SOUTH STAFFORDSHIRE®
WATER PLC

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Dear Stephen

Setting price controls for 2015-20: SST/CAM response to consultation on the framework and approach

Here is the combined response from South Staffs Water and Cambridge Water to the PR14 consultation. We are content for our response to be published in full on your website. Our response is structured with this covering letter that focuses on our principal issues, followed by specific responses to the 55 questions posed by Ofwat in your consultation document.

There are a number of issues that we welcome with the proposed methodology. For example, we support the continuation of SIM; we consider that the decision to allocate meter installation costs to wholesale is sensible; and, the desire to have lighter touch regulatory scrutiny / interference of robust business plans with outcomes that customers support are approaches that we welcome.

However there are five inter-related issues that are of significant concern to us. These are the timetable; the baseline; potential complexity of PR14; lack of clarity over new processes to be introduced; transparency of modelling and the basis of decision making. Our response also discusses some key guidance issues that are currently omitted.

Timetable

We are aware from the recent Wholesale workshop that Ofwat are also concerned about the timetable. The key issue arising appears now to be that of identifying a timetable that allows Ofwat to derive a realistic future baseline level of total expenditure for each company. We would prefer less time to respond to the baseline, providing it does account for our business plan projections of future costs, rather than a scenario whereby the date of our business plan submission is bought forward. This would be unacceptable given the extensive work to be done in 2013 at a time when the business plan requirements are far from clear. We feel that bringing forward the final business plan submission date would reduce time for Board involvement in decisions; increase the risk of poor quality plans; and frustrate the CCGs who still need time to review the emerging outcomes and business planning proposals from companies.

Baseline

It now appears clear that the success of the Price Review will depend significantly on the ability of Ofwat to set a fair baseline assessment of future costs needed for each individual company to operate efficiently. Every effort is needed to ensure this process is transparent so that stakeholders can be comfortable with the basis of a company's relative efficiency; the costs needed to operate the business; and the incentives to outperform the baseline.

Potential complexity of PR14

It does appear that this price review is attempting to tackle many strategic aims of government. The wholesale and retail split is a fundamental change that will itself need concerted effort to implement effectively. We support this. However, the additional approaches in respect of AIM; network plus; network management; and to some extent even water trading are a potential distraction and unnecessary complication that may need postponing. We now doubt these will be implemented with great success given the practicalities of implementing these concepts is not clear. Time is running to provide clarity to these particular aspects of the PR14 methodology and communicate these clearly to stakeholders.

Lack of clarity over new processes

There are many new concepts to be introduced that we have struggled to grasp how they would apply and some have can be subject to different interpretations. This not helpful when at this stage we are engaging with our Board and our CCG and soon we will be writing our business plan. Some examples of these are:

- Default tariffs – who sets these? What is the link to the wholesale charges? How are they communicated to existing and prospective customers?

- ACTS – will the industry level change for metering / debt (if made) adjustments, or is the ACTS fixed and such adjustments are just for company specific levels?

Our specific response to the 55 questions attached to this response provides further examples of where we are struggling to follow the approach to be taken.

Transparency of modelling and the basis of decision making

This price review will be very different to previous ones. The absence of a proven and consistently-used financial model concerns us. Any concerns with gaming are dwarfed in our view by the increased risk of modelling errors / mis-interpretations. Furthermore it creates a new burden on the smaller companies in particular. We are also very disappointed with the lack of commitment to share the cost assessment models and therefore urge Ofwat to review this stance. Comparative spend and efficiency levels are extremely useful tools for all stakeholders – including company Boards and CCGs – to assess the context of future expenditure levels that each company puts forward. It will be difficult to respond to the baseline that Ofwat set in spring 2014 without us having confidence that the models used by Ofwat to determine this baseline are fair and credible.

Further Guidance from Ofwat

We also feel that Ofwat should consider options to avoid companies submitting extremely large business plans. We are concerned that the lack of detail about what is expected in a Business Plan increases the risk that each company feels compelled to include large volumes of data and commentary, just in case it is required for Ofwat's assessment. The length of business plans is already in danger of escalating due to the wholesale / retail split. This risk of lengthy business plans goes against the aim of having proportionate plans. There is a real danger that Ofwat receive extensive business plans from companies who feel they need to prove the business case is robust by providing lots of supporting detail. Ofwat could meet with individual companies to hear their high level proposals then clarify which parts of this need light or comprehensive coverage in Final Business Plans. We would encourage Ofwat to confirm a timetable for high level meetings with individual companies, as this process worked well at PR09 to identify the specific issues that each individual company had as a priority to resolve.

