

2014 Price Review
Business Plan Supporting Appendices
Change Protocol

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Section 1. Introduction

Our household customer and business customer retail plans and wholesale plan are built around outcomes that are grouped into three types: Customer; Sustainability; and, Compliance. When planning to meet these outcomes we do not have complete certainty over what we will need to deliver to meet these outcomes. Experience shows that changes will inevitably arise which could not be taken into account or foreseen when the outcomes were set.

- These changes may affect customer, compliance or sustainability outcomes and they can arise from:
- new statutory obligations or policy changes, e.g. on business rates, competition;
- other evidence (for example, on the costs and/or scope of necessary asset improvements); or
- changing customer priorities.

Implementing the Environment Agencies National Environmental Programme (NEP) is particularly notable in this regard. As the NEP has not yet been finalised with the Company, it has not been possible to clarify its full implications in creating the business plan. In addition, we have based our plan on NEP stage 4, the Environment Agency anticipates two further review phases during the period 2015-20. This may, for example, require the Company to carry out investigatory work or actual interventions to ensure compliance.

Other examples of possible drivers include new drinking water quality schemes under existing drivers namely deterioration in raw water quality, business rate policy changes and cost of competition including Open Water costs.

This change protocol sets out a framework for dealing with the financial implications, arising from changes to the requirements or improvements we face.

Where appropriate reference has been made to section of the Ofwat's 2010-15 protocol (the "Ofwat Protocol") in relation to procedural aspects which this protocol incorporates.

Section 2. Mechanism for implementing the change protocol

This change protocol sets out the process that will be followed if the Company seeks financial recognition of significant outcome or cost changes.

A submission pursuant to this change protocol will be made in respect of either:

- logging up or logging down: whereby the financial implications of significant output changes in the current price limit period are taken into account at the beginning of the next price limit period; or
- an interim determination of K (IDoK), as allowed for in certain clearly defined circumstances set out in our licence and for notified items.

Section 3. The scope of the change protocol process

Changes to output requirements can arise from:

- changes to statutory outcomes or new evidence necessitating new actions (for example, as required by the quality regulators);
- changes relating to any one or more notified items set out below; and
- changes to service levels associated with an urgent customer priority (that is, any changes that are driven by customers, including changes in demand, rather than changes in statutory requirements).

For the purpose of this protocol, a particular notified item or relevant change of circumstances will be financially significant and therefore allowed to be included in a submission by the Company under this protocol for an interim determination or logging up claim if the net present value of the costs arising out of that notified item or relevant change of circumstances up to the next price review period exceeds 2% of the turnover of the Appointed Business in the latest financial year for which accounting statements have been prepared and delivered to Ofwat under Condition F of the Company's Licence at the time of the relevant reference notice by the Company.

For the avoidance of doubt, no Capital Incentive Scheme adjustment will be made as this mechanism is no longer applicable. However, Ofwat will need to make an allowance for any Totex expenditure incurred through this protocol in its assessment of efficient costs and incentives at the 2020 Price Review.

The Company would like to engage with Ofwat to ascertain what mechanism may be applied in relation to changes disproportionately affecting retail and any of the retail price controls. Considering that Condition B requires a materiality threshold of 10% of the turnover of the Appointed Business for a price control to be changed under an interim determination, a change with significant impact on a retail price control will not reach the 10% threshold despite having a material impact on the retail business for example competition costs. A specific mechanism should be agreed to deal with these circumstances.

Section 4. The process of change control

The procedure followed by the Company under this protocol shall be as set out:

- (i) in section 4 of the Ofwat Protocol in respect of changes to statutory requirements or associated with a notified item; and
- (ii) in section 5 of the Ofwat Protocol in respect of changes to service levels associated with an urgent customer priority.

Section 5. Notified Items

Under condition B of our licence Ofwat can allow for specific notified items that if triggered may result in a change to the level of a price control or price controls. As part of our determination, we believe Notified Items under condition B of our licence should be:

1. increases above the 2013-14 reported numbers of Bad Debt and Debt Management Costs;
2. increase costs associated with the implementation of competition;
3. increased costs relating to business rates arising from a policy change in this area;

All notified items listed above, with the exception of business rate policy change, are one way Notified Items; that is, Ofwat will not exercise its powers under sub-paragraph 14.1(1) or sub-paragraph 14.1(2) of condition B to trigger an interim determination, or take into account any difference favourable to the Company if it triggers an interim determination on other grounds. Item three above is a two-way Notified Item; that is, Ofwat may exercise its powers under subparagraph 14.1(1) or sub-paragraph 14.1(2) of condition B to trigger an interim determination and may take into account any difference that was favourable or unfavourable to the Company at an interim determination.

Bad Debt and Debt Management Costs

The Company has assumed that there will be no net increase above the 2013-14 reported numbers of Bad Debt and Debt Management Costs.

Any net Increase which relates to households in Bad Debt and Debt Management Costs is a notified item provided that:

- (i) the Company provides information documenting the Net Increase to the reasonable satisfaction of Ofwat;
- (ii) the Company provides evidence to the reasonable satisfaction of Ofwat that the Net Increase reasonably relates to a significant deterioration in economic circumstances affecting the Company's operating area relative to 2013-14; and
- (iii) the Company demonstrate to the reasonable satisfaction of Ofwat that it has proactively applied best practice within a coherent strategy on debt prevention and management to maximise cost-effective revenue collection. This strategy on debt collection and management should include (without limitation) tariff design, billing, revenue collection and debt recovery.

"Bad Debt and Management Costs" means any (or all) of the following costs to the Company:

- financing costs associated with increases in revenue outstanding;
- outstanding revenue written-off;
- operating costs involved in managing outstanding revenue; and/or
- capital expenditure due to investment in debt management systems.

"Net Increase" means any net increase in Bad Debt and Debt Management Costs incurred in a Relevant Year above costs incurred for the same in 2013-14 plus those explicitly allowed for in the retail margins.

Competition Costs

Any costs incurred by the Company in connection with the implementation of market opening for non-household customers pursuant to the Water Bill in excess of the costs included within the price determination.

These costs include:

- the Company's contribution to the funding of the Open Water Programme;
- Costs associated with significant system changes required to ensure preparedness for market opening;
- Costs incurred to fund the formation of market architecture including system operator(s).

Business rates policy changes

Any additional costs arising out of business rates in excess of those included within the business plan.

The business plan contains an estimate of a change to business rates likely to be applied in the middle of the 2015-20 period.

Although the Company is unaware of any likely change to policy in this area should a policy change result in a material cost change when compared to that allowed in prices as part of the PR14 determination this change should be reflected in a two way notified item.