

Water 2020,
Ofwat,
Centre City Tower,
7 Hill Street,
Birmingham, B5 4UA

By email only: PR14reconciliation@ofwat.gsi.gov.uk

4th November 2016

Dear Peter,

Consultation on the final 2010-15 reconciliation

Thank you for the opportunity for commenting on your proposals for reconciling the incentive arrangements for performance and expenditure for the 2010-15 period. We very much welcome this aspect of the price control being resolved at this time whilst the various issues are still fresh in the memory rather than later in the process where issues can be overlooked or “lost in the mix”.

Revenue Correction Mechanism

We also welcome the choice you have offered in respect of the recovery of the outturn revenue correction mechanism adjustments. We agree that the proposal to allow companies the additional flexibility to make the final reconciliation adjustments in the current period is a useful mechanism for managing the impact on customer bills. At the current time we are minded to recover the determined true-up as part of the PR19 settlement recognising our customers' preference for smooth bills. We will review the position annually as other factors affecting the bill profile crystallise, including both the impact of current performance and the new incentives being developed as part of the Water2020 programme.

Capital expenditure incentive scheme, change protocol

Habitats NEP (Logging up – sewerage service) We are disappointed that Ofwat are proposing to cap the logging up adjustment to the expenditure incurred in AMP5. All of the expenditure was incurred as a result of a new obligation received in the period and accepted through the Change Protocol process. The outputs were delivered in line with the revised consents and the final scheme was delivered more efficiently than planned. Moreover the experience gained is now contributing to the delivery of a more efficient and effective sludge management strategy for AMP6. Both have contributed to the overall benefit of our customers. We believe that our actions did indeed deliver the required outputs to customers within a tight timescale and did not increase costs inefficiently. We ask that the draft determination adjustment is removed.

We do not consider that the implications of our representations have any impact on other interested parties. For one, the framework for “logging up” and the change protocol are no longer part of Ofwat's price control methodology going forwards. So far as the past is concerned we consider that our arguments are consistent with the underlying principles of Ofwat's established methodology, and therefore would have no effect on other parties.

Meter maintenance shortfall The revenue adjustment to be carried forward to PR19 arising from Water Service logging up, logging down and shortfalls is -£1.6m bigger than we were expecting as we have discussed in an exchange of e-mails between Paul Edwards and Peter Jordan. It is clear from the response that this has arisen from a correction to the Final Determination rather than a replacement of forecast information with complete information¹. We have been in discussions with Ofwat for a number of years regarding a similar correction that is required for the blind year true up from 2009/10. It seems disingenuous to us that you are willing to correct errors you have made in favour of companies, like this one and the CIS error, yet are unwilling to correct errors which are to our detriment.

We ask for some consistency in these matters such that:

- Either, you consider again our submissions for a correction to the FD14 judgement on the 2009/10 blind year adjustment;
- Or, you reset the shortfalling correction made in this consultation so that the only change to FD14 for the 2014/15 true up arises from the change between the forecast shortfall and the actual shortfall in line with your stated policy.

We do not consider that our representations on this issue have any impact on other parties. We have identified an inconsistency in Ofwat's treatment of an error at PR14 and an error at PR09. The effect of addressing our representations would be to restore consistency in regulatory approach, which could not of itself be expected to affect other parties.

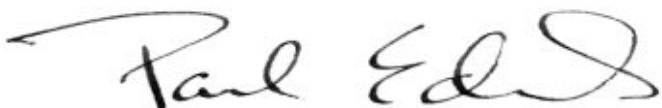
Reconciliation rulebook and supporting models

We have reviewed the revised rulebook and supporting models and have the following observation: The specified input for the WRFIM model #8 of Table 3.6 Inputs on page 46 has changed the source to "Wholesale revenue governed by price control" from "Total revenue governed by price control." It is not clear why this change has been made. This input is compared to the annual "Allowed Revenue" determined from the FD letter adjusted by RPI & K. The comparison is then the basis of the over or under recovery calculation in the model. However, the input as it is now defined is not comparable for these purposes. This is because the "Allowed Revenue" includes capital income and "Wholesale revenue governed by price control" does not. The original source definition of "Total revenue governed by price control" includes capital income which seems more comparable.

If this is not an error it would be useful to understand your thinking behind the change.

If you would like to discuss any of these points further please do not hesitate to contact me.

Kind regards,



Paul Edwards
Head of Economics and Charges

¹ as per stated policy on page 72 of the policy laid out on page 4 of the consultation document.