England and Wales will be 5% lower than in the past five years.

Companies will spend more than £44 billion over the next five years. This investment will deliver improvements in areas of service that really matter to customers including:

- 1,200 fewer households at risk of being flooded by sewer water; and
- cleaner water at more than 50 beaches.

PR14 has not been about the lowest possible prices today at the expense of future generations. And we have ensured regulatory consistency by honouring the commitments made in the past– something which I know is very important to this audience.

But before we get into the specifics, I would like to take this opportunity – which I know that Jonson and Cathryn with the rest of the leadership team echo – to give our

thanks to all of the stakeholders that have engaged with us in this process. We consider it to be a strong foundation to build trust and confidence in the sector.

Moving on to the specifics.

First, we should recognise again the achievement of our two enhanced companies. South West Water and Affinity Water. As expected, their final determinations today are substantially unchanged. This is consistent with our commitment. At the 2019 price review, I hope that more companies will have the confidence to step up to the challenge of delivering plans that clearly stand out from their peers.

These two companies are already at work delivering their plans, which should bring significant practical benefits. They have received direct financial benefits as a result of the up-front reward, £11 million to South West and £5 million to Affinity, and the promise of a larger share of any totex outperformance. They have also not been affected by any other changes to the risk and reward package, including on ODIs (outcome delivery incentives) and cost of capital. Preserving the cost of capital is worth £14 million to South West and £5 million to Affinity.

Moving on to the headline change for all other companies – WACC. Our updated appointee cost of capital is 3.74%, down from 3.85% at guidance in January and from 5.1% in 2010-15.

In January, we took an unusual step in setting out our view of the cost of capital as part of our overall views on risk and reward – this felt like a brave decision.

This delivered substantial benefits to customers and we have observed that having this knowledge has been valuable to stakeholders.

However, as we were clear at the time and again in August, providing early guidance did not mean that we would ignore subsequent market evidence and regulatory precedents.

Let me explain briefly how we got to an 11bps reduction.

On the cost of new debt, we have taken account of the latest market evidence. We have seen real yields on corporate debt indices fall from just over 2% in January to below 1.5% by the end of October – a decline of between 50 and 70 basis points. Yields have moved even lower in recent weeks.

Applying our assumption that borrowing costs during the period will average 60bps higher than they are currently, our significantly lower starting point means that we

have reduced our cost of new debt to 2.0%, pre-tax real, from 2.65% in January. We allow a further 10bps for issuance costs.

On the cost of equity, we have looked carefully at both the falling risk-free rate and the important regulatory precedents from the last twelve months. We have kept the cost of equity at 6.75% – the same as in the risk and reward guidance. We considered that this was the right level within the package of risk and reward for these price controls but we could have taken another view. In particular, the Competition Commission, in its final decisions on Northern Ireland Electricity, confirmed that it saw the ‘upper limit’ for the total equity market return as 6.5%. Ofgem and the CAA responded to this by changing their position on the market return, moving down to 6.5% and 6.25%, respectively.

A 65bps decline in the cost of new debt translates into an 11bps decline in the WACC, bringing our appointee vanilla WACC to 3.74%. At the wholesale level this means a starting allowed return is 3.6%.

Overall, our interventions on the cost of capital have saved customers over £2 billion.

On company-specific uplifts – previously known as the small company premium – for FD we have not changed our position at DD (draft determination).

We have allowed uplifts of 15bps for Portsmouth and Bournemouth Water. They showed that they face a higher cost of raising debt, and we demonstrated that they provide benefits to customers, as efficient wholesale comparators, that more than offset this.

Customers will see a benefit of £70 million as a consequence of our interventions in this area.

As Jonson has already highlighted, PR14 will see a return to focus on operational performance. So, running through these from small to large.

First, the service incentive mechanism has been a strong driver of improving standards in the past and will remain so in this period. For those that are at the leading edge there will be rewards – for the rest it is right to return money to customers for poor service and returns will be lower.

Outcomes and their associated delivery incentives are one of the most important innovations of PR14. Companies have been given considerable freedom in developing the outcomes that matter for their customers and we have challenged

companies hard to make sure that there is genuine customer support and that the outcomes are sufficiently challenging.

