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Keith Mason
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31 March 2015

Dear Keith,

Re: Consultation on company monitoring framework for AMP6

We support the principle that assurance for companies should be risk-based and proportionate. The incentives would be stronger if the framework is made clear and transparent, takes due regard of materiality and the criteria are within a company's control.

Clear and transparent

Ofwat has set out its assessment criteria but only enhanced companies have been assigned to the self-assurance category.

In the Draft Determination for Anglian Water, Ofwat said "We are satisfied with the company's proposals for self-reporting". Coupled with Ofwat's assessment at the RBR of one exceptional and two acceptable ratings we expected that we would be categorised as self-assurance.

It would have been more transparent if it had been made clear that only enhanced companies would be categorised as self-assurance.

Materiality

Ofwat helpfully set out for us (email from Peter Jordan 12 February 2015) the thirteen reasons it noted for assigning Anglian Water's data quality "assurance and data submissions" an amber status. Based on the evidence this seems disproportionate: some reflected unclear Ofwat guidance and errors in interpretation of IFRS Accounting standards, in other cases the

commentary explained our approach and in one case we had included an "-" in a cell instead of a "0" (to indicate that no fixed rate debt had been issued to avoid a misinterpretation that debt had been issued at zero percent). Of the thirteen items noted only two could be classed as errors and neither were material.

The December Business Plan Submission included 68 data tables, with thousands of data points. Much of the Ofwat guidance was unclear and emerged through a series of Q&As very close to the submission date. The last set of Q&A was issued on the day of submission on 2 December.

If Ofwat's assessment for this category is based, as it appears to be, on no errors whatsoever being acceptable then there is no incentive for companies to strive for a self-assurance assessment. Perfection is not achievable and even striving for it would have an excessive cost.

Within companies' control

An important point of principle regarding strategic casework being used to assess the assurance category, is that progress with casework is outside companies' control. We are assuming that the three strategic cases referred to in Ofwat's assessment for Anglian Water are Fairfields (opened 2009), Wing strategic main (opened 2008 but discussions with Ofwat date back to Ofwat's Final Determination in 2004) and Prior's Hall (opened 2009).

The disproportionate and unreasonable time that Ofwat has taken to bring these cases to conclusion creates an unfair barrier to being able to progress to the self-assurance category, in the absence of any other issues. We set out in annex 1 to this letter more details of the two cases which remain open, including a timeline of the Fairfields case which shows the delays in Ofwat's review of these cases: including taking 12 months to serve a Statement of Objections and 19 months to serve a supplementary Statement of Objections. We also set out further details of the Wing strategic main case in which Ofwat has taken opposing positions over the course of the decade that the issue has been in discussion.

Our expectation is that where cases fall outside Ofwat's stated timescales for resolution, they should be discounted from the assessment.

Other matters

There is a need to set out the process for agreeing the assurance categorisation after the Autumn risk assessment and ahead of publishing assurance plans. We also suggest that moves between categories should take place at that point rather than throughout the year. This would allow sufficient time to develop appropriate assurance plans.

We have set out answers to the consultation questions in annex 2 to this letter. We would be pleased to discuss any of the points raised in further detail.

Yours sincerely

Jean Spencer
Regulation Director

Annex 1 – Strategic cases

Fairfields

Ofwat made us aware of the case through serving a s26 notice in November 2009, and a second notice in November 2010. Following our response to Ofwat's second s26 request it took Ofwat 12 months to serve a Statement of Objections ("SO"). The only material interaction with Ofwat in this period was an update meeting in June 2011.

Five months passed between the date on which we asked for an Oral hearing in respect of the original SO (in April 2012) – at which point we offered a range of dates – and the actual date of the Oral hearing in September 2012. The original date for the Oral Hearing (18 June 2012) was cancelled by Ofwat.

Following the Oral Hearing in September 2012, 19 months passed before Ofwat served a Supplementary Statement of Objections (in April 2014). During this period, the only substantive interaction with Ofwat was a meeting in July 2013 at which Ofwat shared PwC's report on the cost of capital.

There has been no progress in the investigation since we served our response to the SSO in July 2014. We are still waiting for a date for the Oral hearing despite the fact that we offered a range of dates in June 2014. We are also waiting for Ofwat to agree the position in relation to our proposed redactions and to respond to our request for (made in August 2014) for copies of IWN's financial information.