We would also urge Ofwat to comment on some fundamental price review issues missing from the consultation. These include:

- Approach to assessing capital maintenance submissions – will Ofwat want detail from all companies and will an "AMA" type scoring approach like that adopted at PR09 to score the quality of company submissions against the Common Framework apply?

- Approach to assessing base operating cost increases – pensions and power costs in particular can have significant influences on the levels of bills customers will pay.

Please let me know if you would wish to discuss any points raised in this response.

Yours sincerely

Matthew Lewis
Finance and Regulation Director

Enc. Response to 55 questions

South Staffordshire Water / Cambridge Water's Response to "Setting price controls for 2015-20 – framework and approach: a consultation", March 2013

Delivering what matters – an outcomes-focused approach

Q1 Do you agree with the process for deciding on the nature of the incentive (non-financial, one- or two-sided and for allowing trade-offs where appropriate)?

We agree that the proposal is a fair way to decide on the nature of incentives, given Ofwat's desire for outcomes. It gives maximum flexibility to the companies to structure the incentives in a manner that is acceptable all stakeholders.

However, we believe that the lack of an Ofwat published performance table for Outcomes (especially for Outcomes chosen by companies and therefore likely to have different definitions - even for Outcomes that look to be comparable between companies) will create a more difficult task of convincing customers that each company has reported its performance accurately.

We are also slightly concerned that there are expectations raised that all outcomes will have financial incentives associated with them, which may not be the case.

Q2 Do you agree with our proposal to consider delivery incentives for the next five years? If not, how should we use longer-term delivery incentives?

Yes, we agree that the incentives should only be set for five year periods (with the option of stating aspirations for future AMPs).

Q3 Under what circumstances do you think we should set consistent performance commitments and incentives across all companies? Are there particular examples where consistent incentives would be beneficial?

We agree with the proposal that SIM and leakage are useful as industry-wide Outcomes. We feel that leakage should be measured in a comparable way (i.e. not the absolute level (e.g. 14 ml/d) rather in leakage per connection, per length of mains or as a percentage of DI). This will provide meaningful comparison between companies. We are not convinced that AIM should apply to all companies.

Defining retail (and wholesale) services

Q4 Do you agree with our definition of retail? Specifically, do you agree with our preferred option for demand-side water efficiency services, customer-side leaks and developer services?

We agree with the split of retail services for the activities that you are not consulting on.

We feel that demand side water efficiency services and customer-side leaks should sit in Wholesale, since there would be no incentive for Retail companies to undertake this activity for households, since it would increase their ACTS and so possibly reduce their funding.

We acknowledge that the Non-household retail entities may wish for those activities to sit in their areas to allow them to provide tailored services, but given the relative size of the HH and NHH sectors it would be wrong to make decisions that helped the smaller sector to the detriment of the larger one. Clarity is needed that the retail entities can decide to offer more services than the definition determined by Ofwat.

We accept the proposal about new development activities to be split between Wholesale and Retail.

Setting wholesale controls

For controlling wholesale revenues

Q5 Do you agree with our proposed scope for the wholesale water and wastewater controls, given the proposed scope of the retail business we have defined in chapter 3? Are there any revenues of the regulated wholesale business you think should be excluded from this scope – if so, please give your reasons?

We agree with the definition of the water controls (we have no view on the scope of the wastewater controls).

We welcome the use of RPI+K for wholesale revenue.

We accept the proposal to include customers using more than 50 Ml/y in the control. We also cautiously accept the proposal to include connections charges in the control, but some clarity over whether this incorporates developer contributions for off-site network reinforcement costs is needed. Ofwat will need to the inconsistencies in accounting treatment of connection charges amongst companies (are they income? are they capital contributions? etc.).

Q6 Do you agree with our proposal for a mixed revenue and revenue yield form of water wholesale control, including our proposed adjustment mechanisms to smooth allowed revenues within the control period? Are there any adjustments you would suggest?

