
Internal meeting note

Friday 23 March 2016
11 am to 3.00 pm

Regulatory accounts working group (RAWG)

Water only companies

Attendees	
Tim Charlesworth	Affinity Water
Beverley Lawton	Bristol Water
Alex Groves	Bristol Water
David Lovett	Bournemouth Water
Daniel Hughes	Dee Valley Water
Caroline Jemphrey	Portsmouth Water
Nicola Nestor	Portsmouth Water
Patrick Mallon	South East Water
Matt Hersey	South East Water
Philip Saynor	South Staffordshire Water

Scope of meeting

In advance of Ofwat's next RAG consultation for 2016-17 being published we held a RAWG meeting for Water and Sewerage companies on 18 March 2016 and another RAWG meeting for Water only companies on 23 March 2016.

We invited two representatives from each company, one attendee being our usual RAWG contact for each company, and another attendee from each company who is familiar with the practical/engineering processes around Boundary issues for sludge and water resources.

- Targeted review - background and scope
- Water resources: CEPA findings; Key changes to RAGs
- Recharges between price control units: CEPA findings; Key changes to RAGs
- Sludge: Brief update for WoCs
- Other RAG changes: Transfer pricing disclosures; Other changes
- Future RAG changes – Water 2020: Water resources
- Future RAG changes – Water 2020: Cost assessment
- Future RAG changes – Water 2020: Other future reporting
- Future RAG changes – Water 2020: Cost assessment
- Next steps: Targeted review – WoCs, RAG timeline

Key points from meeting

- CEPA's report focused on companies' 2014-15 accounts.
- Ofwat's RAG consultation is for the 2016-17 reporting year (to be published end of March 2016). It will include proposed changes to RAGs, with a caveat that further changes may be applied to reflect Water 2020 decisions in the May document. A second RAGs consultation (for the reporting year 2016-17) is possible if there are material changes from Water 2020.
- We are not making any changes to the reporting year 2015-16.
- Ofwat advised companies that the RAGs consultation will continue to evolve. Companies agreed with Ofwat's approach that the RAGs need to be consistent with any changes to policy (e.g. changes in boundaries).
- Ofwat asked companies to respond to consultation in conjunction with the W2020 May document.
- Ofwat will publish finalised RAGs for 2016-17 in September. Aiming to get 2017-18 (base year) data as good as possible for PR19.

Targeted review – CEPA review

MEAV revaluation in 2009 – looked at asset values to allocate RCV, in particular sludge. CEPA report highlighted a high variation on MEAV as each company had different underlying assumptions.

A company queried the unfocused approach to RCV, whether the high cost of the MEAV exercise was worth the little benefit gained. Report seemed focused on sludge and less so on water resources.

A company stated that the regulatory costs, 20% retail (consistency at PR14 for ACTS), not cost reflective. More than just Ofwat licence fee. Give flexibility to do something different if justified. But deviate from Ofwat allowed revenues. Equal split – lowest common denominator but can deviate – methodology statement - would detail.

Water resources

- Recharges – A company raised a question on recharges. We clarified that we have updated the information on recharges into RAG 2.
- Borehole to WTW pipes – A company raised a question on nested boreholes to WTW. The distance could just be a few hundred meters to treatment. Unsure whether treatment/ transport/ distribution? Do they allocate costs to RWD? Distance up to service reservoir - should be allocated to treated water distribution?
- Cumulo rates - A company raised a question. Previously MEAV, now based on FTEs. Is confused on the allocations definitions. Clarified that RAG 2 was between retail and wholesale not between services. [Action: propose to include an example in RAG 2 to clarify. CEPA looked at 2014-15 with no regard to 2015-16]
- Local authority rates – not cumulo?
- Ofwat will include changes into RAG 2 and RAG 4 as per CEPA's report apart from a few items which Ofwat has rejected.
 - Labour and maintenance costs – this could be picked up through a 'Best practice guide' or in the 'methodology statement'
 - M&G asset allocation – choice of driver – Ofwat to do further work with RAWG in this area. How material is it?
- Definitions:
 - Third party services - Definition of 'third party' in appendix 1 of RAG 4.
 - Bulk supply – bulk supply of treated water imported should be split between treatment and resources, but difficult to get provider to split cost over these elements. Provider (exporter) – special agreement. Third party costs – cost of water, treatment, transport and margin. RAG 4 change to

definition. Was missing bulk supply (treated water) which can be recognised in either Resources or Treatment.

Sludge

Boundaries between appointed and non-appointed activities – e.g. tankering waste, share costs to non-appointed when appointed assets are used.

A company raised a question that was similarly raised in last week's RAWG (WaSC) meeting re: Treating waste from other WaSCs with Mutual aid agreements. RAGs principle – appointed asset for non-appointed business.

Other RAG changes

Reminder on Arms length trading across price control units

RAG 5 tells what is appropriate between price controls. Some companies were not doing this:

'Where assets are used for both appointed and non-appointed activities, to ensure there is no cross subsidy RAG5 requires that a charge is made that reflects both depreciation and financing costs.'

A company asked how financing costs should be calculated.
eg 5% RCV x WACC Cost of debt @ FD

Further guidance on Current cost reporting – Table 4G

- Table 4G contains simplified information for Stakeholders (who have a preference for current cost information).
- Table 4G line 3 – Capital maintenance charges
e.g. IF IRE is fully expensed then capital maintenance charge is nil.

Action: Ofwat to include a worked example in the RAGs to explain this

Other income definitions & Methodology statements

A Best Practice Guidance was published previously on this, but some new starters may not know about it.

Methodology statements should provide detail on compliance, etc and provide detail on changes on methodology. CEPA report provided information that was not included in company's 2014-15 methodology statements.

Question: Companies to publish Compliance Statement?

Defining the Market: The boundaries around sludge and water resources

A company stated that there are boundary issues between water resources, raw water distribution and water treatment.

Cost assessment working group are looking at the cost assessment area.

Other future reporting

- Water resources – Access pricing: see UU paper
- New connections: charging rules

RAGs consultation will continue to evolve e.g. boundaries may change

We asked companies to respond to the consultation in conjunction with the Water 2020 May document.

Timeline

August/ September: 2nd consultation on RAGs eg change in boundaries - the RAGs will need to be consistent with any change to policy [re: Water 2020 May document]

September: publish finalised RAGs - This is prep for PR19. We want to get 2017-18 data (base year) as good as possible for PR19. Therefore, 2016-17 is prepping up for this, and would be a good comparative year data.