



South Staffs Water

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Water 2020,
Ofwat,
Centre City Tower,
Hill Street,
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By email to: PR14reconciliation@ofwat.gsi.gov.uk

4 November 2016

Dear Sir,

South Staffs Water response to the 2010-15 reconciliation consultation.

Thank you for the opportunity to comment on the final 2010-15 reconciliation.

We are generally in agreement with the proposals but do wish to raise one representation in relation to the assumptions made for the Construction Output Price Index (COPI) that has been used for the Capital Expenditure Incentive Scheme (CIS). We also set out below our approach to the treatment of the Revenue Correction Mechanism (RCM).

Construction Output Price Index (COPI) projection for 2014-15

The current proposal is to use the COPI issued for Q1 2014 rather than Q2 2014 as the Q1 data already has one revision to it and is therefore seen as more reliable. Extrapolating the data index using Q1 COPI gives an estimate for Q2 of 120.7 compared to the published Q2 of 123.0. However, all previous revisions to COPI from the first estimate since 2012 have been upwards and therefore this approach and the use of 120.7 must underestimate Q2 COPI. We believe therefore that a more robust approach would be to use the Q2 2014 published data point on which to extrapolate the remainder of the index for 2014-5.

Appendix A sets out a detailed analysis of our thinking, including the likely impact on the reconciliation for South Staffs Water.

Proposed treatment of the Revenue Correction Mechanism (RCM)

We appreciate the flexibility in companies being able to decide on the timing of the RCM adjustment. This is an area that we have been in dialogue with Ofwat over the

past few months as our customer research at PR14 clearly indicated that customers preferred stable bills.

As a result of this research, we decided not to take in-period adjustments within the AMP where flexibility was allowed and accumulate these for true up at the beginning of the next AMP. Therefore, in line with this approach, we are proposing to apply the RCM adjustment at PR19. This will avoid having volatility in bills during this price control period.

Please do not hesitate to contact me if you have any questions.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'P. J. Saynor', with a long, sweeping horizontal stroke extending to the right.

Philip Saynor,
Director of Finance and Regulation
South Staffordshire Water PLC

Appendix A: Representation on the COPI index used for the CIS reconciliation

In the draft proposals for the CIS true-up, an assumption has had to be made on COPI as the index has been suspended since the second quarter of 2014. The approach taken is to use the last published data point that had been subject to a revision (2014 Q1) and compare it to an interim index which is being published by the Office of National Statistics (ONS) to provide a ratio on which to extrapolate an estimate of COPI for the remainder of 2014-15. This is seen as more reliable than the final data point published (2014 Q2) that was a first estimate only.

By taking the above approach, the 2014 Q2 COPI estimated is 120.7 compared to the first initial estimate of 123.0 suggesting that the Q2 COPI would have been revised down if it had continued to be published.

In reviewing the trend of COPI revisions since 2012, every data point has been finalised higher than the first estimate. Below is a summary which shows this trend:

Report publication date	COPI Index									
	2012				2013				2014	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
2012 Q1	111.1									
2012 Q2	111.5	112.1								
2012 Q3	111.5	112.2	113.0							
2012 Q4	111.6	112.1	112.6	113.1						
2013 Q1	111.6	112.1	113.2	113.7	114.2					
2013 Q2	111.6	112.1	113.6	114.1	114.7	115.4				
2013 Q3	111.6	112.2	113.1	113.6	114.3	115.2	115.6			
2013 Q4	111.6	112.2	113.1	113.6	115.4	116.2	117.3	118.4		
2014 Q1	111.6	112.2	113.1	113.6	115.4	116.2	117.3	118.4	120.4	
2014 Q2	111.6	112.2	113.1	113.6	114.9	116.0	117.2	119.1	121.2	123.0
Report publication date	Movement from first data point estimate									
	2012				2013				2014	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
2012 Q1										
2012 Q2	0.4									
2012 Q3	0.4	0.1								
2012 Q4	0.5	0.0	-0.4							
2013 Q1	0.5	0.0	0.2	0.6						
2013 Q2	0.5	0.0	0.6	1.0	0.5					
2013 Q3	0.5	0.1	0.1	0.5	0.1	-0.2				
2013 Q4	0.5	0.1	0.1	0.5	1.2	0.8	1.7			
2014 Q1	0.5	0.1	0.1	0.5	1.2	0.8	1.7	0.0		
2014 Q2	0.5	0.1	0.1	0.5	0.7	0.6	1.6	0.7	0.8	

This data trend suggests that if anything, it is likely that any revision to 2014Q2 would have resulted in a higher data point. The average revision in the index since 2012 has been 0.6 which would give an estimated revision of 2014Q2 COPI to 123.6 rather than the 2.3 point reduction to 120.7 from using 2014 Q1 COPI.

We therefore believe that a more robust approach would be to use the Q2 2014 published data point of 123.0 on which to extrapolate the remainder of the index for 2014-5 (the second option considered in the consultation). This would result in a revised COPI index compared to that in the consultation as follows:

Ofwat proposed COPI

Quarter	Actual COPI	Interim Index	Linking Factor	Linked COPI	Year Average
2014 Q1	121.2	121.4	0.99835	n/a	
2014 Q2	123.0	120.9		120.7	
2014 Q3	n/a	121.8		121.6	
2014 Q4	n/a	122.1		121.9	
2015 Q1	n/a	123.3		123.1	121.8

Alternative approach using published 2014 Q2 COPI

Quarter	Actual COPI	Interim Index	Linking Factor	Linked COPI	Year Average
2014 Q1	121.2	121.4		n/a	
2014 Q2	123.0	120.9	1.01737	123.0	
2014 Q3	n/a	121.8		123.9	
2014 Q4	n/a	122.1		124.2	
2015 Q1	n/a	123.3		125.4	124.1

The Company has updated the CIS reconciliation models using the revised index above. As a result, the CIS revenue adjustment would change as follows:

£m's	Ofwat's proposed adjustment (Note 1)	Company alternative adjustment
South Staffs Region	-2.966	-2.826
Cambridge Region	-1.255	-1.225
Total Service	-4.221	-4.051

1. As per Table A9 of the company specific appendix