

SECTION 66D(2)(b) WATER INDUSTRY ACT 1991 FINAL DETERMINATION BY THE WATER SERVICES REGULATION AUTHORITY (OFWAT) DETERMINING TERMS FOR WHOLESALE ACCESS PRICES OFFERED BY ANGLIAN WATER SERVICES LIMITED TO AQUAVITAE (UK) LIMITED TO FOUR CUSTOMERS

Introduction

- 1.1 Under the Water Supply Licensing ("WSL") regime introduced by the Water Act 2003 ("WA03") licensees are entitled to supply water to premises of customers likely to use at least 50 Ml/year. The appointed water company is required to offer the licensee terms and conditions for access¹ in accordance with sections 66A to 66E of the Water Industry Act 1991 ("WIA91"). Ofwat may determine the terms and conditions of access, in a case referred to it by a licensee, in default of agreement between the parties, under section 66D WIA91.
- 1.2 This is a determination made under section 66D(2)(b) WIA91 of the terms and conditions, specifically the wholesale charges, offered by Anglian Water Services Limited ("Anglian Water") to Aquavitae (UK) Limited ("Aquavitae"). The determination arises from a request made to the Chairman of the Water Services Regulation Authority by Aquavitae dated 10 August 2007.
- 1.3 After a period of negotiation, Anglian Water provided Aquavitae with wholesale access prices for supplies to four of Anglian Water's existing customers. Aquavitae was not satisfied with the wholesale access prices being offered by Anglian Water and asked Ofwat to make a section 66D(2)(b) determination. Aquavitae submitted an application containing the information listed in Appendix 2 of our November 2005 Procedure for handling water supply licensing determinations ("Determinations Procedure"). It has provided us with copies of previous correspondence and copies of information requested by the water undertaker in order for the application to be considered.
- 1.4 We would normally aim to make a section 66D(2)(b) WIA91 determination within 15 weeks, on the basis of the assumptions set out on page 11 of our Determinations Procedure. We have taken longer in this case, because this is the first determination we have done regarding wholesale access pricing, the case involves four separate customers and we have sought and obtained comments from both parties on numerous occasions.

¹ The term 'access' refers both to wholesale supplies of water by a water undertaker to a licensee for the purpose of the licensee's making a retail supply of water to the premises of the licensee's customer and to combined supplies (the introduction by the licensee of water into the water undertaker's supply system in order to make a retail supply of water by the licensee to its customer through the water undertaker's supply system).

Jurisdiction under section 66D(2)(b) WIA91

- 2.1 Section 66D(2)(b) WIA91 states that where a water undertaker and a licensee cannot agree the terms and conditions of a proposed access agreement, then the licensee (but not the water undertaker or the customer) can ask Ofwat to make a determination. In this case, Aquavitae made its request in a letter from its solicitors, Maclay Murray & Spens LLP, dated 10 August 2007. Aquavitae stated it was unable to agree the terms and conditions for a wholesale supply of water from Anglian Water, pursuant to section 66A WIA91, in relation to four industrial customers.
- 2.2 The charges payable by the licensed water supplier to the water undertaker, whether under an agreement between the parties or under a determination by Ofwat, must be fixed in accordance with the Costs Principle, as set out in section 66E WIA91.
- 2.3 Following the determination, the licensee can choose whether to proceed with the access agreement. If it does wish to proceed, the terms and conditions determined by Ofwat become binding on both the licensee and water undertaker, as if they had been agreed between the parties (section 66F(10) WIA91). The water undertaker must then make access available to the licensee on those terms and conditions.
- 2.4 The process for making determinations is set out in our Determinations Procedure. As part of that process, we have sought and obtained comments on this determination from Anglian Water and Aquavitae. (See Case History section for full details).
- 2.5 Before beginning the determination process, Ofwat needs to be satisfied that the parties have at least attempted to reach agreement. In this case, we asked Aquavitae, in a letter dated 17 August 2007, to confirm that it had tried to negotiate an agreement with Anglian Water. On the basis of Aquavitae's response dated 29 August 2007, we are satisfied that the parties have tried, but failed, to reach agreement on terms.
- 2.6 In its response to the draft determination, Anglian Water commented on the period of negotiation between the two parties. Anglian Water stated that it provided wholesale access prices to Aquavitae on 30 March 2007 for Customer A, Customer B and Customer C and on 1 August 2007 for Customer D. In its view, the negotiations were no longer than nine and a half months, since after Aquavitae's submission of the three customer price applications on 15 June 2006 and Anglian Water's price provision on 30 March 2007, Anglian Water received no response from Aquavitae between 30 March 2007 and 3 August 2007. With respect to the fourth customer, Anglian Water received a request for a wholesale access price on 18 June 2007 and provided the price on 1 August 2007. Anglian Water stated in its response to the draft determination that it learned about Aquavitae's complaints on 16 August 2007.

- 2.7 We have carefully considered Anglian Water's comments on the length of the negotiation period between the two parties. We believe that it is not unreasonable to include the periods of time when no communication or further actions have taken place. In our view the whole negotiation process between Anglian Water and Aquavitae took fourteen months, commencing on 15 June 2006 with Aquavitae's price applications and ending with Aquavitae's complaint to the Office of Fair Trading and its request to Ofwat for a section 66D(2)(b) WIA91 determination both filed on 10 August 2007.

Company Background

Anglian Water Services Limited

- 3.1 Anglian Water is part of the Anglian Water Group (AWG). Anglian Water is an appointed water and sewerage company, providing water and sewerage services to customers in the east of England and Hartlepool. Hartlepool Water has been part of Anglian Water since it was acquired in 1997.
- 3.2 Anglian Water's Area of Appointment is the area in which it has the statutory duty to supply water and sewerage services. It covers around 27,500 square kilometres and, apart from the Hartlepool area, stretches from the River Humber in the north to the River Thames in the south, from Daventry in the west across to the east coast. It covers one of the driest regions of Britain with around 600 mm of rain in a year. Anglian Water supplies over one billion litres of drinking water to 4.2 million customers every day through its network of 36,000 kilometres of water mains. The water comes from reservoirs, underground reserves (aquifers) and via abstraction from rivers. Anglian Water receives approximately 980 million litres of wastewater a day from 5.5 million customers, including 1.2 million customers who receive their water from other companies. The wastewater is treated at 1,075 sewage treatment works and returned to the environment via rivers or coastal outlets.

