Consultation on regulatory reporting for 2018-19 reporting year

Response on behalf of Severn Trent Water & Hafren Dyfrdwy

22 February 2019

WONDERFUL ON TAP

Consultation on regulatory reporting for 2018-19 reporting year

Summary Response

We welcome this opportunity to comment on Ofwat's proposals for regulatory reporting for 2018-19 and have set out our responses below.

Overall we consider that the proposals will result in enhanced and more consistent reporting across the sector. We believe that the proposals strike an appropriate balance between achieving consistency of reporting between companies whilst allowing them the flexibility to ensure that their reports are relevant to their stakeholders and appropriately reflect their performance.

In addition to the specific consultation questions we have also attached recommendations from the Water UK regulation network working group on common performance measures reporting (Appendix 1). The working group focused on three measures that were new for 2017-18 shadow reporting with a view to improving consistency through resolving areas of uncertainty/ambiguity:

- Sewer collapses
- Unplanned outages
- Risk of flooding in a storm (waste water resilience)

If you have any queries or wish to discuss the response in more detail please do not hesitate to contact me.

Min Grimshaw
Head of Financial Performance and Reporting

Q1 Transparency of financial flows – Appendix 1 contains our new table 1F;

a. **Do you agree with the scope of the proposed information items in the new table?**
b. **Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for financial flows reporting?**

1F.1 Return on Regulatory Equity
For our RoRE calculation, we have been adjusting the base equity return set at the FD for the element of the return we no longer earn as a result exiting business retail. It is not clear from the line definition whether the same adjustment to the base equity return should also be applied in the financial flows.

1F.5 Gearing
It would be helpful if Ofwat could clarify if the allowed return on regulatory equity – base used in the calculation should be pre or post the PR09 performance adjustments.

1F.8 Cost of debt (adjusted for hedging instruments)
The calculation of (c) in footnote 1 of Appendix 1 states that the nominal interest rate should be deducted for the movement in RPI. Can Ofwat clarify whether companies should use the Fisher equation (as now used in the RoRE calculation) to convert the nominal rate to a real rate i.e. (1 + nominal rate) / (1 + RPI) - 1)?

Q2 New connections – Appendix 1 contains our new table 2K;

a. Do you agree with the scope of the proposed information items in the new table?

We agree with the scope and can understand that setting new connection charges under the rule set implemented from April 2018 onwards created a relationship between infrastructure revenue and infrastructure expenditure which draws the connection to table 2J.

However we note that tables 2K and 2J only present actual figures for a single (current) year and infrastructure revenue is based upon expenditure and connected property volumes (not featured in financial APR tables) over a 5 year period with the emphasis on a future forecast rather than actual historical investment.

We would therefore highlight that table 2K will enable an ‘in year’ comparison between investment and revenue (including the variance brought forward from the previous year) but the investment and revenue in year should not be expected to cancel each other out.

We assume that the variance brought forward in year 1 will be zero, and each year up to year 5 will be a cumulative variance, up until year 6, where it becomes a rolling 5 year balance as per proposals in the New Connections charging consultation. It would be helpful if the definition of line 2K.4 is expanded to include further detail as currently it refers to the ‘variance reported in 2K.7 in the previous reporting year’.

b. Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for new connections reporting?

We note that table 2K does not include information on New Connections costs, despite the table name. The table in fact includes costs related to network reinforcement due to new connections. If the question is whether the APR tables as they stand provide full and clear requirements for all developer services costs and income we do not believe this to be the case. Further, we believe that the definition of network infrastructure reinforcement is still being interpreted in different ways by different companies leading to inconsistent treatment for developers in different regions. We also note that companies in Wales do not currently operate under the same rules as those in England and therefore the information in this table is less relevant for Hafren Dyfrdwy.

If the definitions were to be improved (in light of the PR19 submissions), for example by including other network reinforcement costs reported as non-developer services related, we believe that greater transparency would be achieved. We also note that 'New connections' has a specific definition in the licence which should be aligned to any definitions in the APR.

Q3 What are your views on the proposed changes to the existing tables in Appendix 1?

Table 4C
The additional clarifications provided on the line definitions in the table are useful but the references to "menu baseline" for lines 1 and 3 should align to the methodology in the PR14 reconciliation rulebook. The adjustment to the RCV for totex over/underspend is calculated by comparing actual spend to the totex allowed at FD not the Ofwat menu baseline.

We believe the additional clarifications that have been provided for lines 1 and 3 should be changed to the following;

Line 1 – Allowed expenditure from the menu at FD – actual totex

Line 3 – (Allowed expenditure from the menu at FD – actual totex) x (1 – AMP weighted PAYG)

Tables 4V and 4W
We agree with the changes to tables 4V and 4W which have been amended to allow reconciliation to the totex tables.

However, we note table 4V appears to be a combination of two Cost Assessment tables (one which is specifically for water resources and one which covers all of water), which may be better presented as separate tables. Likewise 4W for wastewater includes a mix of data sets and may be better presented as separate tables.

