PC15 Information Requirements
Appendix B1 – Cost Base General Guidance
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Chapter 1 - Introduction

1.1. Content

1.1.1. In order to fully inform the PC15 Price Control, the Utility Regulator intends to undertake a refreshed cost base assessment of NI Water’s standardised construction costs (from what was undertaken at PC10). Undertaking an updated cost base was outlined as a likely prospect within the Utility Regulator’s Overall Approach document for PC15, published in October 2012.

1.1.2. The cost base will form an important instrument for informing efficiency assumptions for capital maintenance and enhancement expenditure, as well as a basis to forecast capital expenditure in the Price Control period and beyond. To this end we ask NI Water to populate the attached cost base tables, following the guidance and line definitions.

1.1.3. The guidance provided essentially mirrors the approach and layout of our final cost base instructions from PC10 with two notable exceptions - the inclusion of two additional tables used to compare PC15 with previous PC10 unit costs in 2012/13 prices and some additions to the Reporter Guidance.

1.1.4. The cost base information requirements are included in the company guidance and associated Excel tables.

1.1.5. The company should submit:

- an executive overview;
- commentary as detailed in section 2 of the company guidance;
- a complete set of tables; and
- cost breakdown structure Excel spreadsheets covering each standard cost entered in tables C2.2, C2.4, C2.6 and C2.8.

1.1.6. The company should explain any changes to the standard costs between submissions.

1.2. Submission Requirements

1.2.1. The final cost base (v1.0) return and any accompanying commentary should be submitted on 8 November 2013 for initial audit by the Reporter, with the final cost base (v2.0) submitted along with the Business Plan on 24 March 2014.

1.2.2. The company should submit:

- 1 hard copy of the tables and commentary; and,
- 1 electronic copy of the tables and accompanying commentary.
1.3. **Timeline**

1.3.1. The timetable for completion of the cost base for PC15 is illustrated below:

- UR issues cost base information requirements 15 May 2013
- NI Water report any queries on guidance to UR 31 May 2013
- UR provide responses to queries 14 June 2013
- NI Water begin preparing final cost base (v1.0) 15 July 2013
- Reporter begins initial audit of final cost base (v1.0) 14 October 2013
- NI Water submit final cost base (v1.0) 8 November 2013
- Reporter issues report to UR on final cost base (v1.0) 15 November 2013
- UR issues report to NI Water on final cost base (v1.0) submission and Reporter’s commentary 29 November 2013
- NI Water continue development of final cost base (v2.0) 2 December 2013
- Reporter begins final audit of final cost base (v2.0) 6 December 2013
- NI Water submit final cost base (v2.0) 24 March 2014
- Reporter issues report to UR on final cost base (v2.0) 4 April 2014

1.3.2. The Utility Regulator has been informed by the company that there may be exceptional reasons (such as procurement/tendering complications etc) which may lead to some or all of the final cost base (v1.0) dates changing. However, the 24 March 2014 final cost base (v2.0) submission date will not change as the cost base is an integral part of the Price Control decision making process, underpinning as it does the company’s submission of its PC15 Business Plan.

1.3.3. On receipt of the final cost base (v1.0) and Reporter’s commentary, the Utility Regulator will analyse and review the company submission and provide feedback by the 29 November 2013. Following this feedback, the company should re-submit their final cost base (v2.0) along with its business plan submission in 24 March 2014, explaining any changes to the standard costs between submissions.

1.4. **Reporter**

1.4.1. As in PC10 and as detailed in the timeline above, NI Water’s standard costs will be subject to Reporter scrutiny. This will take place on a number of occasions during the process, although in order to ensure proportionate effort in some stages this will be to a lesser degree than experienced in the previous cost base during PC10. The accompanying Reporter guidance sets out their role and audit function in more detail.

1.4.2. In addition to Reporter audits, it will also be necessary to undertake a ‘consistency-check’ of the cost base. While the Reporter is expected to focus and examine the sufficiency or otherwise of how each cost item is built up, amongst other measures, this assessment will focus on the consistency, methodology and benchmarking of the cost base to ensure fair comparability with England and Wales companies.
Chapter 2 - Approach to Efficiency

2.1. Base year

2.1.1. In order to ensure comparability NI Water are asked to put standard costs into a consistent 2012/13 price base using COPI data from BCIS. The actual COPI figures to be used can be found in the company guidance to the cost base.

2.1.2. In the event of an absence of an updated cost base for the England and Wales companies for PR14, Ofwat’s cost base data for PR09 will be uplifted from 2007/08 to 2012/13, using the same COPI figures as NI Water so as to ensure a like-for-like comparison.

2.2. Utility Regulator Approach to Efficiency Targets

2.2.1. Once in receipt of the cost base data, the Utility Regulator has the option of following a number of different methodological approaches to assess the PC15 cost base. In order to ensure proportionality and consistency, the Utility Regulator is minded to adopt a similar analytical approach as was undertaken with PC10’s cost base.

2.2.2. Notwithstanding, where a continuation of the approach made in PC10 would be questionable given present circumstances and/or where NI Water have made valid substantiated arguments for a different approach to the cost base assessment, the Utility Regulator may modify its methodological approach at PC15 accordingly.

2.2.3. In specific terms, the Utility Regulator is minded to adopt the PC10 approach by applying the following:

- Regional Price Adjustment based on additional research into local cost differentials likely to apply to NI Water;
- Benchmarking to upper quartile performing companies in England and Wales;
- A 75% catch-up within a single year;
- A symmetrical approach to modelling efficiencies;
- Consideration of any special factors claims; and
- A continuing efficiency or “frontier” shift

2.2.4. Although the Utility Regulator is to continue with the principle of having a frontier shift for capex, we are minded to differ from PC10 in how this is estimated. While it was the case that during PC10 the Utility Regulator applied Ofwat’s PR09 assumption for industry capex frontier shift (namely 0.4% p.a.), for PC15 the Utility Regulator intends to undertake its own estimate of continuing efficiency. This exercise will be similar in methodological approach to that which was undertaken and then applied to opex at PC13 - however this frontier shift will relate to capex only, with a separate analysis to be undertaken once again for opex.
2.2.1. During PC10 it was deemed appropriate that where standard costs are below benchmark, the Utility Regulator should make a symmetrical adjustment thus allowing the company to offset inefficiencies in one cost category with efficiencies in another. An alternative approach could be to simply assume such efficient procurement required no subsequent adjustment, thus potentially increasing the overall efficiency challenge upon the company. At the present time however we see no reason to change our approach, especially as each issue detailed above should not be considered in isolation.

2.2.2. As with the PC10 cost base exercise, the Utility Regulator invites the company to make special factor claims. Further detail on information to be provided in any special factor claim can be found in Section 2 of the cost base company guidance.

2.2.3. We would welcome any comments you may wish to make on the above topics in advance of the final cost base deadline. Additional detail on the Utility Regulator’s previous approach to capital efficiencies at PC10 can be seen in the price control determinations.