Below we set out the chronology of the Fairfields investigation.

2 November 2009	AWS receives a letter from Ofwat in its capacity as a Competition Authority requiring the company to produce documents and information pursuant to s26 of the Competition Act 1998. The letter states that Ofwat has "reasonable grounds for suspecting that the Chapter II prohibition had been infringed". Ofwat requires AWS to provide documentation relating to offers to developers in respect of two sites (Fairfields & Trumpington Meadows). AWS is also asked to provide answers to a series of questions and to populate a number of spreadsheets.
29 January 2010	The information and documentation requested on 2 November 2009 is provided by AWS to Ofwat.
22 April 2010	Peter Simpson attends a meeting with Cathryn Ross (then Ofwat's Director of Markets & Economics). Cathryn Ross provides no further detail as to the form of exclusionary conduct

	that Ofwat considers AWS may be guilty of.
13 May 2010	Ofwat writes to AWS asking for details of all offers made by AWS to potential Inset applicants in respect of the 12 sites disclosed in the January 2010 response.
29 May 2010	AWS supplies Ofwat with further information re offers made to potential Inset applicants.
July 2010	Management of the investigation passes from Nicola Taylor to Clair Daniel.
15 October 2010	Ofwat serves a further request under s26 of the Competition Act. The notice consists of 19 questions relating to the Fairfields site.
12 November 2010	AWS responds to questions 1 to 8 of Ofwat's second s26 request.
26 November 2010.	AWS responds to questions 9 to 19 of Ofwat's second s26 request.
March 2011	Management of the investigation passes from Clair Daniel to Sheridan de Kruff.
7 June 2011	AWS meets with Ofwat to discuss Ofwat's provisional thinking about the case and to obtain an overview of the next steps and anticipated timing.
November 2011	Management of the investigation passes from Sheridan de Kruff to Ian Strawhorne.
6 December 2011	Ofwat serves a Statement of Objections ("SO") setting out its preliminary conclusion to the effect that there had been a margin squeeze at Fairfields.
16 April 2012	AWS responds to the SO.
16 April 2012	AWS proposes four dates (in June 2012) for an Oral Hearing.
9 May 2012	Ofwat confirms 18 June as "firm date" for Oral Hearing.
7 June 2012	Ofwat cancels the date for the Oral Hearing.
13 June 2012	Ofwat proposes further dates for Oral hearing.
12 September 2012	Oral hearing takes place chaired by Penny Boys.
19 October 2012	AWS makes further written submission addressing issues raised in the course of the Oral Hearing.
30 January 2012	Ofwat advises AWS that it is "carefully considering the detailed written and oral representations made by AWS" and that it will make a further decision by June 2013.

May 2013	Management of the investigation passes from to Ian Strawhorne to Ricardo Araujo.
14 June 2013	Ofwat advises AWS that before it reaches a further decision it would like to meet to update AWS on the "current status of its analysis".
11 July 2013	AWS meets with Ofwat in order for Ofwat to share its latest thinking in relation to the investigation.
22 July 2013	Ofwat supplies AWS with a copy of its recent cost of capital study. Ofwat confirms that AWS can respond to the points made by Ofwat on 11 July 2013.
August 2013	Management of the investigation passes from to Ricardo Araujo to Philip Hand.
2 September 2013	AWS submits a response to Ofwat in relation to the issues raised in the course of the 11 July meeting and, in particular, in respect of the PwC cost of capital report.
14 October 2013	Ofwat advises that AWS can expect a draft decision in relation to the investigation in November 2013.
5 November 2013	Ofwat informs AWS that "a draft is going to the relevant board committee on the 25 November".
4 December 2013	Ofwat informs AWS that there will need to be another meeting of the Board Committee before it can issue a draft decision.
3 February 2014	Ofwat informs AWS that "a further meeting of the Committee will take place in March, likely to be either the 11th or 12th".
24 April 2104	Ofwat serves a Supplementary Statement of Objections ("SSO").
17 June 2014	AWS supplies possible dates for an Oral Hearing in September 2014.
19 June 2014	AWS supplies proposed redactions to SSO.
4 July 2014	Ofwat states that it is "in the process of considering AWS's confidentiality proposal (redactions) further and will revert". AWS is asked to hold 15 Sept (am) and 29 Sept (pm) as dates for Oral Hearing.
18 July 2014	AWS serves response to SSO and supplies a small number of additional documents.
7 August 2014	AWS asks for confirmation that (a) the proposed redactions in respect of commercially confidential developer offer are agreed and (b) that copies of all documents supplied by IWN containing financial information which is more than two years old will be made available. AWS also seeks confirmation that 29