We confirm today, for example, that for all the non-enhanced companies we are retaining an upper quartile challenge for the five most common and comparable outcomes.

The incentives will align investor and customer interests.

On average, companies see 60bps of potential upside and 170bps of downside from the ODIs in their final determinations, broadly in line with draft determinations. A few things can be said about this balance.

First – the imbalance is not universal, South West, as at draft determination, has a broadly balanced ODI range, with 1.4% of upside and 1.7% of downside. This reflects the excellent customer engagement and the broad support that it achieved for its plan. Anglian, Severn Trent, Thames and Wessex all see the potential for 80 or 90bps of upside.

Second, some of the largest individual ODIs are around the delivery of ‘major schemes’ and these ODIs are negatively skewed by their nature.

For example, Severn Trent has ODIs associated with the delivery of its Elan Valley Scheme. It will pay customers £16 million for every year that the resilience scheme is delayed or £360 million if it fails to deliver. For the first time, these incentives reflect both returning the costs to customers and the benefits that have been lost.

ODIs are a new approach for Ofwat – and indeed new for any UK regulator. To help the transition, for the non-enhanced companies we have put in place the protection of a soft cap and collar on ODIs overall. This will mean ODIs won’t contribute or detract more than 2% of RoRE (return on regulatory equity), on average, over the period. ODIs on major schemes, such as the EVA (Elan Valley Aqueduct) and United Utilities’ Thirlmere Link, sit outside the cap.

That brings us to totex out- or underperformance. PR14 has introduced menu regulation in full to the water sector. Importantly, customers will share in the winnings if companies manage to lower their costs.

You will see from the final determinations that companies have implied menu choices which range from 92 to 105, with Bristol sitting out at 130.

The menu choice sets the sharing arrangements between companies and customers for totex performance. The company's exposure will range between 44% (49%, excluding Bristol) and 57%. Companies have until 16 January 2015 to make a final decision on their menu choices with a true-up for any differences at the end of the period.

This approach is designed to reveal valuable information that will be of critical importance in the future as companies will need to deliver more for less. As companies respond to these incentives and root out inefficiency, they will help us to set more challenging benchmarks for all companies in future price reviews.

On average, companies will see 1.5-2.0% of potential RoRE upside and downside from their share of totex out- and under-performance, after sharing with customers, which is broadly in line with our risk and reward guidance. Clearly, some companies have different starting points than others: some companies' business plans assume costs below our threshold while others have costs above. This is not reflected in the notional RoRE stacks, but clearly could affect the likelihood that actual companies outperform or underperform.

Having talked a little about the scope for out- or under-performance, let me give you an overview of where we have landed on wholesale costs – of obvious importance, as these costs represent almost 90% of the value chain.

We have talked about how important the move to totex is for the sector. The move to totex should open up scope for one-off improvements in cost efficiency, as companies optimise across capital and operating expenditure. Over time, it will support the delivery of more innovative solutions that will lower costs.

At draft determinations, companies' plans overall were 2% above our threshold in water and 5% above in wastewater – a total 'gap' of £1.5 billion. At final determinations companies' plans are almost exactly in line with our thresholds in both water and wastewater – a gap of only £18 million across a totex programme of over £40 billion.

At DD, we highlighted United Utilities' wastewater control, Thames Water's share of Thames Tideway Tunnel, and Bristol Water as having the most material gaps. All of these have reduced, to different extents and for different reasons.

At United Utilities, a wastewater gap of £773 million (29%) has fallen to £179 million (6%) at FD. United Utilities reduced its planned spend by over £300 million in wastewater, largely by targeting significant efficiencies. We have increased our threshold by nearly £300 million, too – most of this from including 100% of its

reduced NEP5 scheme, but also making a significant allowance for Oldham and Royton. On water, a smaller gap of 10% has also closed through company efficiencies and a £100 million partial allowance for the Thirlmere Link.

At Thames, the Tideway gap has closed completely. We have a P50 estimate of costs and a tightly defined uncertainty mechanism to protect Thames from costs that are truly outside of management control. The company's costs are now below our threshold on all three of its wholesale controls.

