

UK Water and Wastewater

The economic and financial consulting practice of FTI Consulting provides clients with clear analysis of complex economic and financial issues for use in legal and regulatory proceedings, strategic decisions and public policy debates.

Our UK water and wastewater team comprises experts in economics, finance, econometrics and accounting with a wealth of experience advising companies, regulators and investors across the UK water sector. Our experts have advised many of the water companies in England and Wales in relation to expected regulatory and legislative reforms. We have provided support to companies during PR09, assisted Bristol Water with its appeal to the Competition Commission in 2010, supported the Northern Ireland Utility regulator with the conduct of a price review and worked with the Water Industry Commission for Scotland on a range of issues around opening the Scottish retail market to competition.

OUR EXPERTISE

FTI's water and wastewater team comprises experts in economics, finance, econometrics and accounting who provide expert advice to companies, regulators and investors in a wide range of areas including:

- Price controls
- Business plans
- Market reforms
- Preparing companies for appeals to the Competition Commission
- Mergers and acquisitions

PRICE CONTROLS

PR14 will require companies to complement 'traditional' approaches to price controls with a range of new tools and methods that address the changes being introduced including multiple targeted price controls, a host of new incentives, totex and restructuring of allowed returns. FTI's water and wastewater team offers a range of expert assistance to help the industry prepare for PR14 including:

- Incentive design and calibration: we can help companies design outcome delivery incentives, totex menus and other incentive mechanisms like the AIM and SIM. We can help companies calibrate incentives taking into account risk appetite through RORE, noting that RORE is driven by a range of other factors such as the notional gearing assumption and the proportion of revenue accounted for by allowed profit;
- Cost recovery mechanisms: we can help companies understand the trade-offs between PAYG ratios, WACC and asset lives to help determine the appropriate choices. We can also help companies forecast the implications – especially for RCV, gearing and other financial ratios – of their choices over the medium and longer-term;
- Econometric modeling: our team of econometricians – led by a former professor with many years' experience applying econometric and statistical techniques in a wide range of contexts – has advised water and sewerage companies on totex modeling, special factor adjustments, demand forecasts and willingness-to-pay studies;
- Financial modeling: our team has a wide range of experience building and auditing financial models (often incorporating tools to make sensitivity and simulation analysis easy) as inputs to decision making;
- Cost of capital, small company premium, financeability and retail margins: our experts advised on WACC, small company premium and financeability at PR09 and advised Offer, Ofgas and Ofgem on the establishment and setting of retail price controls in the energy sector – including the level of retail margin. We also have significant cost of capital experience across other regulated sectors and in the context of valuations, disputes and investigations by competition authorities.

We can also help companies build their case for bespoke treatment through special factor adjustments to both wholesale and retail price controls. For example, our experts have previously examined the relationship between bad debt, bill size and economic conditions and have deep econometric expertise to make a robust case for doubtful debt and debt management costs lying at least partially beyond management's control.

Our team has significant international and cross-sectoral experience meaning we are able to bring lessons from other sectors and jurisdictions to inform thinking around all of these issues.

BUSINESS PLANNING

Oftwat has made it clear that it will not provide prescriptive guidance to companies on the content and structure of business plans. It is for companies to present their business plans as they see fit. Drawing on their significant experience of writing reports in commercial and litigation contexts – which requires arguments to be put persuasively and influentially – our experts can assist companies prepare their business plans by:

- Providing guidance around content and structure of household retail, non-household retail, wholesale water and wholesale wastewater business plans as well as the overall plan;
- Assisting with the drafting of plans;
- Acting as a 'critical friend' to review and enhance plans.

FTI Consulting can also help provide assurance to company Boards by reviewing the robustness of business plans and the supporting evidence as an input to the statements Oftwat will require Boards to submit alongside business plans.

COMPETITION COMMISSION READINESS

FTI Consulting's experts advised Bristol Water on its appeal of the PR09 Final Determination to the Competition Commission in 2010. They also assisted a WaSC prepare for a potential appeal, helping the company to identify the strengths and weaknesses of its case and model the effects of alternative outcomes.

In both cases we were brought in to assist with preparations for potential appeals between Oftwat issuing the Draft and Final Determinations.

The work focused on strengthening companies' cases through detailed and forensic review of the business plans and the associated supporting evidence. The team was able to identify areas for improvement and assist the companies to develop additional evidence in support of the plans. This was used to respond to the Draft Determination as well as the preparing documentation which could be submitted to the Competition Commission.

Based on this experience – and drawing on team members from the OFT and the CC who know what it takes to be successful in front of the CC – we recommend that companies should consider the possibility of appealing Oftwat's Final Determination when making all PR14 submissions to Oftwat and be prepared to exercise this option should it be appropriate.

MARKET REFORMS

Our water sector specialists have a range of expertise that can help to design and implement the upcoming reforms contained in the Draft Water Bill including changes to access pricing (including the removal of the Costs Principle), the introduction of access regimes across the value chain and the opening of retail markets for non-household customers.

- Competition: we can advise on preparation for the introduction of competition in retail and upstream markets including through functional separation and the development of cost reflective tariffs;
- Access pricing arrangements: our specialist economists and accountants are experienced at advising on appropriate access pricing regimes in a range of contexts;

- Commercial strategy: our experts have significant experience of analysing the customer base and understanding profitability of different customer types in different business segments as inputs to strategic decision making.

MERGERS AND ACQUISITIONS

Our experts have provided regulatory due diligence support and regulatory advice in the context of many of the recent transactions in the UK water sector. We add value through:

- Assisting vendors or bidders understand the existing regulatory framework in detail, ensuring its implications for future cash flows are appropriately captured in valuation models; and
- Providing practical advice on the potential changes to the regulatory and legislative frameworks by forecasting the likely range of potential outcomes, identifying what the significant changes might be for valuation and reflecting these changes into valuation tools to aid decision making.



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CRITICAL THINKING
AT THE CRITICAL TIME™

About FTI Consulting

FTI Consulting, LLP, is a global business advisory firm dedicated to helping organisations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. FTI Consulting professionals, who are located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring.

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