	September (p.m.) is now agreed as the date for the Oral Hearing.
28 August 2014	AWS asks for confirmation that Oral Hearing will proceed on 29 September.
29 August 2014	Ofwat says that Oral Hearing will not proceed on 29 September and agrees to revert with alternative dates for the Oral Hearing.
03 November 2014	AWS asks for alternative dates for the Oral Hearing.
14 November 2014	AWS asks again for alternative dates for the Oral Hearing.
30 January 2015	AWS asks again for alternative dates for the Oral Hearing and advises that Documatrix access with be discontinued WEF 31 March 2015.
9 February 2015	AWS asks for response to 30 January 2015 e-mail.
13 February 2015	Ofwat acknowledges receipt of 30 January e-mail but provides no substantive response.
25 March 2015	Response on Documatrix access. No update on any possible date for a further oral hearing

Wing strategic main

In the Final Determination in 2004, Ofwat set out that we should collect contributions from developers for strategic mains, and how much it expected us to recover. In 2005/6, we had discussions on how we would collect the contributions and, whilst it was left up to us, Ofwat did make positive suggestions as to how we should communicate with developers and the fact that the charge should be presented on a l/s basis, rather than a per property basis which could have looked like another infrastructure charge.

In 2006, Ofwat received the first complaints, but dealt with them informally. From 2006 – 2009, we had several meetings to discuss the complaints Ofwat had received, but those were largely about timing and whether a deficit in the headroom was the right trigger.

During the PR09 process, Ofwat wrote to us indicating that it thought that the contributions were not lawful, but subsequently changed its mind and said it was up to us to decide whether they were lawful.

Meanwhile, Ofwat had received a formal complaint and said it would be resolving that in due course. However, for AMP5, it made the same assumption that it had made at PR04.

In 2010, Ofwat said it would decide the legal issue first, before deciding whether to review the calculations. In December 2013, Ofwat agreed with our legal analysis, but disagreed with the amount that should be collected. In doing so, Ofwat said they thought the Draft Determination sent the right economic signals.

In 2014/2015, Ofwat set out the timetable for reaching a final decision, but did not adhere to it. In the Final Determination in December 2014, Ofwat acted on the basis of the draft Wing determination and made an adjustment to RCV to reflect the difference between PR04 and the Wing Draft Determination.

We are still waiting for the final determination in the Wing case, a case that has been in discussion for ten years and one in which Ofwat has changed its position more than once.

Annex 2 – consultation questions

Q1 Do you agree that companies in the self assurance category should provide explicit sign off on the assurance that has been provided?

We agree that companies in the self assurance category should provide a Board Statement, approved by the Board, which sets out the assurance that has been provided.

Q2 Do you agree that the assurance process, and the outcome of that assurance process, should be transparent? Do you have any suggestions of how this could be accomplished?

We think that the process and the outcome of the assurance process should be transparent. This could be achieved through annexes to the Board Statement, setting out the processes followed to determine the required assurance, to appoint the assurance providers where third party assurance is used, and the reports from the assurance providers. These could all be published on the company's website.

Q3 Do you agree that a company in the prescribed category should consult on its assurance plans with stakeholders? If not, what approach to prescribing assurance would you suggest?

We agree that such companies should consult, particularly with their Customer Challenge Group, in order to ensure that they are providing assurance in the areas of most concern to stakeholders.

Leading companies would likely consult with stakeholders regarding their assurance processes and plans in any case, and we are already in discussion with our customer challenge group.

Q4 Do you consider the outline approach that we have set out to be practicable, or can you suggest improvements?

For annual assurance processes, we suggest that publishing the plan two months in advance and allowing two weeks for the company to implement any changes would not allow sufficient time to implement any changes required. In particular, should the consultation identify additional third party assurance, there would be insufficient time for the company to carry out a thorough procurement exercise ahead of when the assurance was needed. We agree with the proposal discussed in the workshop on 25 March that plans should be published in November.

