



Water 2020  
Ofwat  
21 Bloomsbury Street  
London  
WC1B 3HF

04 November 2016

Dear Sirs,

### **Consultation on the final 2010-15 reconciliation**

We strongly support the approach Ofwat have taken to conducting the Blind Year review as soon as possible following the final year of AMP5 and after the PR14 price setting process has been finalised. We think this helps to promote good debate and discussion enabling issues to be resolved so that they do not add to the workload of the next price review.

On the whole we find the majority of the information published on 5th October, covering a number of matters, to be helpful. We have set out below, as listed in 'Table A1 Revenue and RCV adjustments 2010-15 (£ million)' of the Affinity company specific appendix, each of the reconciliation items and our response to each.

### **Revenue Correction Mechanism (RCM)**

We agree with the calculations as set out and have no further comments.

### **Capital expenditure Incentive Scheme (CIS)**

We broadly agree with the calculations as set out but have a number of component level comments, as follows:

1. We agree with the calculated adjustments relating to 2014/15 outturn capex.
2. We believe there is a minor error in the RCV adjustment resulting from indexation correction.
  - a. Specifically 'Table A10 CIS RCV adjustments (£ million)', shows £27.8m as the RCV adjustment resulting from 'indexation correction'. However, the correct figure is £22.6m, as shown in the spread sheet model published alongside the main documents.
  - b. The figure of £22.6m is consistent with previous publications on this subject, and we believe that this is correct. While a minor error in process terms, financially it is potentially significant (the difference is £5.2m), and we would be grateful if you could confirm that the £22.6m figure, which is net of 'run-off' is the correct one.

- c. We do not think that any indexation adjustment should be required. We have previously made this point so will not repeat the detail of the argument here.

**Serviceability shortfall**

We fundamentally disagree with the proposal to apply an infrastructure serviceability shortfall penalty to our performance in 2011-12. Our infrastructure serviceability performance was assessed by Ofwat as 'Stable' as part of the PR14 Final Determination. Additionally we question, in procedural terms, how the scope of a review targeted at the 'Blind Year' can be used to revisit earlier decisions made by the regulator that are a matter of record.

We continue to disagree with the Ofwat assessment of performance in 2014-15 that was the result of a single large scale incident opposed to the underlying performance of the wider asset base. We have set out our detailed response on these material items in the appendices to this response.

If you have any further questions regarding our response, please do not hesitate to contact me. We look forward to the opportunity to discuss the content of this response in relation to the proposed serviceability shortfall as your earliest convenience.

Yours sincerely,



Christopher Offer  
**Director of Regulation & Corporate Affairs**

## Appendix A: Serviceability shortfall for 2011-12

The serviceability regime is a ‘legacy regime’ that relates to PR09, not PR14. The Blind Year adjustments are a necessary and accepted feature of the regulatory regime. Their purpose should be to allow Ofwat to take into account information relating to the AMP that was unknown at the time of the Final Determination. In the case of serviceability, this means being able to take into account, outturn information that is now available in relation to a PR09 legacy measure.

Affinity Water’s Final Determination at PR09 set out a clear position with regards to serviceability outputs:

*‘We have assessed your water infrastructure sub-service as ‘marginal’. You must restore stable serviceability by the end of financial year 2011-12-and demonstrate this in your June return 2012” (p12)*

*‘You are at risk of being shortfalled at the next periodic review should we assess serviceability as less than stable in an any year form the 2012 June return onwards. (p14)*

This was a commitment which the company took very seriously, and worked very hard to meet. We did indeed achieve stable infrastructure serviceability in 2011/12 and Ofwat recognised this both at the time and at PR14 in our Final Determination.

‘Table AA3.9 Serviceability assessments for 2010-15’ taken from the publication ‘Setting price controls for 2015-20 Final price control determination notice: company-specific appendix – Affinity Water’ clearly shows our infrastructure serviceability performance was assessed by Ofwat as ‘Stable’.

Final price control determination notice: company-specific appendix – Affinity Water

**Table AA3.9 Serviceability assessments for 2010-15**

		2010-11	2011-12	2012-13	2013-14	2014-15
Water infrastructure	Company view	Marginal	Stable	Stable	Stable	Stable
	Ofwat view	Marginal	Stable	Stable	Stable	Stable
Water non-infrastructure	Company view	Stable	Stable	Stable	Stable	Stable
	Ofwat view	Stable	Stable	Stable	Stable	Stable

**Note:**  
Assessments are based on actual and forecast performance submitted in the company’s revised business plan. Assessments for 2014-15 are based on forecast data and are subject to review once actual performance data becomes available.

Whilst we can accept that Ofwat may want to revisit the assessment of our performance in 2014-15, as assessments at PR14 were based on forecasts, we cannot understand any possible justification for Ofwat to revisit 2011-12. We do not believe it is appropriate for Ofwat to retrospectively change decisions and to do so could have reputational and procedural implications that undermine the stable predictable regulatory regime.

## **Appendix B: Serviceability shortfall for 2014-15**

Ofwat have concluded that the single incident that led to us being above our control level was within management control as we could have:

1. Improved our operational response
2. Completed a capital project in this area that would have eliminated a single point of failure

We accept that this was a difficult operational incident to manage and with hindsight probably could have improved our operational response. While proximity of strategic mains to major gas mains is not uncommon it does require careful co-ordination with National Grid and often requires manual excavation to avoid potential damage to the gas main. This complexity cannot always be fully controlled by management.

We work hard to identify and remove single points of failure whenever possible. This is key programme of work for us and elimination of this weakness is not a matter of maintaining the infrastructure, but of improving specific points within it. We could have completed a capital project in this area that would have eliminated the risk of this incident occurring but we do not have perfect foresight to intervene in all instances ahead of an burst incident.

We question the basis upon which an operational response to a single incident and can be used as the basis for an assessment of the underlying 'serviceability' of the wider asset base. We believe that if Ofwat consistently applies the principles of assessing serviceability set out as part of FD09 for the whole of AMP5 (2010-15), it will conclude that it is not appropriate to shortfall Affinity Water in relation to this one incident.