We are not convinced that the there is a need to move away from the average charge approach towards a revenue cap. This will be harder for customers to understand and will result (assuming growth in the customer base over the next AMP) in the K profile for total revenue to be higher than the respective movement in average bills. Currently the K allows customers to estimate their future bills as the K relates to their bill. The new approach would see positive K for companies with static average bills, but experiencing a growth in their customer base. While we acknowledge that this is down to companies to explain, it does seem an unnecessary complication. Customers do not like volatility in their bills and this concept could encourage this through weather variations. There is also a risk of bias from judgements needed to be made prior to year end on future revenue needs.

We agree that the total revenue required to operate our business is a mix of fixed and variable costs, and therefore can see the merits of combining the ‘total revenue’ and ‘revenue yield’ approach.

We believe that an annual income adjustment will further complicate the setting of tariffs and make it less transparent to customers why bills are moving. We feel that ‘once an AMP’ (like the current RCM) would be more appropriate.

Q7 Do you agree with our proposed simple revenue control for wastewater wholesale services? Do you have any evidence that suggests a revenue yield element should also be included?

As a water only company we have no comment on this matter.

Q8 How do you suggest we incentivise companies to prepare and update accurate demand assumptions to apply our proposed forms of wholesale control?

Accurate demand assumptions are required for the Water Resource Management Plans. Ofwat should take data directly from this work and it is for the EA to ensure that the assumptions are correct.

For cost assessment

Q9 Do you agree with our draft process for developing baselines? If not, how might it be improved?

If there are statistically valid TOTEX models available, then we support their use. However, we are concerned that this is not the case and we are concerned about transparency. We are also concerned that the inclusion of what would have been called at PR09 "Enhancement CAPEX" will present modelling difficulties, especially for smaller companies with 'lumpier' spending profiles. We would not wish for models that are deemed to work across the industry to be used, only to find that they are problematic for smaller WoCs like ourselves.

We support the use of multiple model outputs, but are concerned about how 'triangulation' is used to determine the baseline. If one model produces the 'correct' answer and a second produces a 'very wrong' one, the average of the two will be 'wrong'.

We believe that we need to have a view of the baseline prior to submitting the business plan, since this will impact on bills, and better allows us to assess willingness to pay. The baseline is a very significant issue in determining if the price review is successful. It also is key to clarifying Ofwat's view on how efficient each Company is, which is a fundamental principal of whether Determinations are acceptable to companies.

Q10 What areas of expenditure do you consider we should exclude from the general cost assessment methodology (that is, advanced econometric models and econometric models)? How should we assess these costs?

Enhancement CAPEX, business rates, abstraction charges - the former should be assessed through review of the individual projects being proposed, the latter two based on the amounts being charged to the companies.

Q11 What special factors should we consider for your company as part of our cost assessment? What criteria should we use to assess whether we need to take account of these in our view of your costs?

We are keen to avoid the generation of a 'special factor' industry, we instead Ofwat to allocate two-way adjustments across all companies. We feel that the number of these adjustments are kept to a minimum, but where they are made that they are applied to all companies and in a symmetric manner. We are concerned that some companies are suggesting debt costs should account for those companies with large customer bills. It seems odd to reward companies with high bills and the reality is that water bills are only a part of localised household bills (other utility bills, council tax bills etc. will influence ability to pay water charges). Debt levels and collection costs are clearly linked to local deprivation extremes and we feel Ofwat should continue the process adopted at previous reviews to account for this.

Without transparency of models, it is difficult to know whether company specific adjustments are needed. For example, we assume models that consider power costs would use the average pumping head as an explanatory factor. However, if they did not, then South Staffs would wish to submit a company specific claim for our circumstances.

Additional comments

We believe it would be beneficial to use year 4 TOTEX data (2013/14) data in the assessment of costs for PR14, but cannot find specific mention of it in the consultation.

For cost performance incentives

Q12 Do you agree with our criteria for excluding costs from the general cost performance incentive framework? What types of costs should we exclude from the general framework? Please explain how these meet the cost exclusion criteria and how we should incentivise cost performance for these costs.

We agree with the criteria proposed for exclusions. The costs we believe should be excluded are business rates and abstraction charges, given their uncontrollable nature. They should not be incentivised for cost performance. Only when/if abstraction reform allows licence costs to be related to volumes abstracted should these costs be included in the assessment.

We understand the principles of the CIS mechanism and would support a similar approach to cost performance.

For cost recovery

Q13 At what point should we take the MEA values to split the 2015 RCV in order to set water and wastewater price controls?