Aquavitae (UK) Limited

- 3.3 Aquavitae was formed on 1 February 2001 and was granted its combined Water Supply Licence² with effect from 1 December 2005. Aquavitae is not linked to any of the appointed water companies. Operating nationally, Aquavitae generates an annual turnover of approximately £14 million. Although it does not currently provide any customers with supplies under the WSL regime, it does provide other services to over 30 customers and manages around 180 eligible accounts. Aquavitae currently has in place

² A Combined Supply Licence is a Retail Licence with the Supplementary Authorisation, authorising the holder to introduce water into a water undertaker's supply system and to retail that water to a customer's eligible premises (section 17A(5) and A(6) Water Industry Act 1991 (WIA91). A retail Licence is a Water Supply Licence giving the holder the retail authorisation to purchase wholesale a supply of water from the water undertaker and to supply it retail to a customer's eligible premises (section 17A(4) WIA91).

wholesale master agreements (WMA)³ with Anglian Water, Bournemouth and West Hampshire Water Plc, Dŵr Cymru Cyfyngedig, Northumbrian Water Ltd, Severn Trent Water Ltd, Southern Water Services Ltd, Yorkshire Water Services Ltd, Thames Water Utilities Ltd and United Utilities Water Plc. Aquavitae has recently undergone a change of ownership and has been acquired by a new private equity group.

Case History

- 4.1 On the 11 April 2006 Aquavitae and Anglian Water signed a WMA. They were the first companies to do so. On 15 June 2006 Aquavitae submitted three access price applications for three customers to Anglian Water. On 30 March 2007 Anglian Water provided prices, offering discounts amounting to **0.09%**, **0.11%** and **0.54%** off Anglian Water's retail charges to those customers.
- 4.2 On 18 June 2007 Aquavitae made an application to supply a fourth customer. On 1 August 2007 Anglian Water proposed a discount amounting to **0.53%** off Anglian Water's retail charge to that customer.
- 4.3 On 10 August 2007, Aquavitae sought from Ofwat a determination under section 66(2)(d) WIA91 of the access prices offered by Anglian Water.
- 4.4 Also on 10 August 2007 Aquavitae submitted a Competition Act 1998 ("CA98") complaint to the Office of Fair Trading ("OFT") about the same wholesale access prices. Under the Concurrency Regulations⁴, the OFT formally passed the CA98 complaint to Ofwat on 30 August 2007.
- 4.5 As set out in paragraph 2.7 of OFT 422 "Competition Act 1998: Application in the water and sewerage sectors", where Ofwat receives a complaint about an agreement or practice which raises issues which might fall within the scope of both the WIA91 and the CA98, Ofwat will "make use of whichever statutory powers [it] judges to be the most appropriate to address the specific conduct" (if any).
- 4.6 On 5 and 17 September 2007 we informed Aquavitae and Anglian Water respectively that we would undertake a section 66D(2)(b) determination. These were the main reasons:
 - Section 66D(2)(b) WIA91 provides bespoke powers for determining access agreements under the new WSL regime set out in the Water Act 2003.

³ A WMA sets out the main terms and conditions of wholesale supply arrangements between an appointed water company and a licensee. A licensee must have a WMA in place before it can make an application for a wholesale supply to a specific eligible customer's premises.

⁴ The Competition Act 1998 (Concurrency) Regulations 2004.

- A section 66D(2)(b) WIA91 determination would set a definitive access price which Aquavitae could then use to decide whether to take forward its customer-specific applications.
- The dispute about Anglian Water’s wholesale access prices could be more quickly dealt with under section 66D(2)(b) WIA91. Due to the nature of the procedures involved and the information required, CA98 investigations can last over a year, excluding the time for any appeal. For example, unlike a section 66D(2)(b) WIA91 determination, a CA98 investigation requires the establishment of a market definition, and dominance. In comparison, even having undertaken a lengthy determination (for the reasons set out above), this has been completed in well under one year. We would aim to complete future, similar section 66D(2)(b) determinations within the period set out in our Determinations Procedure.
- It would not have been an efficient use of Ofwat’s resources to conduct a CA98 investigation at the same time as a section 66D(2)(b) WIA91 determination.
- Finally, the WSL regime was established specifically to define and govern the circumstances in which an undertaker had to give access to its supply system and the charges to be paid to it for doing so.

The determination process

4.7 The table below summarises the correspondence and meetings between the parties since Aquavitae made its determination request on 10 August 2007.

Table 1 - Communication with the parties

2007	Communication by:		
	Ofwat	Anglian Water (ANH)	Aquavitae (AQV) and its solicitors, MMS
10 Aug			Letter to Ofwat requesting a s66D(2)(b) determination of ANH's offered access prices. Letter to OFT making a CA98 complaint about the same access prices.
16 Aug		Phone call from ANH requesting a copy of the CA98 complaint.	
17 Aug	Letter to AQV requesting a non-confidential version of its CA98 complaint, information about the services AQV expected from ANH and details of AQV's own retail costs.		Letter from AQV in response to Ofwat's telephone conversation with its solicitors earlier that day.
	Telephone conversation with AQV's solicitors to request further clarification on what information had been passed onto ANH.		E-mail from AQV's solicitors seeking clarification on means of communication with Ofwat.

	Telephone conversation with ANH regarding AQV's s66D request. We informed ANH that we would request extensive details of ANH's cost estimates in taking forward a s66D WIA91 request.		
20 Aug			Letter from AQV's solicitors enclosing a copy of a non-confidential version of its CA98 complaint to the OFT.
29 Aug			Letter from AQV's solicitors in response to our letter of 17 Aug.
30 Aug	Letter to AQV's solicitors' 17 Aug letter confirming that we are happy to communicate via both fax and e-mail.		
31 Aug	Reply to AQV's letter of 29 August. Letter to ANH with detailed questions on the access prices.		
4 Sep		Telephone call with ANH extending the deadline for ANH to submit information.	
5 Sep	Letter to AQV's solicitors explaining why we were taking forward the s66D WIA91 request for a determination.		
7 Sep	Phone call to AQV's solicitors again requesting information on their own discount estimates.		
12 Sep		ANH response to our questions of 31 Aug.	
14 Sep			Letter to Ofwat. Did not provide requested information. Expressed concern over costs of providing information on AQV. Requested copies of correspondence with ANH.
17 Sep	Letter to ANH explaining why we were undertaking the s66D(2)(b) WIA91 request for a determination.		
24 Sep	Letter to AQV's solicitors confirming we have very limited information on the		

