

AMP5 final true up

*Consultation response from Severn Trent on
the reconciliation of 2010-15*

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SEVERN
TRENT

AMP5 final true up

The Ofwat consultation sets out:

- the outturn of the incentives that are impacted by 2014/15 blind year performance;
- the proposed correction of the CIS indexation error; and
- the WRFIM and totex PR14 true-up models.

In our response we discuss three issues – the presentation of the information, the treatment of the RCM adjustment, and the PR14 incentives.

We have also included in the appendix our review of the company specific information published by Ofwat. We have separated the impact of the indexation error in these tables to promote transparency about the specific adjustments for interested stakeholders. We confirm that we do not seek to dispute any of the adjustments in themselves.

Presentation of indexation error – A13

The presentation of the information in table A13 has the potential to create some confusion about the impact of the CIS adjustments. This is because the number cited in the RCV adjustment includes both:

- the RCV adjustments; and
- a small element relating to the CIS indexation error (which runs contrary to footnote 1 which notes *“The CIS RCV indexation correction is not included in the RCV carry forward in table A13 above because it will be applied separately at PR19 in accordance with the PR14 reconciliation rulebook”*)

This arises because the table has been calculated by first updating the FD for the indexation error, then adjusting for actuals and then stripping out the same indexation error (which in practice is lower due to the update for actuals). This means that a portion of the indexation error is reported in this table. For Severn Trent the impact is £1.9m for water and £1.2m for waste. We present our calculations in Appendix 1.

Note - the specific tables relating to the indexation error (A13) and the presentation of the CIS total in table A10 is unaffected (although the split between “actuals” and the “indexation error” needs to be rebalanced as we show in the appendix).

RCM

In the consultation Ofwat requests that companies should set out how they propose to take the RCM adjustment.

As we have discussed in previous correspondence with Ofwat, the Final Determination stated that the RCM adjustment would occur at PR19.

*“...we would reconcile for the revenue correction mechanism (RCM), change protocol and serviceability in 2015, and in 2016 for the CIS, when we have the company’s actual performance for 2014-15. In carrying out this reconciliation we will take a proportionate approach (for example, applying materiality thresholds where appropriate) to making adjustments for company’s actual performance and **implement these changes at the next wholesale price control review in 2019.**”¹*

¹ Ofwat, Severn Trent Final Determination, p. 29, 2014.

Our position remains that the incentives and adjustments from the Final Determination should be applied as Ofwat stated. The principle of delivering on these regulatory commitments is very important. Because the regulatory framework will continue to evolve, commitments in the Final Determination and associated policy documents are an important tool to maintain stakeholder confidence. Ensuring that these commitments are delivered as stated helps to maintain trust and confidence in the regulatory regime and benefits customers in the long run by ensuring that the sector can access capital at low rates and keep bills low. Given that the RCM adjustment will be indexed and so it is NPV neutral, we think the best value to customers is taking the adjustment as per the original determination – namely at the end of the AMP.

Other adjustments

We will respond to the WRIFM licence change amendment separately, however we welcome Ofwat's commitment to provide clarity around how revenue adjustments for 2018/19 and 2019/20 will be treated. The sooner Ofwat are able to provide this clarity the easier it will be for all stakeholders to understand the impacts of the chosen treatment.

Finally Ofwat included changes to the PR14 rulebook as part of this consultation, we do not have any further comment to make in relation to these proposed changes.

Appendix 1 – Revised data tables

Table A1 Revenue and RCV adjustments

We have examined the Ofwat calculations and considered that there are some benefits in representing the table to enhance transparency associated with the different calculations. We have also added the company view for completeness.

We also note that throughout the document Ofwat restated the FD position as if the indexation correction had been included in the FD. We have shown this separately, to aid the reader, and we note that the figure has reduced slightly as a result of RPI being lower than forecast when Ofwat published the original adjustment. This does not impact the CIS total but rather the split between updated actuals and the indexation correction.

Our revised table presentation is shown below. Where figures have been adjusted from those presented in the consultation document they are highlighted in pink. Other figures, in blue highlight, remain unchanged although they may have been included in a different table.

	Water			Waste		
	FD position	Company BYR view	Ofwat BYR	FD position	Company BYR view	Ofwat BYR
Revenue adjustments						
RCM	12.350	-1.331	-1.330	-24.698	-39.499	-38.580
CIS	-42.468	-47.024	-47.777	-19.190	-18.668	-17.979
Total revenue adjustments	-30.118	-48.355	-49.107	-43.888	-58.167	-56.559

RCV adjustments						
CIS – updated actuals	-7.718	6.684	8.571	-98.501	-99.830	-98.791
Indexation correction	-73.148	-71.573	-71.573	-89.882	-87.857	-88.896
CIS total	-80.867	-64.889	-63.002	-188.383	-187.687	-187.687
Serviceability shortfall	-24.870	-24.870	-34.827	-23.401	0.000	-23.401
Total RCV adjustments	-186.603	-154.647	-160.830	-400.167	-375.374	-398.775

Table A13 – RCV adjustments to be implemented

The model to calculate these adjustments does not include any adjustment for the indexation error. However, when populating table A13 in the consultation document, Ofwat uses its figures which include this adjustment.

Given the value of the indexation adjustment changes due to actual totex spend and actual RPI, the result is that the figures presented overstate the adjustment required at PR19 by these movements in the indexation adjustment which will not materialise. For Severn Trent the impact is £1.9m for water and £1.2m for waste, as shown below.

A13	Water	Waste
RCM revenue adjustment	-13.680	-13.882
Total adjustment revenue carry forward PR19	-6.336	1.446

PR19 adjustment to RCV carry forward calculation

FD position	-7.718	-98.501
Ofwat BYR (excluding indexation adjustment changes)	8.571	-98.791
Change from FD position	16.289	-0.290

Difference to Ofwat approach	1.576	0.986
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Calculation in blind year model

CIS adjustment (from above)	16.289	-0.290
Serviceability shortfall	-9.957	0.000
Total adjustment RCV carry forward to PR19 (excl. financing)	6.332	-0.290
Total adjustment RCV carry forward to PR19 (incl. financing)	7.557	-0.346

Difference to Ofwat approach	-1.880	-1.177
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