

United Utilities response to the Ofwat consultation: Final 2010-15 reconciliation



Introduction

United Utilities welcomes the opportunity to comment on Ofwat's consultation on the final 2010-15 reconciliation. The consultation document invites comments on Ofwat's proposals for reconciling the incentive arrangements for companies' performance and expenditure for the 2010-15 period, with this reconciliation being based upon the actual information that is now available for the complete period, including 2014-15 the last year of the price review 2009 (PR09) price control.

Overall comments on the proposed reconciliation adjustments.

We recognise that this reconciliation has been undertaken in line with the approach previously consulted on and set out in the PR14 Reconciliation Rulebook. We are therefore not proposing that any further revisions are made to the adjustments set out in the consultation document or the United Utilities specific appendix

We have therefore focussed our comments on the approach that we are planning to adopt to implement revenue correction mechanism adjustments during the AMP6 period. We have also provided high level feedback on the other key areas discussed in the consultation document.

Revenue correction mechanism

We have advised Ofwat that U UW accepts the proposed licence changes which have been published under Section 13 of the Water Industry Act 1991 and are designed to ensure that the WRFIM can operate during APM6 as was intended at PR14.

We also consider that the proposed RCM adjustments for U UW are appropriate. There is extensive evidence that customers tend to prefer bill stability and predictability in place of volatile or sudden movements in bills. This was demonstrated in our own research at PR14 and Ofwat itself has highlighted this evidence in its recent Water 2020 publications. (For example, a summary is included in section 3.2.1 – *"Evidence on consumers' preference for bill stability and predictability"* in *"Water 2020: Regulatory framework for wholesale markets and the 2019 price review – Appendix 1: Securing legitimacy of future price controls – further evidence and analysis"* – Ofwat, May 2016.) Therefore, in order to avoid introducing any unnecessary volatility in customer bills, and consistent with customers' preference for bill stability, we intend to implement these revenue adjustments through WRFIM across 2017-18, 2018-19 and 2019-20.

We agree with the email we received from Ofwat (Peter Jordan) on 21 October, that if we were to use the RCM output published by Ofwat on 5 October within the WRFIM model, this would result in a duplication of the adjustment for the time value of money. Therefore in order for us for to input a percentage of the RCM revenue adjustment into the WRFIM model to allow this to be corrected through 2017-18 wholesale charges, we will require an updated version of the RCM output.

We would look to receive this updated output in advance of the publication of November RPI on 13 December 2016. This will allow the data to be input to the WRFIM model and allow us to appropriately consider what percentage of the adjustment to include in the 2017-18 wholesale charges and what percentage should be corrected in the remaining years of the AMP6 period. We would therefore welcome Ofwat's confirmation that this will be made available in that timeframe.

We would also like to draw Ofwat's attention to a potential error in the WRFIM spreadsheet provided with this consultation. The spreadsheet appropriately calculates the Adjusted Allowed Revenue (AR) taking into account RCM impacts (row 30 of the calculation worksheet). However the Baseline revenue for calculation of penalties (AR*) (row 31) is capped at the lower of the Adjusted Allowed Revenue (row 30) or the Allowed

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Revenue from the FD (row 29). This means that if the adjusted allowed revenue is above the allowed revenue from the FD, then a penalty could be incurred, if the correct level of revenue is recovered, but this is more than the penalty threshold above the allowed revenue from the FD (row 29).

Serviceability

We are pleased that the reconciliation confirms that we have delivered at least stable serviceability to customers throughout the AMP5 period.

CIS

We acknowledge that the approach that Ofwat has used to determine Construction Output price Index (COPI) data to calculate the proposed final 2010-15 reconciliation adjustments is based upon appropriate assumptions and is in line with the guidance published by the Office for National Statistics (ONS).

Change protocols and the 2009 agreed overlap programme

Although Ofwat has not accepted the position we proposed on a number of capital programmes, particularly those involving variations in the level of costs incurred in respect of activities which have straddled the AMP5 and AMP6 periods, we do acknowledge that the approach which Ofwat has followed is in line with the expectations set in the PR14 methodology paper (that Ofwat would not adjust assumptions made at PR14 for the 2015-2020 price control period) and set out in the Reconciliation Rulebook (that the final reconciliation exercise is confined to updating information for the period 2010-11 to 2014-15).

The 2014-15 transition mechanism

We believe that the 2014-15 transition mechanism was effective in allowing us to plan more effectively and make better use of internal and external resources and that it has made a significant contribution to smoothing our expenditure levels between the price review periods. We would recommend that a similar mechanism is applied in PR19 for 2019-20 and ideally qualifying 2018-19 expenditure.

Further changes to the PR14 Reconciliation rulebook

We agree that the changes to the PR14 Reconciliation Rulebook, set out in Appendix 3 are relatively non-contentious, minor amendments that are generally required to implement policy that is already agreed.