	service Aqv wants from ANH. Letter to ANH requesting clarifications and additional information.		
1 Oct	Letter to Aqv's solicitors acknowledging receipt of their e-mail and letter. Meeting Ofwat and ANH at Ofwat's offices to discuss ANH's draft responses to Ofwat's questions of 24 Sep.		
2 Oct	Letter to Aqv's solicitors acknowledging their request for information. Letter to ANH requesting information on confidentiality of information supplied by ANH to Ofwat and its disclosure.	E-mail to Ofwat, ANH provides a reworked spreadsheet of supporting calculations.	
8 Oct	Meeting Ofwat and ANH at ANH's offices to discuss the detail of spreadsheets provided to Ofwat. Met the head of ANH's business customer services (BCS).	Letter to Ofwat. ANH agrees to partial disclosure to Aqv of its 12 Sep letter.	
9 Oct	E-mail to ANH with questions following meeting on 8 Oct.		
12 Oct	Letter to ANH asking for ANH's views on the confidentiality of correspondence between Ofwat and ANH.		Letter to Ofwat enquiring as to what access pricing rule Ofwat will follow for the determination.
15 Oct	Letter to Aqv saying that we had been dealing with Aqv's request for information under FOIA2000 and that we were consulting ANH. We disclosed a redacted version of ANH's letter of 12 Sep.		
16 Oct		Letter to Ofwat responding to questions of 24 Sep and 9 Oct.	
17 Oct		ANH's response to 12 Oct letter on confidentiality.	
19 Oct		Letter from ANH's solicitors concerned about Aqv's solicitors' suggestion that we use a different approach to the Costs Principle in the determination.	
22 Oct	Letter to Aqv's solicitors		

	disclosing Ofwat's information requests to ANH of 30 Aug, 24 Sep and 9 Oct with minor redactions. We also disclosed parts of ANH's letter to Ofwat of 16 Oct.		
25 Oct	Letter to ANH, fourth set of detailed questions.		
29 Oct	E-mail to ANH with one additional question.		
30 Oct		Letter to Ofwat - response to questions of 25 and 29 Oct.	
1 Nov	Letter to AQV's solicitors disclosing Ofwat's information requests to ANH of 25 and 29 Oct. We also disclosed parts of ANH's letter to Ofwat of 30 Oct to AQV.		
2 Nov	Reply to AQV's solicitors' 12 Oct letter.		
6 Nov	Letter to ANH, fifth set of questions (two additional questions) and seeking permission for disclosure of information to AQV.		
6 Nov	Letter to ANH's solicitor clarifying the process and methodology that we are following in making the determination.		
9 Nov		Letter to Ofwat - response to questions of 6 Nov and further correspondence of 6 Nov.	Phone call from AQV's solicitors telling us they would soon comment on the correspondence between Ofwat and ANH.
14 Nov	Letter to AQV disclosing information provided by ANH.		
15 Nov	Letter to ANH informing it of the timeframe in which we would disclose the draft determination to ANH for a standard confidentiality check.		
16 Nov			Letter to Ofwat from AQV's solicitors with comments on Ofwat's correspondence with ANH and the method to be used in the s66D determination.
21 Nov		Telephone call from ANH enquiring if it could comment on the	

		16 Oct letter from AQV's solicitors.	
28 Nov		Letter from ANH commenting on issues raised by AQV in its correspondence of 16 Nov.	
5 Dec	Telephone conversation with and e-mail to ANH requesting additional information.		
5 Dec		Telephone call from ANH requesting further clarification on the additional questions.	
		E-mail from ANH with responses to some of the additional questions asked on 5 Dec.	
7 Dec	Telephone conversation with ANH providing further clarification on the 5 Dec questions.	Telephone call from ANH asking for clarification on the planned date of issue of the draft determination.	
		E-mail from ANH responding to the outstanding questions of 5 Dec.	
13 Dec	E-mail to ANH responding to ANH's query on the draft determination timetable.	E-mail from ANH requesting confirmation of the draft determination timetable.	
18 Dec			Phone call from AQV's solicitors asking when they should expect to receive the draft determination and how long they would have to prepare their response.
19 Dec	Draft determination (with Ofwat's analysis redacted) sent to ANH for comments on confidentiality.		
20 Dec	E-mail to ANH responding to confidentiality issues raised in ANH's e-mail from of 20 Dec.	E-mail from ANH providing comments on confidentiality.	
21 Dec	Reply to AQV's solicitors' letter of 16 Nov about the methodology to be used in the determination.		
	Draft determination sent to both parties for comment on substance by 18 January 2008.		

2008	Ofwat	Anglian Water (ANH)	Aquavitae (AQV) and its solicitors, MMS
14 Jan		Telephone conversation with ANH regarding our estimates of the ARROW costs for retail categories R2 and R4.	
15 Jan		Discussion in person with ANH regarding our ARROW cost estimates for retail categories R2 and R4.	
18 Jan		Letter from ANH commenting on the draft determination.	Letter from AQV commenting on the draft determination.
25 Jan	Letter to ANH responding to its request for information and providing the relevant correspondence between ourselves and AQV.		
30 Jan	Letter to ANH thanking them for its comments on the draft determination and welcoming feedback on AQV's response to the draft determination.		
30 Jan	Letter to AQV thanking it for commenting on the draft determination and welcoming their comments on Anglian's response to the draft determination.		
1 Feb		Letter from ANH informing us that it has sent AQV a redacted copy of its response to the draft determination.	
11 Feb		Letter from ANH commenting on AQV's response to the draft determination.	Letter from AQV commenting on ANH's response to the draft determination.
29 Feb			Phone call from AQV enquiring when the final determination will be issued.
3 Mar		Phone call from ANH asking when it should expect to be issued with the final determination.	Letter from AQV requesting information on a number of issues, including when to expect the issuing of the final determination.
13 Mar	E-mail to ANH to clarify ANH's explanation of two of the sub-	E-mail from ANH confirming that our	

	activities associated with retail category R5.	understanding is correct.	
19 Mar	Final determination sent to both parties for comment on factual content by 25 Mar.		
25 Mar		E-mail from ANH commenting on the factual content of the final determination.	
26 Mar	E-mail and telephone call to AQV enquiring whether it has any comments to make on the factual content of the final determination.	E-mail from ANH with additional comments on the factual content of the final determination.	Phone call from AQV stating that it would like to make comments on the factual content of the final determination and asking for an extension of the deadline. We granted an extension to 27 Mar.
27 Mar			E-mail from AQV commenting on the factual content of the final determination.
28 Mar	Final determination issued to both parties.		

