



**Rachel Fletcher**

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Dear Rachel

**Portsmouth Water's Response to Ofwat's Final Determination**

Following careful consideration of the Final Determination for Portsmouth Water, published on 16 December 2019, our Board has decided not to ask Ofwat to refer the determination to the Competition and Markets Authority.

This conclusion is due in large part to the constructive and focused engagement between Ofwat and Portsmouth Water in relation to the Havant Thicket Winter Storage Reservoir project, particularly in the period post the Draft Determination.

I must emphasise, however that whilst we believe the outcome of the process may be seen as representing good value for customers over the next five years, the Final Determination represents an extremely challenging settlement for our business.

In reaching its decision, Portsmouth Water's Board has looked at the consequences of all of the policy decisions made by Ofwat. Whilst there remains uncertainty over a small number of forward looking requirements, the Board accepts the Final Determination in the round. However, as you will be aware from recent communications and discussions the Board is very disappointed with Ofwat's assessment of the WRFIM adjustment.

The inference of the decision is that we have overcharged our household customers in AMP6 by £3 per household per year; this is patently not the case. We have taken the decision to accept the Final Determination on the understanding that the WRFIM matter will be considered separately outside of the 'swings and roundabouts' of the Final Determination.

Our Board has recognised Ofwat's recent engagement on this matter and following the discussion earlier today between our respective Chairmen, we are led to believe that you fully understand the impact that this decision has had on our business and are willing to discuss the matter further at a PR19 reconciliation meeting in March.

We were pleased by the underpinning Totex assessment and the company specific uplift to the cost of capital. We are also pleased with the AMP6 SIM reward, recognising our industry

leading customer service. That said, the Board has asked me to elaborate further on its high level concerns with the Final Determination and I have set these out below.

### **1. Wholesale Revenue Forecasting Incentive Mechanism**

The Board remains concerned with the decision that Ofwat has made relating to connection charges collected in the period 2015-20. We believe we have demonstrated unambiguously that over the first four years of AMP6 the variance between our forecast and actual connection charges revenue is £133,000, which is less than 5% of that forecast in our PR14 plan. The revenue penalty of £4.4m in AMP7 is therefore totally disproportionate and unfair. As noted above, we are looking forward to further dialogue with you on this critical matter.

### **2. Wholesale Totex efficiency**

The Board is disappointed that at the Final Determination, Ofwat applied an arbitrary cap on funded Totex of no more than 10% of the Ofwat benchmark despite the Ofwat assessment being that the Company was 16% better than the Ofwat benchmark. We note this is a cap which is not applied to others in the industry who are more than 10% higher than the Ofwat benchmark. We estimate this cap reduces our allowed revenue by £3.3m in AMP7.

### **3. Outcome Delivery Incentives**

The Board is very pleased that for many of the common ODIs our current and proposed performance have been used to set industry targets. We remain concerned that the 6.3% reduction target for PCC is not realistic given our very low charges, our relatively low PCC for the region and our inability to compulsory meter our customer base.

Further, the Board wishes me to re-iterate that our customer research did not support the magnitude of financial penalties and rewards we have arrived at in the Final Determination, and are concerned of the potential impact these may have within AMP7 on customer bills.

### **4. Retail**

Finally, the Board has concluded that as a consequence of the Final Determination our household retail business will be loss-making throughout AMP7. We note that Ofwat's cost assessment models for Retail were objectively less robust than the wholesale models, and in our case results in an efficiency target which we believe is unachievable.

There remains material scope to improve retail cost models by taking account of wider factors such as standards of service, and by improving underlying data. We suspect that differences in accounting methods in relation to bad debt and revenue recognition also skew the models and undermine their validity. The low level of our household bill (an outlier in nature) should also be recognised in any efficiency assessment.

**Conclusion and next steps**

Notwithstanding the points raised above, you have our commitment to deliver against this Final Determination for our customer base and the South East in general and we look forward to a continued constructive dialogue leading to an equitable resolution of the WRFIM matter.

If you wish to discuss this further, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'C R Taylor', with a stylized flourish extending to the right.

**C R Taylor**  
**Chief Executive Officer**