

Consultation on economic asset valuation for the bioresources RCV allocation at PR19

Southern Water's response

31 March 2017

Southern Water's response to Ofwat's consultation on economic asset valuation for the bioresources RCV allocation at PR19

Overview

Thank you for the opportunity to respond to your consultation on the valuation of BioResources assets for the purpose of apportioning the RCV.

We are broadly supportive of the proposed approach and found the supporting information helpful in understanding the thinking behind the proposals.

While we have had some useful discussions at the working group on this subject, the detail of the approach set out in the consultation has not been discussed at length. In the time available it is therefore difficult for us to make detailed comments on the precise methodology and the detailed information requirements.

As we develop our approach we will no doubt identify issues and have further queries and we think it would be helpful for Ofwat to facilitate further dialogue between companies over the next few months. Given the complexity of the valuation process, we would also suggest that the initial September 2017 submission is treated as a first draft for feedback and that a further iteration is built in to the process, ahead of the formal business plan submission in September 2018.

We set out below our high-level responses to the specific consultation questions. We would welcome the opportunity to discuss any of our responses further.

Q1: Do you agree that the focused RCV allocation should be based on the economic value of assets as set out in this section?

We agree in principle with the proposed approach. We have not yet had time to consider some of the practical challenges involved in the valuation approach, but will engage further with you as we develop our approach over the next few months.

Q2: Do you agree that companies should consider the impact on customers and markets and propose an alternative RCV allocation if this will better protect customers, including by promoting a level playing field for markets?

We agree that this is clearly an important area to consider. In practice it will be difficult to demonstrate what the impact on prices is since unbundling current wholesale tariffs is dependent on how the RCV is allocated and so there is a clear circularity.

Similarly, demonstrating the impact on markets that do not yet exist and which may evolve in ways that we have not anticipated is difficult, per se. We would therefore suggest that the test should be whether the allocation is likely to lead to charges that would be inconsistent with competition law.

Q3: Do you agree that the assumptions in table 4.1 are appropriate for companies to use for the valuation exercise? We welcome any comments on these assumptions; suggestions of further assumptions you consider all companies should use; or requests for clarification. If you disagree that any of the above assumptions are appropriate to be used by all companies please explain why and if relevant suggest an alternative.

We support the assumptions set out in Table 4.1. The guidance provided in these areas is very helpful in ensuring consistency between companies' valuations. As companies develop their approaches, we expect that new, unanticipated issues will arise and we would urge Ofwat to keep the assumptions table 'live' so that this consistency is maintained.

Q4: Do you agree that the assumptions in table 4.2 are appropriate for companies to use for the valuation exercise? We welcome any comments on these assumptions; suggestions of further assumptions you consider all companies should use; or requests for clarification. If you disagree that any of the above assumptions are appropriate to be used by all companies please explain why and if relevant suggest an alternative.

We agree with the assumptions set out in the table. The one area where additional guidance would be helpful to maintain consistency of approach is the methods for allocation of indirect overheads (central IT etc). The Regulatory Accounts Guidelines already include guidance on cost drivers in certain areas, so it should be straightforward to develop an equivalent set for use in this exercise.

Q5: Do you have any further suggestions of potentially useful cross checks, beyond those presented in table 4.4 that companies may want to consider?

Companies We do not have any additional suggestions and some of those listed in the table may not be relevant – for example, we are not clear how Gross MEAV could provide a relevant cross-check on a forward looking, net asset value.

In practice the most useful cross-check will be against other companies' valuations and this is one that Ofwat intends to carry out using the information provided in the data tables. We would also urge Ofwat to facilitate dialogue between companies over the next few months to provide that cross-check.

Q6: Do you have any comments on our timetable?

The expectation of a fully audited and board-assured data submission in September 2017 is very ambitious, given that the final guidance will not be published until late April 2017.

Given that this is a new area for all parties and we will learn through the process we do strongly support an early opportunity to compare valuations and to get feedback from Ofwat. We would suggest that the September 2017 submission is treated as a first draft (without the requirement for full Board assurance), with a further, fully-assured iteration to take place in Spring 2018, ahead of submission of the business plan in September 2018.

Q7: Do you have any comments on our assurance expectations?

See response to Q6 above.

Q8: Do you agree that companies should publish information on their websites to allow other stakeholders to comment, and when this could happen?

Q9: At what level of detail do you think that this information should be published at? Please comment as to what you consider the benefits or disadvantages to companies publishing information at a site level?

We do not think it is appropriate to require detailed site-level costing information to be published.

The benefits from publication of such information need to be balanced against the potential commercial risks for undertakers in publishing detailed cost information that could prejudice future commercial arrangements, with adverse impacts for customers. In considering this balance, it is not clear to us that stakeholders would, in reality, be motivated to take any time to review the valuations, unless they had a strong commercial reason to do so.

We think publication of high-level information by Ofwat on the valuations and comparisons between them is more likely to be useful and more likely to help stakeholders understand the overall picture and raise any concerns they may have.

Q10: Do you have any comments or require any clarification on the proposed tables? Where you have alternative proposals, please set out how this meets the objectives of the asset valuation for the purposes of allocating the legacy wastewater RCV to the bioresources control.

We were surprised at the level of detail required in the tables, but have not, in the limited time available to comment had the opportunity to review the information requirements in detail. The establishment of a formal clarification process to share queries and responses on the tables with all companies would be helpful.

Should you have any queries regarding our response, or would like to discuss any aspect of it with us, please contact our Head of Economics and Strategy, Kevin Wightman, on 01903 272421 or by email kevin.wightman@southernwater.co.uk