For Bristol at draft determinations this was £203 million, or 57%, and has narrowed only to £132 million, or 32%. Through the application of the totex menu, the gap to allowed expenditure falls to 19%. To reach FD we have worked with Bristol and provided it with additional opportunities to make representations. We have reviewed our approach carefully to ensure that Bristol's customers are protected and the company will need to seek out a wide range of further efficiencies (including reviewing the scope of its investment programmes) or it is likely that its shareholders will be exposed to additional costs.

Overall, PR14 has been the biggest efficiency challenge for wholesale costs with the move from average to upper quartile efficiency delivering benefits worth over £3 billion to customers in 2015-20.

Through ODIs and totex sharing, it's clear that companies will be earning their returns and managing their risks differently than they have in previous periods. For example, in the 2010-15 period companies could ask for price limits to be reopened if a poor economy caused bad debts to rise or if the Environment Agency increased abstraction charges. This is no longer the case.

We set out our view on uncertainty mechanisms in our risk and reward guidance. In short, risk should remain with the company, at least in part, if it's able to influence the impact or mitigate the effect. As a result, at final determinations we have only allowed a single, industry-wide notified item, beyond the 'relevant changes of circumstance' and other mechanisms defined in their licences. There is also a very targeted mechanism for Thames Tideway.

In my introduction, I talked about how we had ensured regulatory consistency by honouring the commitments made in the past. This is obviously relevant to the adjustments we make at PR14 to reconcile the performance of the companies during the previous period, 2010-15.

There were two main areas of representation in response to the adjustments we made at DDs. All companies that were affected by serviceability shortfalls, with the

exception of Severn Trent, made representations about our approach to serviceability. And Severn Trent also raised a number of detailed points about our technical approach to legacy adjustments.

I will deal with them in turn.

First, serviceability.

At DDs, eight companies received serviceability shortfalls totalling £360 million. The representations we received were around the approach we had adopted, the scale of the serviceability shortfall relative to the failure, and the volatility of certain individual indicators.

We have considered the representations carefully, to ensure that our approach to serviceability shortfalls is proportionate and have done a lot of work on this since DDs. As a result of this, for final determinations the total shortfalls have fallen to £149 million.

Second, Severn Trent made representations on our technical approach to certain PR09 adjustments, including the indexation of the CIS.

Our Board has decided to make no material changes to the position as at DD for the period 2015-20 to the approach to all PR09 adjustments.

We will engage with stakeholders on any reconciliation of the CIS that is appropriate to protect the long-term interests of customers from the period 2020 onwards. There will be no retrospective application for the 2015-20 period.

I'll say a few quick words on retail costs. We are looking at these separately for the first time, both to facilitate competition from 2017 in non-household retail and to create real incentives to drive more efficient costs in household retail.

Changes from draft determinations have generally been small. The most significant change is that prices are now set using 2013-14 costs and price base.

In household retail, we have made a new adjustment for bad debts for Northumbrian and a slightly larger adjustment for Dŵr Cymru, and some allowance for input price pressure for Bristol, Portsmouth and Wessex, which are already at the upper quartile level of efficiency. Finally, we have accepted additional new costs from a small number of companies.

At final determinations, we are allowing £4.0 billion of expenditure for household retail costs. This represents a 7% reduction from what was proposed in the companies' December business plans, saving customers £300 million between 2015 and 2020 because of our interventions and changes made by the companies.

Finally, I should say a few words on financeability.

Ensuring that **efficient, notionally financed** companies can finance their functions is one of our key responsibilities. We focus on 'efficient', because we would be failing our other primary duty, to protect customers, if we allowed them to bear the costs of a company's inefficiency. We focus on 'notionally financed company' because we allow companies choose their own capital structures, but can't allow a situation where they are protected from the decisions they take around this.

How do we fulfil our duty? We allow companies a fair return on their capital, and give them the tools to manage other measures of financeability – but only where a company with a notional capital structure would find it necessary to.

We required companies to provide assurances from their Boards and in a few cases further additional, independent assurance that their plans were financeable.

Post our interventions financial ratios we calculate at FD are similar to those at draft determinations.