It should however be noted that should specific issues, that require assurance over, be identified during the year, there may need to be a

faster, more ad-hoc, process to ensure assurance can be delivered in a timely fashion.

Q5 Do you think that our guidance could be minimal or do you think that it is necessary for us to define a high level of prescription to protect customers?

If a risk-based approach is followed, there should not be a need for specific or detailed guidance on the assurance required. Any guidance should be limited to the risk assessment process itself rather than to the assurance required.

Q6 Do you think that companies in the targeted category should publish an assessment of risks, strengths and weaknesses, to be used to target more prescriptive assurance requirements? If not please suggest how we should target the areas that require more prescriptive assurance.

Publication of risks, strengths and weaknesses would provide transparency over the areas of the company's performance that may require assurance.

Q7 Do you think that the prescription for targeted areas should be the same as for the prescribed assurance category? If not please suggest how assurance should be prescribed.

It seems sensible that the assurance plans for specific areas are consulted on with stakeholders in the same way that the entire assurance plan will be consulted on for prescribed companies. The model that companies in the self assured category do not need to publish and consult on plans ahead of them being implemented, prescribed companies consult on their entire plans and targeted companies follow a blended approach informed by their risk assessment seems proportionate.

However as previously noted, self assurance companies will have gained this status through transparency and would already be in consultation with their stakeholders so in practice there would be little difference in the actions the companies would take.

Q8 Do you think that for areas that are not targeted that the prescription for these areas should be the same as the self assurance category? If not please suggest how assurance should be prescribed.

See answer to Q7.

Q9. Do you think that companies should move to a tighter assurance category immediately an issue that reduces trust and confidence comes to light, rather than wait for an annual review? Do you think that the examples which we have provided are appropriate?

With the exception of the strategic casework criterion, we agree that the examples provided are appropriate and could result in an immediate downgrade. We note that 'immediate' may actually follow some time after an issue is discovered, as the actions a company takes to resolve the issue may also influence which assurance category it is placed in.

However, in practice, there will be no difference in the process followed. Whether the company is moved immediately or at an annual review, the company will be required to publish its risk assessment in Autumn, and then in due course its assurance plan and implement it the following year. It is unclear what actions would be taken should the move come in to effect immediately, as the assurance processes for the current year will be either in progress or complete. We do not agree that there is any increased regulatory burden on companies if the move happens at predefined intervals rather than immediately.

Clearly should such an issue come to light a company will wish to address it immediately in any case, and any actions taken will help inform the assurance plans for the following year.

Q10. Do you think it is appropriate that companies can move up from the prescribed to targeted category or targeted to self assurance category without the need for a positive relative assessment?

Following the principles of a risk based approach, the assessment should respond to companies' behaviour. However it is unclear how this would be applied in practice, as there would be no set criteria that Ofwat and companies could measure against.

Q11. Do you think that an annual relative review is unnecessary? If you think Ofwat should undertake an annual relative assessment, do you consider it necessary for moving companies both up and down or only in one direction?

We do not think there is a need for an annual relative assessment process, although Ofwat may wish to consider the benefits of such a process that may create some competition between companies. Reputational competition has always been a part of the industry, for example in past years the OPA score and latterly the SIM score has driven companies to continuously improve their service.

In any case, there will need to be some mechanism of Ofwat and companies agreeing on any moves upwards after risk assessments are published in Autumn.

Q12. Do you think that it is appropriate for companies to spend at least two years in the prescribed assurance category?

We disagree that two years is an appropriate time, and we think that it should depend on the circumstances particularly if the downgrade to prescribed was due to Ofwat opening a strategic case, or due to Ofwat's view of Board governance.

Q13. Do you agree that the overall package of proposals leads to appropriate incentives for companies? Are there ways you consider that these incentives could be improved?

Other than the obvious reputational incentive, it is unclear what other real incentives are being proposed. In order to provide incentives, it is important to include in the assessment only issues that are within the company's control. Any categorisation that is dependent on Ofwat resolving strategic cases in a timely manner removes any incentive as it is beyond the company's control. In including strategic casework as a criterion, Ofwat has also introduced a disincentive for companies to use established and legitimate regulatory mechanisms to resolve issues.