We are concerned that any allocation of WaSC's RCV that results in their water bills decreasing and their sewerage bills increasing will have an impact on our customers. We acknowledge that customer receiving both services from the WaSC will have the sewerage increase offset by the water decrease; our customers will see the impact of only the sewerage increase. This will affect our ability to collect the water service bills.

We believe that it is in customers' best interest for the allocation of the WaSC RCVs to be done in a way that reduces the impact of this.

If the impact is minimised, we do not have a view on when it should be done.

Q14 Do you agree that it is possible to simplify our approach to calculating tax?

This may reduce the burden for Ofwat but for companies the workings will still need to be progressed so we are not convinced this proposed approach represents a simplification to the price review process.

Retail controls for household customers

Q15 Should the ACTS be calculated on the basis of historic cost data or forecast cost data?

ACTS should largely be based on historic data; but any significant changes to forecast data do need to be accounted for. It is important that the Accounting Separation data used is comparable, and this will only be available if the definitions of both the services and the HH/NHH split are detailed in guidance.

Q16 Do you agree with our proposed criteria for assessing other adjustments to the ACTS? Are there other factors we should take into account, and (if so) how?

We agree with the principals of materiality, uncontrollability and individuality.

We believe that doubtful debt and collection costs should be taken into account. The current proposal would allow a fixed amount per unique customer to all companies, regardless of the size of bill or whether that customer received one or two services from that company.

We don't understand why companies are being asked to provide proof that the value of bad debt is relative to the size of the bill being sent. We believe that this is obvious and conversely suggest that Ofwat provide evidence that the size of debt is not related to the size of bill. Efficient companies will still have high debt costs and collection costs if the customer base they serve are deprived relative to those customers serving more affluent customers.

Q17 Do you agree with our preferred option of applying an industry-wide adjustment to the ACTS for levels of metering?

We agree. If this did not happen then there would be no incentive for us to promote metering. We also think the debt adjustment should be industry-wide.

Q18 How do you think we should apply the ACTS for those above the industry ACTS? Do you think that we should use a glide path and (if so) of what form?

We agree that a glide path would be a fair method of limiting the costs of companies with above average ACTS. We suggest a three year glide path. This would be a straight line approach from the actual reported for 2013/14 and the average, taken in three steps.

Q19 How should we set a forward-looking efficiency challenge for those companies below the industry ACTS?

If there is not going to be an indexation of ACTS then no efficiency should be set. This would result in an effective "efficiency = RPI" approach.

If the ACTS will be inflated (and we believe it should – see 'Additional comments' section below) then the efficiency should be calculated in the same way that efficiency targets have been set at previous price review – Ofwat considering the data, making a determination about the gap between that company and an "efficient" one and setting the efficiency challenge based on this gap.

Q20 Do you think we should use a net margin to remunerate household retail invested capital and risk over the period 2015-20? How can we avoid over-recovery of returns and take into account any implicit margin that exists in the difference between efficient retail costs and the retail price?

We understand the need for a margin to encourage competition. We acknowledge that this will lead to double recovery on the retail assets in the RCV at 1 April 2015. However we do not think that this is material or long lasting.

There will continue to be an incentive to reduce costs, as at previous price reviews.

Q21 Do you agree that we should retain the service incentive mechanism (SIM), in a modified form, to encourage good customer service for households?

We accept that the SIM drives good customer service and would welcome its continued use. The SIM has changed company behaviour for the benefit of customers.

Q22 Do you agree with our preferred option of funding additional water efficiency services and customer-side leaks through the wholesale control?

We believe that there is a risk to the level of these activities unless they are funded by the wholesale business, given the impact of ACTS. We would welcome further information about this funding arrangement, as the details seem vague at the moment (see also our response to question 4).

Additional comments:

We are concerned about the lack of inflation being applied to the ACTS. Input prices will increase, mainly by labour costs (given the high proportion of costs that are labour). We do not intend to invest time and resources to provide evidence of this; conversely we would pose the question to Ofwat to demonstrate that retail costs do not increase with RPI. The assumption that this is the case has worked well since privatisation.

We would be happy with RPI as the indexation for these costs, but alternatively would accept average wages inflation.

Retail controls for non-household customers

Q23 Do you agree with our preferred option of rolling over existing tariff structures to form default tariffs?

Yes, this will reduce the impact of incidence effect on customers.

Q24 What are your views on our approach to customer churn under the proposed form of control for default tariffs?