Method of determining prices

- 5.1 Under the WSL regime water undertakers must set their access prices in accordance with the Costs Principle, as set out in Section 66E WIA91. Section 66D(3) WIA91 requires Ofwat to determine prices in accordance with the Costs Principle.
- 5.2 In making the determination, we have followed the Costs Principle and the method set out in Ofwat's Access Codes Guidance. Our interpretation of the Costs Principle can be summarised as follows (see equation 6.5.1 in our Access Codes Guidance).

Access price = any expenses reasonably incurred + retail charge – ARROW costs

- 5.3 Under the Costs Principle, the water undertaker is able to recover from the licensee any expenses which are reasonably incurred in providing wholesale water supplies or in allowing water to be introduced into its system, together with costs in respect of 'qualifying expenses' and a reasonable return on that amount, to the extent that those sums exceed any financial benefits which the water undertaker receives as a result of the supplier supplying water to the premises of the relevant customers. The Costs Principle also takes into account those costs that the water undertaker will no longer incur because the licensee now supplies water to the customer. These costs are expenses that can be avoided or reduced, or any amount that is recoverable in some other

way (other than from other customers of the water undertaker). These costs referred to by the acronym ARROW costs.

- 5.4 In making this determination we have had regard to the fact that Anglian Water, as the incumbent water company, is the only party likely to have full access to the information necessary to accurately and fully identify its avoidable costs and additional expenses. We have challenged Anglian Water to justify its cost allocations and to prove why certain costs are not ARROW costs or why offsetting expenses will be incurred. Where we consider Anglian Water has not fully justified its position, we have made assumptions based on the best information available to us, having regard to the information asymmetry that exists between Anglian Water, on the one hand, and Ofwat and Aquavitae, on the other hand, and our duty to protect the interests of consumers, wherever appropriate by promoting effective competition and to maintain an approach consistent with the legislation.
- 5.5 In its response to the draft determination, Anglian Water stated that the determination should make clear which specific activities are to be carried out by Aquavitae rather than Anglian Water. In certain cases Anglian Water has indicated that it would continue to undertake the activity irrespective of whether Aquavitae undertook responsibility or not, and recover the cost of doing so from its other customers.
- 5.6 In the process of estimating the discounts that should be offered to Aquavitae, we have considered the ARROW costs for each of the categories, assuming that Aquavitae can carry out certain activities instead of Anglian Water. Throughout the determination process, it has never been wholly clear which activities Aquavitae intends to provide and which it does not, although we have asked it to clarify this several times. In calculating the discount margins, we have assumed Anglian Water ceases to provide a number of activities, implying that Aquavitae will need to decide whether to continue these activities or not. Aquavitae has not disagreed with this approach or with any of our assumptions regarding these avoidable retail activities.
- 5.7 It is Anglian Water's business decision as to whether it would still carry out certain activities which are subsequently provided by the licensee. However, the Costs Principle refers to expenses that can be avoided, not those that are avoided. We therefore do not agree that Anglian Water can expect to charge for the duplication of activities. The Costs Principle prohibits the recovery of ARROW costs from other customers.

Analysis of Anglian Water's cost allocation

- 6.1 The method Anglian Water employed to calculate its wholesale access prices can be summarised as follows.

- 6.2 Step 1 – Anglian Water started from its June Return⁵ data for customer services (table 21, line 13) and doubtful debts (table 21, line 18) and added its own calculation for the cost of customer credit. Anglian Water then allocated this total across the 14 retail activities⁶ (R1 to R14) set out in our Access Codes Guidance (Version 4, July 2007). See **Annex A** for definitions of the retail activities in Ofwat’s Access Codes Guidance, as well as a description of how data to be provided should be reconciled to June Return information.
- 6.3 Step 2 – Anglian Water then allocated its costs between fixed and variable costs. The main component of fixed costs were I.T. systems. In Anglian Water’s view fixed costs could not be considered avoidable, reducible or recoverable in other ways. At our meeting on 1 October 2007, Anglian Water said that the life expectancy of its SAP computer system was at least 10 years. Subsequently, in its letter of 16 October 2007, it explained that the vast majority of fixed customer services costs were for the support and maintenance of its Information Services function. Anglian Water regards those costs as fixed in the medium term. Anglian Water has replaced Information Services systems on average approximately every six years. In the case of its principal billing system, however, Anglian Water has only replaced that system once, in 2006, with the previous system being in place for sixteen years.
- 6.4 Step 3 – Anglian Water allocated the fixed and variable costs between ineligible and eligible customers according to four cost drivers: customer numbers, number of bills, number of meter readings and number of customer contacts. The cost driver used by Anglian Water depended on the retail activity being analysed. For certain categories (doubtful debts and cost of customer credit), Anglian Water used actual data to allocate costs between eligible and ineligible customers rather than having to use a cost driver.
- 6.5 Anglian Water’s Business Customer Service (BCS) team manages Anglian Water’s relationship with its larger customers, but not just Anglian Water’s eligible customers. More than half (59%) of the costs for the BCS team have been allocated to 194 eligible customers, and 41% of costs to the other large customers. Anglian Water did not use cost drivers for this allocation but analysed the amount of time each of the four BCS teams spent managing eligible customers and other large customers. It then did a single average for eligible and non-eligible large customers.
- 6.6 Step 4 – The results of Step 3 were total variable costs for all eligible customers for each retail activity (R1 to R14). Anglian Water then calculated the unit variable costs for each activity by dividing the total variable cost by the relevant unit (e.g. bills, meter readings) for each retail activity. That produced average variable unit costs, reflecting the fact that many of the

⁵ June Returns are appointed water companies’ annual regulatory returns to Ofwat. They provide a framework for the submission of the majority of information we require, enabling us to monitor progress and compare performance between companies.

⁶ In fact, Anglian Water did not allocate any data to R10 – see section 6, paragraph 6.55 for discussion on this.

services provided are standard costs (e.g. the cost of billing does not vary per bill).