We have allowed a limited number of companies to change their PAYG (pay as you go) or RCV (regulatory capital value) run-off rates to increase cash flows in 2010-15. We have allowed some adjustment for Severn Trent, United Utilities and South East Water on grounds of the notionally efficient company maintaining a credit rating.

Given the extent of Bristol Water's totex efficiency challenge, we have – exceptionally – given them a short glide-path by allowing them to increase revenues 2015-16.

Some other companies proposed to use PAYG and RCV run-off to smooth bills between periods. Of these, we have accepted only Yorkshire's proposal.

We have challenged hard for customers throughout this price review, while always taking a long-term view. We have recognised the value of stability and predictability to investors, and that this helps to preserve the sector's access to low-cost financing. Because of this, customers' long-term interests are sometimes best served by decisions which do not get the lowest possible bills in the very short term, and we have worked hard to strike the right balance.

The price review has been delivered on schedule and with an unprecedented level of transparency. We have done what we set out to do.

In short, PR14 has set a solid foundation on which to build for the 2019 price review. The Water Act means that we will need to make changes in order to enable upstream reform, and our drive toward better-targeted regulation will inevitably mean other changes. Importantly, we will need to return to questions about the allocation of the RCV, and this will be the subject of conversations in the next year or so.

I hope that this year has given you confidence that we will approach all of these changes in a deliberate, transparent and balanced way.

We will now take any questions that you may have.

Thank you.

Questions and answers

Operator: Thank you. If you would like to ask a question at this time, please press the * or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered you may remove yourself from the queue by pressing *2. Again please press *1 to ask a question. We will pause for just a moment to allow everyone to signal.

We will now take our first question from Jamie Tunnicliffe of Redburn.

Jamie Tunnicliffe: Yes, hello it's Jamie Tunnicliffe. Three questions please. Just looking at the FFO to debt figure that you show on the detail, is that done on exactly the same basis as S&P (Standard & Poor's) and if not is it likely to be higher or lower than their approach would imply? The second question is just on those pay as you go adjustments, you seem to have basically allowed more for UU (United Utilities) in terms of what they were asking for in the post draft discussions than for Severn Trent, I just wanted to check that's right and if you could just explain the basis for that, was that better customer engagement and the third question is just whether you could help me with the natural rates of opex and IRE (infrastructure renewals expenditure) versus totex against the pay as you go rates that are actually quoted for both UU's and Severn Trent, thank you.

Sonia Brown: Okay, thank you very much Jamie and I think that I will start off and then I will hand across to Graham to pick up on the last point. I think the first thing to

say is that, on our calculations of FFO to debt, we hope we're really clear that these are our calculations. We are not attempting in any way to replicate the calculations that are used by any of the rating agencies: they are designed for us to make sure that we meet our responsibilities that I outlined around allowing an efficient company to finance their functions.

We have done some work looking at how the S&P ratio would translate across for the companies and I can say that we've taken exactly the same approach to UU and to Severn Trent in the way in which we have done that, so the basis of the calculation is exactly the same. It does result in different revenues being moved between the periods for the two companies but the basis of the calculations is exactly the same for the two. Graham, do you want to pick up on the natural rate?

Graham Taylor: Yes, Jamie, to your question about getting information you need to calculate the natural rate, that isn't a concept that we really subscribe to: there is no 'natural' level for a pay as you go. That said, if what you are looking for is information on accounting capex and opex, the financial models will be published by the end of the day today. You'll be able to get the information you are probably looking for in there.

Jamie Tunnicliffe: Can I just check on my second question was about the pay as you go adjustments, so that hasn't been picked up. And then just, coming back on the first one, I can totally understand you have your own calculation and it's consistent across all the companies and that's only right and proper but you also suggested you have thought about how the S&P number would be calculated and generally, then, is your number coming out slightly better or slightly worse? Is there a general trend you find of your calculation versus the S&P, given how important it is?

Sonia Brown: I guess I would say that it's not really for me to second guess how S&P are going to view these issues because they look at a wide range of factors that we don't look into, but equally we take account of other factors that they don't take account of. I guess one of the important ones is around index-linked debt and I think that you can work out for yourself the way in which that would impact on the calculations.