Q4 What are your views on the issues highlighted in section 3 'Future developments in performance reporting'? Are there any other issues which we should consider? We are particularly interested in your views on the impact of additional price control units (section 3.2).

New Accounting standard; IFRS 16 - Leasing
For 2019-20, we will be able to explain and quantify the operating costs that would have been recorded as expenditure in the income statement had IFRS 16 not been introduced, so that the difference can be explained and compared with the forecasts included in the business plan.

Table 2A – Impact of additional price control units
We agree with the proposal to expand table 2A to include the revenues for all of the 2020-2025 price control units and would expect the revenues to be included in several tables and reconcile to each other.

With regard to use of asset disclosures, an alternative presentation would be to include the recharges to and from price controls as separate line items in the totex tables. This would eliminate the requirement to include these charges on the face on table 2A and ensure that operating costs in the totex tables agree to table 2A.

It would be helpful to have some additional guidance around principal use classification of shared operational assets between the new price controls e.g. Borehole pumping assets where costs will in future be classified under both Water Resources and Water Network +.

Bioresources trading
We agree with the proposal for table 1A to be expanded to include costs and profits for bio-resources.

Impact of Retail non-household exit
We think that there is scope for reclassifying the activities that are currently considered to be "residual non-household retail" for those companies that have exited.

Severn Trent Water completed the disposal of their non-household retail activities to Water Plus (a joint venture with United Utilities) during 2016/17 in advance of the market opening on 1 April 2017. However, certain activities which are classified as non-household retail under RAG 2.06 remained within Severn Trent Water. These activities were performed by Severn Trent Water wholesale teams and recharged to retail under the requirements of RAG 2.06. These were recorded in the Severn Trent Water non-household retail price control.

- Developer services costs in relation to providing information and administration for new connections
- Investigatory visits / first visit to the customer where the cause of investigation is not a network issue
- Customer side leaks expenditure (excluding costs to meet wholesale outcomes)

Although the above costs will remain with Severn Trent we think there is scope for each of these items to be recorded as either wholesale or non-appointed in the future. This would mean that following the exit of non-household retail activities there should be no residual income or costs remaining in the non-household price control.

As such, the price control assignment of the above activities should be considered;

- *Developer services costs in relation to providing information and administration for new connections*

We maintain a developer services call centre that handles applications and other queries directly from developers. As such activities are performed by the wholesaler we would expect income and costs in relation to these activities to be recorded in the wholesale price control.

- *Investigatory visits / first visit to the customer where the cause of investigation is not a network issue and customer side leaks expenditure (excluding costs to meet wholesale outcomes)*

The reporting of these costs going forward should be considered for both household and non-household customers. As an example, for any activity relating to repairing customer side leaks, the customer has the option to employ a third party other than its water retailer or the incumbent wholesaler to provide this service (e.g. a local plumbing company).

A competitive market for such services exists and therefore the water retailer or incumbent wholesaler is not a statutory supplier of this activity. With this in mind, it should be considered whether the investigatory and follow up visit costs (and related income) for this activity should sit within the appointed or non-appointed activity of business. Household retail costs relating to vulnerable customer investigatory and follow up visits should be separately considered as to whether they are appointed or non-appointed.

The above assignment of costs and related revenue would lead to there being no residual costs recorded in the incumbent non-household price control.

Income from 'diversions' activity

We do not think that including income from any developer services activity in a combined control with billed income protects customers, because shortfalls or increases in development activity are reflected within company costs and should not be offset through customer bills. Setting that aside, if Ofwat is including diversions income within the control then reporting should be aligned with the control.

Q5 What are your views on our preference to require all costs associated with the 'Traffic management act' to be reported (section 6)?

It would be helpful to understand how the information relating to Traffic Management Act costs is intended to be used by Ofwat. The direct administration cost of TMA activity is fairly easy to identify, but the additional delays and complexities that this process adds to our operational costs would be very hard to measure (these are potentially significant).

Our PR19 table equivalent to 4V only included the actual permit costs with no overheads.

Q6 What are your views on our additional asset type descriptions for Water resources which require ‘desalination’ and ‘effluent reuse’ abstraction assets (section 7)?

We agree it is appropriate to include these asset types within Water Resources.

It would be helpful to provide schematics depicting the classification of effluent reuse assets between price control units, for example;

- Treatment assets required to improve effluent quality (which is over and above that which is required by the current discharge permit to a local watercourse) prior to transfer to a different water body with a tighter discharge permit
- In a ‘closed system’ the pipeline between the waste treatment assets and remote water treatment assets. It is unlikely the two treatment systems would be on the same site due to WQ risk and customer perception, therefore would this be classed as raw water transport?

Appendix 1

Recommendations from the Water UK regulation network working group on common performance measures reporting

Sewer collapses

Proposed revisions to reporting guidan

Unplanned outages

Proposed revisions to reporting guidan

Risk of flooding in a storm (waste water resilience)

Wastewater resilience common p