We accept your approach to customer churn by setting average revenue per customer (and by customer type). We feel that this reduces the likely impact of existing customers of others switching.

Q25 What approach should we take to determine the aggregate level of operating costs to include in the non-household retail control? For example, should we use historic costs or forward-looking costs?

Historic costs are more robust than forecast ones. We support the use of historic costs for PR14.

Q26 Do you think we should use a net margin to remunerate non-household retail capital employed and risk over the period 2015-20? How can we avoid over-recovery of returns and take into account any implicit margin that could exist in the difference between efficient retail costs and those used to set default tariffs?

We understand the need for a margin to encourage competition. We acknowledge that this will lead to double recovery on the retail assets in the RCV at 1 April 2015. However we do not think that this will be material or long lasting.

There will continue to be an incentive to reduce costs, as at previous price reviews. If there is the appetite for competition that we are led to believe (from all NHH customers, not just the large ones) then market forces will encourage more competitive tariffs and remove this risk.

Q27 What constraints, if any, should we place on companies' ability to set the gross margin levels for individual default tariffs for non-household customers?

The gross margin should be set by Ofwat and mandated for companies. This will ensure that it is set at an appropriate level that is not anti-competitive and encourages switching, but removes the risk of companies being accused of increasing charges for NHH customers who don't wish to switch. It is very odd for a Regulator to introduce the concept of a retail margin but then expect companies to set this.

Q28 Is there evidence that demonstrates that the costs of providing retail services to non-household customers are driven by uncontrollable changes in input prices? Are these difficult to predict? Given this, what is the appropriate approach in non-household retail controls for 2015-20 for uncontrollable changes in input prices?

Input prices will increase, mainly by labour costs (given the high proportion of costs that are labour). We do not intend to invest time and resources to provide evidence of this; conversely we would pose the question to Ofwat to demonstrate that retail costs do not increase with RPI. The assumption that this is the case has worked well since privatisation.

We would be happy with RPI as the indexation for these costs, but alternatively would accept average wages.

If these costs do not increase by some type of inflation then the default tariffs will become increasingly attractive to customers and discourage switching over time.

Q29 Do you agree with our preferred option of setting the default tariff minimum service level using the existing GSS standards?

GSS is an acceptable level of service, but most of its conditions relate to services that the Wholesale business would provide, rather than Retail.

Q30 What aspects of service should we target in setting a service incentive for non-household customers in Wales?

We have no view on this.

Q31 Are there other options for setting an efficiency challenge for non-household retailers in Wales we have not considered? If so, what are they? Which approach do you think best meets our objectives?

We have no view on this.

Making better use of water resources

Q32 Do you agree with our preferred option for implementing water trading incentives?

We agree with the incentives proposed but do feel that this initiative could be parked for PR14 as it is a further complication to a radically different price review. It may be that companies respond to the challenge to trade more without these new incentives. Water trading did not feature heavily at previous reviews and the Government's challenge to the sector is clearly understood.

The over-recovery of costs from customer for importers may be difficult for customers to understand, but it would be for the company to explain if cheaper options (that would have resulted in lower bills) were rejected on environmental grounds, and agree that this was a cost that those customers were willing to pay for.

Q33 What are your views on the sharing of export profits that the incentive should aim to deliver? Please provide your reasons and supporting evidence where possible.

We agree that a higher retention of profits from trades should make exporters more likely to export. However, given that we don't believe that this is the reason that trades are not taking place, we are not able to decide what that level of incentive should be.

Q34 What evidence should we take into account in setting incentive rates for importers (buyers) of water?

The over-recovery of costs from customer for importers may be difficult for customers to understand, but it would be for the company to explain if cheaper options (that would have resulted in lower bills) were rejected on environmental grounds, and agree that this was a cost that those customers were willing to pay for.

Q35 Do you agree with our preferred approaches to securing efficient trades and protecting the interests of customers? Please provide your reasons and supporting evidence where possible.

We agree that limiting the gain for importers to the lost income for the exporter will result in trades only taking place where it is beneficial for both parties.

Trading for the sake of trading should not be the goal; rather trading to reduce abstraction from over abstracted areas should be encouraged. A better way to achieve this would be through abstraction licence reform.

We agree that a cap on exporters is undesirable and that a cap on importers may be needed to restrict trading taking place at a level which is detrimental to customers. We don't, however, have a suggestion for what this level should be.