- 6.7 Step 5 – Anglian Water then calculated the ARROW costs for each of the four customers based on a licensee taking over the retail supply to those customers. Anglian Water used the unit variable costs from step 4 and multiplied them by the relevant customer-specific driver to obtain the annual cost of that retail activity for the customer (for example for R1, customer billing, Anglian Water took the unit variable cost of a bill and multiplied it by 12, the number of bills per year for an eligible customer, to obtain the cost of customer billing for an eligible customer). The meter reading cost driver varies by eligible customer depending on the number of meters at that customer's site. The ARROW costs for doubtful debts vary in proportion to the billed amount for each customer.
- 6.8 Step 6 – Anglian Water then considered what costs it would incur in supplying the licensee in place of supplying the customers. It identified licensee-specific cost drivers for providing the requested (or assumed) level of service to the licensee. The unit costs to which the drivers were applied were the same as those derived in step 4. This produced a figure for "expenses" for each retail activity.
- 6.9 Step 7 – Finally, Anglian Water deducted the expenses from the ARROW costs to calculate the discount for each retail activity and added them up to calculate the discount due to the licensee for taking over the supply to each of the eligible customers.
- 6.10 There are small differences between the original discounts for R2 "Meter reading" and R8 "Water efficiency advice" supplied to Aquavitae on 30 March 2007 and 1 August 2007 and the values which Anglian Water supplied to Ofwat on 1 October 2007. The discrepancy is due to the different price base used. The figures submitted to Ofwat on 1 October 2007 were expressed in 2005-06 prices. The original discount offered to Aquavitae used 2006-07 prices. At our meeting with Anglian Water on 1 October 2007 we agreed that for the purpose of the determination we would use 2005-06 prices, for consistency with data already supplied. Aquavitae made no comment on this in their response to the draft determination.

Ofwat's views on Step 1

- 6.11 Anglian Water's allocation is consistent with our Access Codes Guidance on how appointed water companies should reconcile their allocation with their June Return data (see page 88 of our Access Codes Guidance, version 4, July 2007). The cost of customer credit (R11) is additional to the June Return data, as required in our guidance. We have not challenged the individual allocation of the June Return data between R1-R6, R8-R10 at Step 1, although we have confirmed that the total cost allocation is consistent with the June Return. We have challenged in more detail the expenses allocated to each retail activity in Step 6.

Ofwat's views on Step 2

- 6.12 Anglian Water then allocated its costs between fixed and variable costs. The main component of fixed costs were I.T. systems. We questioned whether the I.T. system costs truly were fixed over a longer period. Anglian Water explained that the vast majority of fixed customer services costs were for the support and maintenance of its Information Services systems. Anglian Water stated that Information Services have typically been replaced or upgraded on average every six years and that its last principal billing system was in place for sixteen years and it does not foresee changing the newly implemented system for another ten years.
- 6.13 Anglian Water explained that it replaced its billing system in 2006. It said that while it had considered alternative, smaller and more responsive systems, it would not consider changing to a smaller billing system unless it lost 90% of its customers. It therefore sought a commercial decision about its future I.T. costs, in the light of the existing WSL regime and concerns about the Costs Principle. We considered that these I.T. costs should not be classified as “fixed” and excluded from the ARROW cost assessment. We do not want companies to entrench potential inefficiencies (e.g. inflexible billing systems). In this particular case, I.T. costs could have been incurred in such a way as to make them avoidable if customer numbers reduced. Since the structure of the Costs Principle was known in 2006 Anglian Water could have set up the cost structure for its billing system to enable cost to be avoided as customers were transferred to licensees. That Anglian Water chose not to do so is its own commercial decision. We therefore included these “fixed” costs in Anglian Water’s variable costs, retaining the policy that I.T. costs should not be attributable to customers who switch. We have allocated ARROW costs with regard to the maintenance of this activity, assuming that there will be savings in terms of human capital costs arising from the switch of the four customers to Aquavitae. However, the effect of allocating I.T. system costs to variable costs has only a very small effect on eligible customers, as the cost is only £2,100 from the total fixed cost of £2.8m that were applicable to eligible customers (194 in total). This adds only £10.82 to the gross ARROW costs per eligible customer. The following table gives the additional ARROW costs per retail activity for each of the four customers. We have used these estimates within the discount calculations in Table 10.

Table 2: Impact of Fixed Costs Redistribution on Gross ARROW Costs

Retail Activity	R1	R2	R3	R4	R5	R6	R7	R8	R9	R10	R11	R12	R13	R14
Additional ARROW Cost (£)	3.00	6.67	0.18	0.28	0.43	0.19	0	0.03	0.04	0	0	0	0	0

Ofwat's view on Step 3

- 6.14 We consider that Anglian Water used appropriate cost drivers for nearly all the retail activities. For example, it seems sensible to allocate customer

billing costs on the basis of the number of bills a customer receives. We questioned other drivers such as the use of the "number of meter readings" driver for allocating meter reading costs. On the one hand, we considered that eligible users might have larger sites with more distance between meters leading to higher costs per meter reading; but on the other hand an appointed water company is more likely to obtain access to an eligible customer's site than a household customer's site and would be less likely to require a repeat visit. We conclude that these factors would probably counteract each other.

- 6.15 The main driver we were concerned about was the use of "number of bills" for allocating the customer service costs associated with R6 "Debt collection and debt procedures" (the costs for business customer services were allocated as described in step 3). Using the number of bills as the driver implies that Anglian Water spends as much money on chasing a household bill as it does chasing an eligible customer's bill, despite an eligible customer's bill being on average 173 times larger than a non-eligible customer's bill. We considered that, in practice, Anglian Water would put more effort into chasing an eligible customer's bill than a non-eligible customer's bill. However, the rate would not be 173 times as much effort (which would be the effect of using "revenue" as the driver). We considered that a ratio of about 10 times more effort put into chasing an eligible customer's bill compared with an ineligible customer's bill would be appropriate. This reflects the fact that eligible customers can be threatened with disconnection for non-payment and that eligible customers receive 6 times more bills per year than households and therefore several bills can be followed up at the same time.
- 6.16 Further analysis of the information provided by Anglian Water revealed that Anglian Water allocated business customer service costs (including those for R6) by its own assessment rather than using the driver "number of bills", as it did for customer services. The resulting cost allocations imply Anglian Water spent 13 times as much chasing eligible customers' bills. This was in line with what we considered to be an appropriate ratio, i.e. that it spent around 10 times as much chasing eligible customers' bills. We adjusted our final calculations to reflect Anglian Water's data.
- 6.17 For R7 "Doubtful debts" Anglian Water did not use a driver but used direct data on the doubtful debts attributable to eligible customers on average over the last three years. The data showed that Anglian Water incurred a very low proportion of its doubtful debts from eligible customers. This meant very little of the costs in R7 could be allocated to eligible customers. We queried the data with Anglian Water who confirmed that the doubtful debt data is based on actual information because Anglian Water is able to identify the doubtful debts attributable to eligible customers, due to the relatively small number of eligible customers.

