

14<sup>th</sup> May 2008

**To Chief Executive of NIW**

## **WR 2: Special Factors and Atypical Expenditure Claims**

This letter sets out the Utility Regulator's approach to allowing some or all of NIW's future special factors and atypical expenditure claims. As such the contents are of direct relevance to our advising Minister of appropriate efficiency targets for 2009/10 and our developing of same around PC10 (2010/11 to 2011/12).

I can confirm our general approach will follow existing Ofwat/WICS approaches to such claims. The criteria we shall apply in determining their applicability and timeline to the setting of new efficiency targets are set out below:

### ***Special Factors Criteria***

We would expect you to include information about each claim based upon the four criteria:-

1. What is different about the circumstances that cause materially higher costs?
2. Why do these circumstances lead to materially 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?

### ***Treatment of Atypical Operating Costs***

NIW may wish to declare such "one-off" expenditure as "exceptional" within your accounts. Alternatively, our approach to the Annual information return and cost base allows NIW 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**


The timelines to facilitate advice to Minister and PC10 are essentially the same as previously communicated to NIW at our recent workshop:-

- NIW submits AIR07 related special factor & atypical expenditure claims – May 08
- NIAUR determines allowed special factor and atypical claims – Jun 08
- NIW submit AIR08 (including atypical expenditures as “exceptionals”) – Aug 08
- NIAUR provide further submission to Minister iro 2009/10 opex target (AIR/JR07 based) – Sep 08
- NIW submit AIR08 related special factor claims – Sep 08
- NIAUR determines allowed special factor and atypical claims – Nov 08
- NIW submit AIR09 (including atypical expenditures as “exceptionals”) – 15<sup>th</sup> Jul 09
- NIAUR Draft Determination – Aug 09
- NIAUR run efficiency models with AIR09 plus special factors data and construct sensitivity analysis around efficiency targets – Sep and Oct 09
- NIAUR Final Determination – Nov 09

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.

To help facilitate the outworking of our efficiency workstream I should also ask you to communicate the named NIW individual leading on efficiencies.

Yours sincerely

  
J Aston  
Director of Water Regulation  
NIAUR