We think that the WRMP process should ensure that only appropriate trading is taking place, reviewed and controlled by the EA. We don't see that Ofwat should need to also check on this through a 'trading and procurement code'.

Q36 Do you agree with our preferred option for implementing the AIM?

Whilst we agree with the concept that the AIM is trying to deliver, we feel that abstraction licence reform would be a better tool. AIM is another complication to the price review that may need to be parked at PR14 and considered for PR19.

In the absence of this the AIM does, in principal, meet the objective so long as it is calibrated appropriately. There is an urgent need to clarify to companies which sources are “band 3”.

Q37 Do you agree with our preferred limit to the scope of the AIM?

We would expect the EA to decide on the scope of the AIM and look to them to decide on the range of water bodies included. We have no alternative suggestions to the WFD Band 3 proposed.

Q38 What evidence should we take into account in calibrating the AIM?

We can see the benefit of measuring companies’ performance against their historic levels, but propose that the historic baseline is set based on performance before now, removing the risk of gaming the baseline.

The threshold trigger should again be based on the EA’s assessment of when damage is caused, preferably on a site by site basis, rather than a blanket figure e.g. 50% of EFI.

We support the use of WtP data for the incentive rate, but it should also be based on the value of the damage caused by over-abstraction, as determined by the EA.

Q39 What are your views on our proposed phased implementation of the AIM?

We acknowledge the timeframes involved and accept that phasing it in would be of benefit. Perhaps running it as a shadow version for two years would be better so that we can more fully understand how it will work in practice over a wider range of weather and demand profiles.

Our response to question 36 notes our views that AIM may be an issue to consider for PR19.

Overall incentives, risk and financeability

Q40 Do you agree we should develop the balance of our proposed incentives using initial quantitative analysis of notional companies, and refine the calibration of incentives to reflect individual companies’ business plan proposals?

We agree with the proposal.

Q41 Do you agree that we should evaluate the overall risks relevant to each price control in assessing the allowed returns?

We agree with the proposal.

Q42 Do you agree with our broad approach to setting the WACC for wholesale services, given our proposals for the remuneration of retail services in chapters 5 and 6?

We agree with the proposal. We understand the desire to review returns on a range of the return on regulatory equity (RORE) in conjunction with the traditional return on RCV.

Based on recent Ofwat presentations we are unsure whether this would be calculated on actual gearing, as opposed to the notional one. The consultation reiterates the statement that “Actual capital structures are a matter for companies to determine…” – we agree with this statement.

Q43 In setting the WACC are there specific considerations we should bear in mind taking account of the profile of relevant risks to wholesale service provision?

The removal of bad debt risk from wholesale does reduce the risk for wholesale, but there are enough other uncertainties around the price review to suggest that overall risk is not significantly reduced. We imagine that a process for setting WACC similar to that done at previous Price Reviews would continue to be appropriate.

The Ofwat approach needs to account for the small company premium on both debt as noted at PR09 and on equity determined in the Competition Commission's determination for Bristol Water.

Q44 Do you agree with our broad approach to assessing financeability? Are there specific factors we should take account of in the next price control review?

We support the proposals. We acknowledge the assessment of financeability based on actual gearing levels, as well as the notional levels.

Assessing performance during 2010-15

Q45 Do you agree with our preferred option of implementing adjustments for legacy tools through wholesale controls?

Yes, we agree with this proposal. The application of the SIM incentive to Wholesale may seem counterintuitive, but it will keep the Retail price control simpler.

Q46 What factors should we take into account when determining whether to spread adjustments over the price control period?

If the adjustment is large then we would propose that spreading it over the five years as it reduces a step changes in bills. This will assist in the collection of revenue and reduce the likelihood of customer calls.

However, if any adjustment is small then we would suggest that a one off adjustment would be simpler and would support that approach.

Either way, we support the statement that the timing of the adjustment options would be revenue neutral.

Delivering price controls in 2014

Q47 What are your views on our emerging criteria for identifying high-quality business plans? Are there other criteria we need to consider?

We are concerned that the lack of detail about what is expected in a Business Plan increases the risk that we feel compelled to include large volumes of data and commentary, just in case it is required for Ofwat's assessment. This goes against the aim of having proportionate plans. There is a real danger that Ofwat receive extensive business plans from companies who feel they need to prove the business case is robust by providing lots of supporting detail. Ofwat could meet with individual companies to hear their high level proposals then clarify which parts of this need light or comprehensive coverage in Final Business Plans.