Ofwat's view on Step 4

- 6.18 In Step 4 Anglian Water calculated the average variable unit costs for each eligible customer. Our Access Codes Guidance recommends this approach stating "Water undertakers should usually base case-specific retail ARROW

costs on the average retail ARROW costs that they have calculated for indicative prices in table A3.1. If the water undertaker has identified specific reasons for a particular customer's ARROW costs to differ from the indicative ARROW costs then water undertakers should record these reasons." (page 67, version 4, July 2007). This reflects the fact that for many of the retail services provided the customer-specific cost is equal to the average cost e.g. the per-bill cost of billing does not vary between eligible users. Using the average costs also ensures the ARROW costs are consistent with Anglian Water's June Return data. However, for R8 "Advice on Water Efficiency and Quality" we did question Anglian Water about whether using the average cost was appropriate or whether customers varied in the cost of advice on water efficiency and quality they imposed on Anglian Water (see discussion on R8 under Step 6).

Ofwat's views on Step 5

- 6.19 At Step 5 Anglian Water calculated the ARROW costs for each of the four customers by taking the unit variable costs from step 4 and multiplying them by the appropriate customer-specific driver to obtain the annual cost of that retail activity for the customer. This approach is in line with our Access Codes Guidance.

Ofwat's views on Step 6

- 6.20 We have systematically analysed Anglian Water's information on each retail activity listed in our Access Codes Guidance.

R1 – Customer billing

- 6.21 Anglian Water argued that its billing system is currently structured around holding information and producing bills by meter and premises, not by customers. So, for customers with two or more premises, it does not aggregate bills. Therefore, Anglian Water would provide separate bills to Aquavitae for each premise it supplies, because to provide a single bill would require either manual aggregation or a change to Anglian Water's billing system, which would in turn result in additional costs greater than any savings made through reduced printing, postage or envelopes. Anglian Water added that Aquavitae had not asked for anything different and in particular it had not asked for a combined bill. Anglian Water had therefore assumed no change in billing or billing frequency. Anglian Water also noted that the price of billing reflects the full cost of producing a bill, not just the water proportion.
- 6.22 Within its current billing system, Anglian Water could not realise any ARROW costs savings. But according to the Costs Principle, it could have done so if its billing system had been more flexible and could aggregate customer bills. We have assumed that a 75% ARROW cost saving could have been made, given that the 4 customers are now aggregated to 1.

R2 – Meter reading

- 6.23 Anglian Water's view is that there are no savings to Anglian Water in dealing with four customers, compared with one, as the meters continue to be located

on four separate sites. Anglian Water's policy is to allow Aquavitae to read meters, but, depending on the size of the customer, to read the meter itself either half-yearly or quarterly. This results in expenses being only one third of ARROW costs for three of the customers for R2 (Aquavitae has only asked to read the meter for three of the four customers; it made no request to read the meters for Customer D). Anglian Water also stated that it planned to use logger data, rather than manual meter reading, to produce bills which would result in the electronic transfer of data and no avoidable costs resulting from a licensee's offering to read meters in the future.

- 6.24 Anglian Water has acknowledged that savings could be made given that Aquavitae is taking over the meter reading activities for three of the four customers. We have assumed lower expenses for Anglian Water as we consider it should only be necessary to read the meter itself once a year (unless the pattern of use seems unusual based on previous customer use), resulting in expenses being 25% of ARROW costs. In its response to the draft determination, Anglian Water disagreed with our discounts, stating that it needs to check the meter readings on a quarterly basis and not on an annual basis in order to safeguard its financial probity. It stated that it will need to recover the costs from other customers, if not from Aquavitae. We do not accept that Anglian Water needs to check meter readings so frequently. For example, in the household sector customers supply their own meter readings or even pay annually if they are unmeasured. Therefore, we have maintained our original position and our estimates of ARROW costs associated with this category. In addition, Anglian Water is prohibited by the Costs Principle from recovering ARROW costs from other customers.

R3 – Maintenance of customer account information

- 6.25 Anglian Water has argued that there are no savings for this category because the issues arising at the four premises are operational in nature and will continue to arise when Aquavitae takes over their supply. Anglian Water pointed to its existing customers with multiple sites who do not receive any reductions in charges.
- 6.26 We questioned Anglian Water's view and asked it to explain what activities it had included in R3, so that we could judge whether they were operational activities. Anglian Water said that it had included the following activities in R3:
- Maintenance of customer records incorporating maintenance of:
 - Supply agreements (creation, negotiation and development);
 - Maximum daily demand (MDD);
 - Monitoring for revenue purposes
 - Exceedances (e.g. investigation into unauthorised exceedances of MDD)
 - Increase MDD or grant exception due to firefighting and leakage;
 - Site Information Report creations for account managers;
 - Income/cash flow forecasting;
 - Growth/reduction forecasting;
 - Verification of logged data with meter reading;

- Maintenance of account details, contact and operational e.g. flooding, interruptions;
- Maintenance and reconciliation of billing information;
- Entering meter reading data onto the billing system;
- Proactive and reactive (but not prompted by customer) meter maintenance and meter exchange;
- Maintenance of logger and remote logging system.

6.27 Anglian Water said that all of these activities were expected to continue when the licensee took over the customers because the activities are premises-related (e.g. maintenance of supply agreement) or because Anglian Water would have no choice but to continue the activity (e.g. entering of meter reading data onto the billing system). Anglian Water considered that dealing with a licensee may in practice increase costs as queries relating to items such as MDD exceedances and exceptions, meter maintenance and exchange would require Anglian Water to raise a query with the licensee, who would be likely to need to discuss the issue with the customer before then contacting Anglian Water again. Anglian Water argued that this would double the number of contacts it had to make.