Jamie Tunnicliffe: Okay, so you're not really sure how your number compares to theirs, thanks, okay. And the other question, Graham or Sonia, in terms of the second question I asked about the pay as you go adjustments and what the companies were...

Sonia Brown: Sorry, I'll try again to answer it. We have calculated that on exactly the same basis between United Utilities and Severn Trent. It does have different

consequences for both of the companies but both of the companies have stated that they were looking to target a FFO to debt number which was in the 9-10% range. We have targeted that number for the notionally efficient company, pre-legacy, within that range.

Jamie Tunnicliffe: Okay. Thanks.

Operator: Our next question comes from Guy MacKenzie of Credit Suisse.

Guy MacKenzie: Good morning, three questions from me as well. Firstly, specifically on United Utilities, it looks like you increased the wholesale totex allowance by about £200 million relative to the draft. I was just wondering, when you talk about the gap being narrowed to about £179 million, are you talking about the gap between UU's most recent proposal and Ofwat's baseline which I guess is the basis for the sort of £628 million gap that we had coming in, or is that the gap between the actual allowance based on that 75/25 Ofwat/company proposal split, so a lower optical gap but obviously offset by the additional menu income. Secondly, not sure I'm reading this right, just reading off the bar charts, it looks like you've tweaked down the incentive ranges at least for Severn Trent and UU down to about 0.8 to 9.1% on equity returns for Severn Trent, 1.4 to 7.9 for UU. Just to clarify that's indeed the case and if so what was driving that.

And the final question, Sonia, you mentioned at the very end there that you'd be revisiting conversations about allocation of the RCV next year, I guess as you look towards facilitating more trading and upstream competition. I was just wondering if you could give us a bit more detail on that, at least on specifics of timing and also whether that would also be a time where you would be revisiting the question of CPI versus RPI for the next time.

Sonia Brown: Okay, thanks very much Guy, I think overall the position of UU is against the baseline levels, and then in addition to that there is obviously the menu that comes over the top of that. As we set out, basically where we are with UU is on the wastewater side is that we've reached a position where all of the enhancement expenditure we think has been addressed, so things like their National Environment Programme. And the gap really remains around their base level of totex, which I know that they talked to you about on a number of occasions.

I think that the change that you've picked up with regards to Severn Trent and UU is because we've taken non-household retail out of all of the numbers there; I think that's the change that you are identifying.

And the third thing on our future conversations, we're really, really excited about having new conversations, being really open with all of our stakeholders. Our forward work programme is going to be coming out shortly and that will set out our programme of activity over the next twelve months. What I can assure you of is that we are looking to have the conversation very early about what the scope of what we are going to be considering in PR19 will be, in part to learn lessons from this review process and make sure that we get those conversations up and running as quickly as possible.

Guy MacKenzie: Okay, can I ask maybe one follow up question on that? You sort of committed before to grandfathering, or securing the 2015 RCV. Does that mean if you were to, say, break up the RCV to a certain extent, that some of the expenditure that's been allowed today that's going into the RCV could potentially be taken out and moved into a competitive segment? I guess I'm just looking to understand a little bit further what really we're looking at here.

Sonia Brown: I think that the commitment that we made was absolutely up until 2015; that means that any additions to the RCV from 2015 onwards could be reallocated. I think that there's a difference in language here that is really quite important: we are talking about how the RCV could be reallocated. You've seen us do that this price review, with retail, and I know that retail is much smaller in terms of the impact of that within the RCV but you have seen us taking this approach during this price review of reallocating RCV and I think that that's the conversation that we want to have.

Guy MacKenzie: Okay, so that's just reallocating within, say, a regulated framework where you maintain that link to RPI and I guess the final part of that question was whether the RPI link would be revisited as well.

Sonia Brown: I think as I said before the question as to whether the appropriate index is CPI or RPI is definitely within the scope of questions that we want to ask ourselves as we start to think through what might be the right answer for PR19. But I guess that there's a very long list of those questions. You know we're going to want to return to questions like, 'should debt be indexed?' There's a whole list of things where we're going to want to have those conversations with you all over the next 12 to 18 months.

Guy MacKenzie: Okay, thank you.

