

27th October 2011

To Chief Executive of NI Water

WR 18: Special Factors and Atypical Expenditure Claims

This letter sets out the Utility Regulator's approach to allowing some or all of NI Water's future special factor claims. The contents are of direct relevance to NI Water's PC13 Business Plan submission and have been prepared in advance of our issuing guidance on same to enable the company to make a head start on preparing its subsequent submissions.

I can confirm our general approach follows that previously established at PC10 with the addition of a materiality threshold as agreed at the Information Requirements Working Group – Opex efficiencies. This letter supersedes the contents of WR2 with respect to special factor claims, the guidance in WR2 on atypical expenditure remains and is repeated here for completeness.

The criteria we shall apply in determining their applicability and timeline to the setting of new efficiency targets are set out below:

Special factor Assessment Criteria

The means by which the Regulator shall assess the company's submission will include examination of each claim against the following criteria:

1. What is different about the circumstances that cause materially higher costs ("material" claims have previously been agreed by company and Regulator as those individual claims which amount to greater than 1% of total service modelled opex)?
2. Why do these circumstances lead to higher costs?
3. What is the net impact of these costs on prices over and above that which would be incurred without these factors? What has been done to manage the additional costs arising from the different circumstances and to limit their impact?
4. Are there any other different circumstances that reduce the company's costs relative to the industry norms? If so, have these been quantified and offset against the upward cost pressures?

The company return on special factors should be submitted with the PC13 Business Plan in May 2012. The Regulator will make its draft determination 13th September 2012. As an aid to the decision making process, the Regulator will require an audit of the information be carried out by the Reporter in May/June 2012.

Treatment of Atypical Operating Costs

NI Water may wish to declare such “one-off” expenditure as “exceptional” within your accounts. Alternatively, our approach to the Annual information return allows NI Water to flag specific cost items you consider atypical. We can then consider making adjustments to exclude them from our modeling and benchmarking analysis.

Some examples of such costs taken from Ofwat might include:-

- Extreme climatic events;
- Unusual compensation payments to customers; and,
- Abnormal changes in pension contributions.

Timeline

- 14th October 2011 – Regulator sends NI Water indicative COLS 2010/11 datasets/specifications (completed)
- 2nd November 2011 – Regulator issues WR letter, “Special Factor and Atypical Expenditure Claims” as guidance for NI Water
- 3rd November to 22nd May 2012 – NI Water prepare their Special Factors claim for submission as part of PC13 Business Plan [early discussions of draft claim(s) can be timetabled during this period]
- *February 2012 - latest date for early NI Water draft submission for UR initial comment April 2012. The Regulator may apply a “comprehensiveness test” to NI Water’s draft submission, indicating areas where additional company information might provide greater clarity for the Regulator in coming to its determinations*
- 22nd May 2012 – NI Water submit SF claim with its PC13 Business Plan
- 23rd May to 21st June 2012 – Reporter examines NI Water SF claim and reports to UR
- 22nd June to September 2012 – UR determines allowed SF and Atypicals to apply to 2010/11
- 14th September 2012 – UR publishes draft determination for consultation
- 17th September to 9th November 2012 – draft determination engagement
- 13th December 2012 – UR publishes final determination

I hope you find the above useful in setting out NIW's strategy towards such claims and if you have any further questions please address these to Mr Caspar Swales, Head of Comparative Efficiency & Performance Branch.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Aston', with a stylized flourish at the end.

J Aston
Director of Water Regulation
NIAUR

cc: Ronan Larkin