6.28 We questioned Anglian Water's view that there were no net avoidable costs in category R3. We suggested that we might assume that all costs in R3 are avoidable with no offsetting expenses. Anglian Water disagreed with this suggestion. Anglian Water made the following comments:

- It maintained its view that the activities incorporated within R3 are either activities which Anglian Water would be required to provide to customers site by site, and would need to continue to provide to a licensee as Anglian Water's customer e.g. billing and responding to payment queries; or were activities which Anglian Water regarded as essential to the efficient and effective operations of Anglian Water in delivering water site by site, and which Anglian Water considered added value to customers and licensees.
- Aquavitae had not indicated to Anglian Water that it does not require Anglian Water to provide these services. Anglian Water added that it was not clear that the customers were aware or had indicated their support that these services may no longer be undertaken.
- Anglian Water argued that the implication of disallowing costs for R3 activities is that they will cease to be provided to licensees and their sites. Anglian Water considered this was completely untenable in most cases, for reasons of financial probity or because the customer would rightly expect the activity to be a normal part of a sensible water delivery arrangement.
- Anglian Water added that stopping the R3 activities will be detrimental to the efficiency of their operations and potentially the customer's operations. Anglian Water gave the example that if the costs of growth/reduction checks with licensee's sites for forecasting purposes are disallowed, the activity will not be undertaken. As a result investment required for growth will not be made, and water may not be available to support the eligible customer's expansion thus impacting on the customer's operations and future viability. Conversely, if Anglian Water did not anticipate reductions in licensee site

demand, Anglian Water might continue to invest in planned capital, which is no longer required by the eligible customer. This detriment to forecasting impacts on the efficiency of Anglian Water's operations and ultimately is paid for by the generality of customers.

6.29 Anglian Water set out in a table an explanation of its activities under R3 and the consequences for the customer if Ofwat assumed all costs under R3 were avoidable with no offsetting expenses.

Table 3 - Anglian Water's analysis of the activities it provides under R3 and the consequences of no longer providing those activities

Activity	What we do now and why	Impact if we stop doing this
a) Maintenance of supply agreements.	Supply agreements set out the water supply requirements of each site including the terms and conditions upon which we provide supplies. The agreement includes maximum consumption details to assist Anglian Water with its investment planning. Supply agreements are created, negotiated and developed. Each site supply agreement is reviewed every 2 years. These are site specific and an essential activity.	No negotiation or development of agreement with licensee. Agreement shall be put in place by Anglian Water to reflect Anglian Water's optimal planning and operational requirements. Changes to the licensee's requirements to reflect a change in circumstances shall not be incorporated.
b) Maintenance of Maximum Daily Demand (MDD) figure	Charges to eligible customers are based on MDD therefore it is essential to monitor for expected revenue, identify and investigate unauthorised exceedances and increase the MDD or grant an exception if the increase is due to fire fighting, leakage etc. This is site specific and an essential activity.	Any increase in the customer's actual consumption above the MDD will automatically and permanently increase the MDD irrespective of the circumstances. We will not respond to queries about changes nor investigate the circumstances which could arise e.g. through water required for fire fighting or because of a leak.
c) Site Information Report creations for account managers	Created in advance of site discussions and/or visits to customers. The reports detail site specific data including consumption and MDD data and movements and are used both by BCS and the customer to identify process improvements and efficiencies. This is site specific and an essential activity.	No discussions or visits will be provided by Anglian Water. Without the data included in these reports, licensees will have to collect these data themselves otherwise it will not be possible to identify process improvements and efficiencies.
d) Income / cashflow forecasting	This indicates expected income and cash flow from our largest users used for business planning and performance monitoring. This may not be site specific but is essential for AWS operations.	Not forecasting income and cash flow will have a detrimental effect on the accuracy and efficiency of Anglian Water's business planning and monitoring.
e) Growth / reduction forecasting	Undertaken through discussions with customers which helps in the monitoring and planning for optimal efficiency in Anglian Water's operations and capital investment programming. This is site specific and an essential activity.	We will not take account of licensee specific requirements in forecasting growth or reductions and therefore capital may not be invested in time to fulfil the licensee's growth requirements or conversely capital may be spent which is not subsequently required. Both will be detrimental to Anglian Water's efficient operations and customers.
f)	Undertaken to ensure the integrity,	We will not verify logged data with meter

Verification of logged data with meter reading	accuracy and consistency of billing data and confidence in the billing and charging process. This is site specific and an essential activity.	readings. This is likely to bring into question the accuracy of the billing process and increase enquiries and complaints. We will not respond to such enquiries and complaints.
g) Maintenance of account details, contact and operational e.g. flooding, interruptions	Required for facilitating contact with customers for routine and emergency reasons. Routine contact might be customer specific and therefore the same for each site (but no confirmation of this). For emergency contact, site specific details may be needed in addition to licensee details, hence our reference to increasing costs. This is an essential activity.	We will not maintain contact details and not facilitate contact with customers. In the event of an interruption or event such as flooding we may be unable to contact the appropriate person and therefore be unable to avoid unnecessary and costly interruptions to customer's operations.
h) Maintenance and reconciliation of billing information	This ensures the integrity, accuracy and consistency of billing data for customers. This is site specific and essential to the financial probity of Anglian Water.	We will not maintain and reconcile billing information which may result in increased billing queries and complaints. Such queries and complaints will not be responded to.
i) Entering of meter reading data onto the billing system	Required in order to bill customers accurately. This is site specific and essential to the financial probity of Anglian Water.	Site specific. It is difficult to envisage how we will bill without ever entering meter read data.
j) Proactive and reactive (but not-prompted by customer) meter maintenance and meter exchange	Undertaken to ensure integrity of meter and meter data (and hence billing data) and customer confidence. This is site specific and essential to the financial probity of Anglian Water.	Meters will not be maintained and exchanged through Anglian Water work, only through a licensee request. If the licensee is unaware of a problem then the customer may be disadvantaged.
k) Maintenance of logger and remote logging system	Undertaken to ensure integrity of logger and logger data (and hence billing data) and maintain customer confidence. This is site specific and essential in providing Anglian Water with consumption data for addressing issues such as leakage in Anglian Water's system e.g. nightlines. It is also essential to the financial probity of Anglian Water.	The cost of this will have to be borne by other customers.

6.30 We have carefully considered the above information relating to the R3 sub-activities, as well as Anglian Water's comments on our estimates for activity R3, set out in the draft determination. These are summarised below, along with our final position on each of the sub-activities in R3. We have assigned ARROW cost savings to many of the sub-activities, taking the view that Anglian Water should not completely cease the provision of these sub-activities, but should be able to reduce its involvement.