Operator: Our next question comes from James Brand of Deutsche Bank.

James Brand: Good morning and congratulations. Two questions, please. Firstly, just in terms of the politics and kind of how you've gone about the review process I was wondering how it's kind of worked in terms of the interaction with politicians. Have you kind of already got political sign-off on these proposals from the main parties? Or – obviously you're an independent regulator, maybe you haven't consulted them with much – but I was just wondering how that kind of process has gone and whether or not that you feel that there is support for these proposals from the main political parties

And the second question is just on mergers. You kind of flagged up earlier in the year that you would be open to companies coming and talking to you about mergers. Obviously the main focus over the last few months has been on getting the review out the way, but I was wondering if you could just tell us whether – obviously wouldn't expect you to name names – but were there any companies that have approached you about mergers? And if you could give an update on how you might think about mergers, if it's something you're still open about whether you'd kind of developed your thoughts in that area? Thank you.

Sonia Brown: Okay, thanks ever so much James. I'm going to hand over to Jonson on the first question.

Jonson Cox: So good morning. On the political question, absolutely no discussions take place. I think you know this regime is independent for very good reasons: there is no political guidance on the regime. Politicians learned of the outcome of this review at the same time you did this morning, at 7 am, when they were published, and that's obviously the way we conduct this review because we are charged to do so independently. I think that's what gives investors and all others confidence that it is independent. So I hope that answers that question for you.

On the merger regime, we've been rather obsessed by getting this review out, so apart from a few comments I made at a Utility Week event last week, this is an issue we'll return back to in the New Year. But clearly the sort of changes going on in the sector open the way to thinking differently about how the industry is vertically integrated, or not. And the one thing we did very clearly flag was 'big is not better', as you can see if you look at our efficiency ratings. What we are interested in is questions like, 'is it right that a retail business is within a wholesaler?' That's for companies to think about and we'll look forward to hearing proposals from them.

Sonia Brown: I guess the only additional build that I would just put onto Jonson's really helpful comments is that the government is consulting on retail exits for the non-household side of the sector and I guess that that's an important component of realising some of those changes that Jonson has just outlined.

James Brand: Okay, thank you very much.

Sonia Brown: Thanks James.

Operator: Our next question comes from Dominic Nash of Macquarie.

Dominic Nash: Yes, good morning. A couple of questions please. Firstly on ODIs, is it possible to give some colour on what proportion of the ODI out- or underperformance will come through as cash within the review and what proportion comes through at a true up at the end of the year? I think that it differs between companies, so obviously there are the three that we're most interested in and you can probably focus on. And secondly, on totex and ODIs and outperformance regimes, totex I understand is going to be completely trued up in 2020. Have you been looking at the impact on your earnings under IFRS with this sort of shifting around of revenues and costs between 2015 and 2020 and then the potential true-up going into the next review and have you been doing any consultation alongside the FTSE accounting board is potentially looking at tweaking IFRS changes for accounting for regulatory assets – whether or not you've spoken to them and I presume whether or not the water companies will be reporting on a sort of a trued-up basis on their returns as they go forward.

Sonia Brown: Okay, I'm going to try to answer the first question and I'm going to pass over to Keith to pick up the second if that's okay. You're absolutely right the situation differs between the three listed companies that you're interested in. So Severn Trent and South West Water have license changes that are part of the package going out today which will enable them to earn some rewards on the appropriate ODIs within the period and that isn't the case for United Utilities. And so United Utilities will true up their position on ODIs at the end of the period.

Dominic Nash: And do we have the sort of rough proportions or is that in the detail?

Sonia Brown: It's in the detail and there is a list of the ODIs that are covered by the license change; they're generally things that companies care about on a more annualised basis and things being longer term. That's all set out in the document, so I'm sure that the companies have worked out for themselves what they think the financials are associated with that. Keith, do you want to pick up on the second question?

