

Wessex Water Services Ltd Response to Ofwat's PR19 Draft Determination – August 2019

Representation reference: Risk and Reward R1

Representation title: PAYG ratios

Summary of issue

Ofwat's draft determination has assessed the efficient level of costs to deliver our obligations to be 10% below our plan level. The expenditure reductions have been almost entirely made in areas where there is a large amount of long-life capex and a very small amount of opex. The PAYG ratios (which were submitted at the "natural rates") have not been amended accordingly.

This materially impacts on allowed revenues and the financial resilience of the business.

Wessex Water's chief executive wrote to Ofwat on the 1st August highlighting the importance of this issue.

Change requested

In the event that a difference in view about the efficient level of cost remains between the company and Ofwat at the FD we request that Ofwat adjusts PAYG ratios so that they are in line with the natural rates applied.

There is sufficient granularity in our cost submission, outlining both capex and opex in tables WS2 and WWS2 at the level that cost assessment it undertaken to inform a fast / slow money split. Ofwat could use this to make adjustments to PAYG rates depending on where it has determined that it needs to make expenditure reductions.

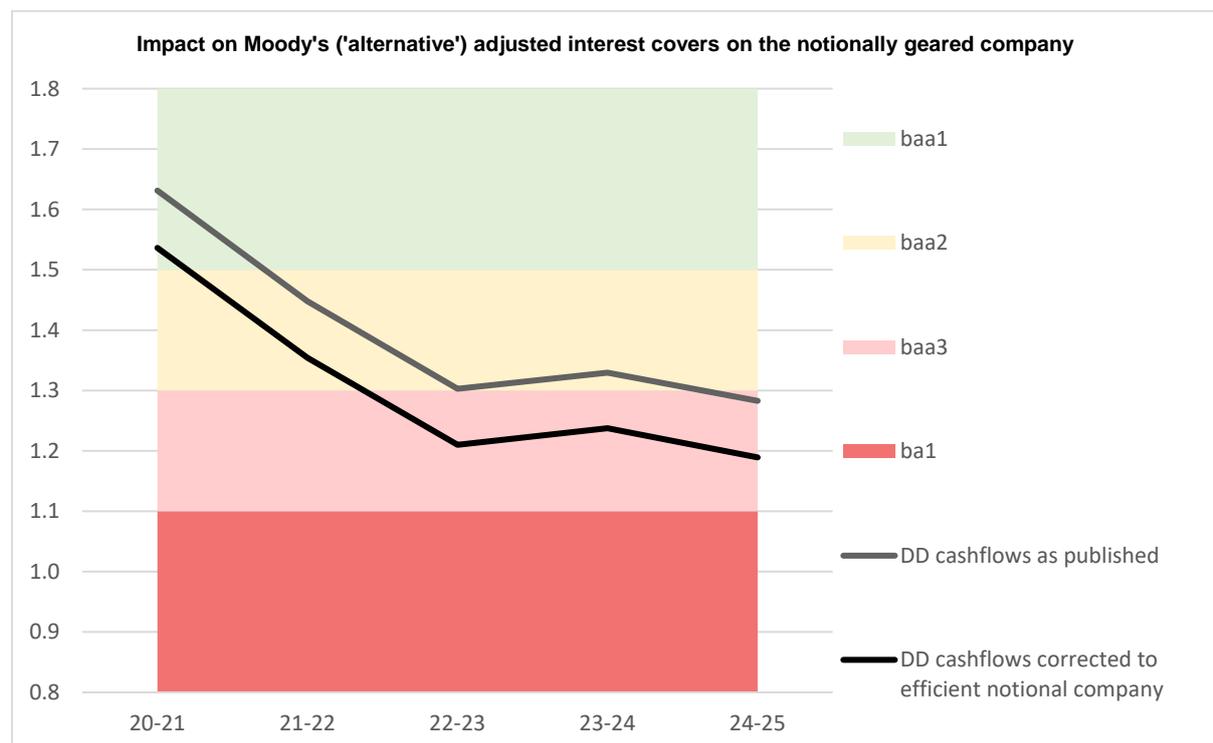
To assist the process appended to this representation is the explicit cost recovery plan for each line in WS2 and WWS2 along with true base costs (adjusted for enhancement opex). We also set out in this appendix the correct interpretation of the fast / slow money based on the published draft determination totex allowance using this method.

Rationale (including any new evidence)

The approach taken in the DD is not in accordance with the approach detailed in Ofwat's DD document (p.36 of the technical appendix) which Ofwat has said in its query response has only actually been applied in a small number of cases. It also does not match with Ofwat's PR19 methodology which favoured the use of natural rates unless companies could show that their customers supported a different approach [check] and that this was in their interests.

Our customers have not been shown to favour a different approach. Our customer research, particularly that related to resilience, supported the concept of intergenerational equity.

The impact of the DD approach is material and means that the credit metrics that are used in its financeability assessment cannot be relied upon. The chart below shows the impact on Moody's interest cover if we remodel the determination holding revenues constant but applying the actual opex, IRE and capex that the Draft Determination implies the efficient company should spend. Note that we have incorporated our positive AMP6 revenue adjustments into the revenues in this analysis and shown indicatively the credit ratings that might be implied by the ratio.



Why the change is in customers' interests

Making this change means customers will continue to pay for the services as they are received.

Our customer research showed that customers' preference was to pay for services received as the value was delivered to them, although this was subject to avoiding unnecessary fluctuations from year-to-year. Making this change would therefore be in line with customers' views.

Additional financial resilience will also benefit customers through lower financing costs.

Links to relevant evidence already provided or elsewhere in the representation document