In simple terms, a short plan with CCG support and low bill impacts should be encouraged and accepted.

We agree that if a plan is proportionate, reflects customers' view and is robust then there should be a light touch approach to its assessment. We also feel that a company's past performance with Ofwat should be taken into account, i.e. those with a history of regulatory compliance and flat bill profile should require less scrutiny than others.

Q48 What factors should we take into account in further developing our process for a risk-based review?

We agree that if a plan is proportionate, reflects customers' view and is robust then there should be a light touch approach to its assessment. We also feel that a company's past performance with Ofwat should be taken into account, i.e. those with a history of regulatory compliance and flat bill profile should require less scrutiny than others.

Q49 Is the timetable we propose for introducing menus feasible? How could we improve it? What can we and the companies do to address the challenges of the timetable to allow companies to make a real effective menu choice?

While the timetable is very tight, we do not consider that the removal of a menu choice saves much time. If the menu choice was removed, and the TOTEX costs applied based on a CIS approach (i.e. a baseline is determined and companies Business Plan proposal is taken to be their choice), the only activities that are removed is the choice of a menu position and the recalculation of the incentive and funding.

The financial model is required to allow companies to make informed decisions about menu choice.
The TOTEX models are also required to allow us to understand the reasons if Ofwat's view of our funding requirements are different to our assessment. Given the inclusion of enhancement CAPEX in the model, despite the lumpiness of this type of spend, we feel concerned that the TOTEX model outputs may not agree with ours, especially given the small size of our company.

<u>Addition comments:</u>

We find it difficult to be able to make a decision on the timing of the Business Plan submission given the lack of concrete dates. There are a number of activities that need to be timetabled (e.g. Board & CCG meetings) to coincide with the submission and either a weakly defined or moving timetable is impossible to manage. We request that a fixed, detailed (specific dates not seasons) timetable is produced and stuck to.

We are committed to helping Ofwat and the industry deliver a successful PR14, as it is in none of our interests for this process to fail.

The Business Plan requirements consultation is eagerly awaited as this will give us a steer as to what we do and (also as importantly) don't need to produce for the Business Plan.

We are concerned about the August 2013 data submission. If the data required is in line with the old June Returns, then we should be able to produce it relatively easily. However if the data required is different then there is a concern that it will distract us from the business plan. The sooner we know what is required, the sooner we can ensure we can produce the data.

If the timetable is felt to be too tight we suggest that:

- all companies could be given 0%K for 2015/16 and we defer the price review by a year or
- that non-essential aspects of the price review are deferred until PR19 (AIM, Network Management, Network plus, etc.).

Under the first option, given the flexibility for companies to adjust income each year any under or over recovery could easily be adjusted for.

Building for price reviews in 2019 and beyond

Q50 Do you agree with our preferred scope for network plus?

Given the tight timetable we feel that this area could easily be deferred until we are in AMP6.

We see Network Plus as simply an extension of Account Separation and, as a WoC, it is just "Wholesale less Water Resources". As such we do not consider this to be particularly complicated.

We understand the desire to split out the costs of potentially contestable activities.

Q51 Do you agree with our preferred option to implementing network plus?

We don't see the benefit of non-binding price limits. Given the data on this area will improve over the years our belief is that rather than focus on PR14 business plan forecast data, we should review AMP6 actual data and use that at PR19.

Q52 Do you agree with our preferred scope for network management?

As a WoC, the scope of Network Management simply mirrors the Wholesale side of the business. We are therefore happy with the scope.

Q53 Do you agree with our preferred approach to implementing network management?

Given the tight timetable we feel that this area could easily be deferred until we are in AMP6.

Q54 Given our objectives for network management reporting over the period, what questions should be included in the first round of reporting within business plan requirements?

Given the tight timetable we feel that this area could easily be deferred until we are in AMP6.

Q55 Do you agree with our preferred approach to financial incentives for network information reporting?

We are still unsure of the precedent set by financially incentivising companies to provide data that Ofwat are already entitled to under our licences. There is a concern that any bill increases to provide this incentive (which we would struggle to demonstrate customers' willingness for pay for) might restrict our ability to provide genuine service improvements. If customers are willing to pay an additional £1 a year on their bills, but this is taken up with the Network Management incentive, we may be unable to raise bills by an additional £1 to fund an improvement in service.