Keith Mason: Yes, we did put a consultation paper at the end of September on updating the regulatory accounts but also trying to take account of reporting in respect of the price review. We received quite a few comments on that and we're finalising those comments and putting out a final response probably towards the end

of January or early February, but you're right to say IFRS doesn't give you a true picture. We did consult on the idea of having regulatory reporting on the economic basis under which the price review has been set, so the impact of better performance or worse performance on totex ought to be shown through the regulatory accounting statements as we go forward. Your final point, Dominic, yes we have been contacted by the IASB. I think they are just looking to update an accounting for regulated companies paper they put out about 7 or 8 years ago, so I don't think it is anything particularly special this change for regulated businesses but really the big difference is IFRS between economic accounting which is quite a bit different.

Dominic Nash: And so when you do your FFO/net debt numbers and your ACICR (adjusted cash interest cover ratio) numbers, do you think that the credit rating agencies will also be looking at this sort of cash flow issue versus economic issue or do you think they'll be able to factor in these differences?

Keith: I think they will. The rating agencies were quite pleased that we were looking to report actual performance on the basis of the price review was set, as opposed to just trying to decipher it from the statutory accounts, so I think they will be quite supportive of it, yes.

Dominic Nash: Right, thank you.

Operator: As a reminder if you wish to ask a question please press *1 on your telephone keypad. Our next question comes from Philip Maton of Santander.

Philip Maton: Hi there. In relation to the cost of debt, can you say with confidence that if there was an equal and opposite move in market conditions, an increase in WACC would have been announced today as opposed to a decrease; and secondly, given the materiality of the impact of these moves, would you consider a more prescriptive methodology for the next product review to allow companies to better quantify their financial risks.

Sonia Brown: Okay, thanks very much Philip. I think the first thing to say on the cost of debt I can answer absolutely. If we'd seen the markets move in a different direction then it would have been the right thing to do for customers to have changed the cost of capital upwards. That clearly isn't the case and the evidence points in the opposite direction as I set out. And as I also set out, there are important both evidence and regulatory precedents on the cost of equity side that have changed since January but we have chosen to stick with the position on the cost of equity.

As to the second point on a more prescriptive approach for the future, I am not sure how I'd square that with being in customers interests, I think that we gave really early and good guidance on the cost of capital. I think that has really helped all of the stakeholders in understanding their plans and I know that every single company has been working off of scenarios associated with what the cost of capital is likely to be at this point because obviously we clearly flagged and signalled that this is something that we were looking at post August.

Philip Maton: Thank you.

Operator: As a final reminder if you wish to ask a question please press *1 on your telephone keypad. We will now take a question from Verity Mitchell of HSBC.

Verity Mitchell: Morning, thank you for taking my question, I just clarification question on ODIs. You mentioned that Thirlmere is outside the cap; did you say one of Severn Trent's schemes was? I didn't quite catch that – was Elan Valley or was it another scheme with another company? And secondly, when you thought about changing or reducing drastically the price re-openers, you didn't mentally give any compensatory risk allowance on the positive side to companies? Because it strikes me that that's quite new in terms of radically reducing the number of price re-openers in this review. Or did you feel that you had already accommodated that additional risk in the rest of your considerations on returns?

Sonia Brown: Yes, thanks ever so much Verity. I think that you've answered your own question on the second one. The position that we set out on uncertainty mechanisms was part of the risk and reward guidance when we established the original 3.85% appointee-level WACC. We did think hard about the risk allowance associated with it, and the way in which I described it is it's an all-in base return and that's really important in protecting customers.

On your first question, with regards to the ODIs, all major projects sit outside of the collar because there is no shortfalling for PR19 for the non-delivery of capital schemes. So that means that UU for Thirlmere has an ODI; it also has other ODIs around other major projects that it will be delivering within the period. Severn Trent has the one that I outlined for the Elan Valley and again also has other ones that would sit outside of those collars. The reason why they sit outside is that there is no shortfalling in the future.

Verity Mitchell: Right, thank you that was helpful.

Operator: As there are no further questions at this time I would like to hand the call back to the speakers for any additional or closing remarks.

Jonson Cox: Okay, it's Jonson again, I think it's probably time to close this. Thank you, we'll look forward to seeing how this is all assessed by you, but thank you for joining us this morning and I'll say goodbye for now.

Sonia Brown: Thank you.

Operator: That will conclude today's conference call, thank you for your participation ladies and gentlemen, you may now disconnect.