- Maintenance of supply agreements – Anglian Water claims that it needs supply agreements with each customer (reviewed every 2 years) setting out each site's requirements, for planning purposes. Anglian Water argues that allowing greater changes around expected and peak volumes provides a preferential service to licensees and their customers, compared with existing

customers. It disagrees with our assignment of ARROW costs associated with this sub-activity. We believe that the licensee would be more proactive than the customer in providing information to Anglian Water for each site, including negotiating the need to review the agreement every 2 years. In our view the Wholesale Master Agreement will overarch any individual supply agreements. We do not suggest that Anglian Water needs to completely cease the provision of this activity, but only to reduce its involvement, as Aquavitae will play a greater role in the negotiation than the individual customers used to. We disagree that there would be no net savings associated with this sub-activity. The initial agreement between the appointed water company and the licensee should be framed to allow some changes around expected volumes and peak volumes. We envisage that this should be progressed through the licensee. There should be some 75% ARROW cost savings here, based on Anglian Water having to deal with the licensee as opposed to the original four customers.

- Maintenance of Maximum Daily Demand (MDD) – Anglian Water states that this sub-activity is of a monitoring nature and that there is an agreement between the original four customers and Anglian Water for it to investigate increases in MDD. The investigation would incur a cost. Anglian Water claims that the purpose of the MDD charge is to be cost reflective and to identify peak requirements to assist its planning and asset management. Hence, it disagrees that there should be any savings associated with this sub-activity. We think that increased responsibilities should be taken on by the licensee. Aquavitae can replace Anglian Water and should investigate increases in MDD and be more proactive in providing information to Anglian Water. The Wholesale Master Agreement can provide for this. The agreement Anglian Water is referring to is between Anglian Water and the customers, not the licensee. We disagree with Anglian Water’s view that there would be no net savings associated with this sub-activity. We assume that there will be 75% ARROW cost savings here, based on Anglian Water having to deal with the licensee as opposed to the original four customers.
- Site information report creations for account managers – Anglian Water has not contested our estimates of ARROW cost savings associated with this sub-activity. This is a service for the licensee to provide. We have assigned 75% ARROW costs savings to this sub-activity, given that Anglian Water will have to deal with the licensee as opposed to the original four customers.
- Income/cash flow forecasting – we have determined that this is an operational sub-activity and hence we have not assigned any ARROW costs to it. In addition, we have removed the associated expenses.
- Growth-reduction forecasting – having determined this is an operational activity we have assigned no ARROW costs to it. We have also removed the associated expenses.
- Verification of logged data with meter reading – Anglian Water has indicated that it needs to continue providing this service, even if Aquavitae undertakes this activity with Anglian Water’s involvement, in order to safeguard its

financial probity. It states that it will recover the costs of verification from other customers, if not from the licensee. We disagree with Anglian Water. It verifies meter readings for its own benefit as much as for any benefit to the customer (e.g. to spot faulty meters). We have assumed ARROW cost savings associated with this sub-activity. Aquavitae can undertake the responsibility to identify faulty meters and report inconsistencies. Anglian Water is prohibited by the Costs Principle from recovering ARROW costs from other customers. On the basis that the licensee can check the accuracy of the logger at the site for all four customers, we have assigned 75% ARROW cost savings to this sub-activity.

- Maintenance of account details, contact and operational – Anglian Water has not commented on our assignment of 50% of ARROW costs associated with this sub-activity. The licensee and appointed water company should deal with each other on such issues. It is the licensee's responsibility to deal with the customers. We have based this assignment of ARROW costs on the assumption that Aquavitae will provide this service. If the final agreement between the two parties changes, then the access price will need to reflect the new updated conditions.
- Maintenance and reconciliation of billing information – in its comments on the draft determination, Anglian Water states that it needs to undertake this activity, in order to safeguard its financial probity and does not believe that Aquavitae has any incentive to supply it with a revised set of data, should there be the need. It states that by not doing so, billing enquiries will increase. We cannot agree with this duplication and have estimated ARROW cost savings associated with this sub-activity. Anglian Water reconciles billing information for its own benefit (to protect its financial probity) as much as for any benefit to the customer (or licensee). Aquavitae will be the first point of contact, as opposed to the original four customers. We do not suggest that Anglian Water completely ceases the provision of this sub-activity, but that its involvement is reduced, as Aquavitae will be in a position to provide information to Anglian Water. On this basis, we have assigned 50% of ARROW cost savings to this activity.
- Entering of meter reading data onto the billing system – Anglian Water commented that this is either entered onto the billing system or it is not. We agree that this is a matter for Anglian Water. Hence, we have not assigned any ARROW cost savings for this sub-activity.
- Proactive and reactive meter maintenance and meter exchange – this section, as set out in Anglian Water's comments on the draft determination, appears to repeat the section for the sub-activity "Verification of logged data with meter reading", where Anglian Water states that meters under-register by approximately 3% (measured non-households) and, as the party paying by reference to the meter reading, there is little incentive for Aquavitae to proactively identify and prompt investigation of water maintenance requirements. Anglian Water also states that it needs to undertake the activity in order to safeguard its financial probity, regardless of Aquavitae taking over the sub-activity. It states that it would recover the costs from other customers. We

cannot agree with this duplication of activities and foresee 100% reduction in the associated expenses. In addition, Anglian Water is prohibited by the Costs Principle from recovering ARROW costs from other customers.

- Maintenance of logger and remote logging data system – we have determined that this is an operational activity and have removed the associated expenses, assuming no ARROW cost savings.

- 6.31 Following our analysis of Anglian Water's arguments we disagree with Anglian Water's view that there are no net avoidable costs in R3. It is acknowledged that Aquavitae has not indicated very clearly to Anglian Water that it does not want these services, but we consider Anglian Water can reasonably assume that Aquavitae would not require some of those services. Ideally, Aquavitae would have engaged in a more detailed discussion over the services required under R3, and similarly Anglian Water would have sought more proactively to understand what Aquavitae required.
- 6.32 Anglian Water has argued that several of the activities in R3 are necessary for operational reasons. It is not clear to us that such operational costs should be included in the June Return line for customer services. We can see that there might be some overlap between customer services and operational issues, hence we have removed the associated expenses and have assigned no ARROW costs.
- 6.33 For most of the activities Anglian Water has identified above we consider there should be some net avoidable costs. We would expect the licensee to deal with at least some customer account information enquiries instead of the appointed water company.
- 6.34 We asked Anglian Water to identify the costs of R3 for each of the sub-activities they listed above in Table 3, (within the total estimated by Anglian for R3 of £339). Table 4 presents our avoidable costs calculations. In the second column of the table, Anglian Water has provided us with the breakdown of percentage of the ARROW costs associated with each sub-activity of R3. The third column represents our estimates of the percentages of the ARROW costs which should not be allocated to expenses and column four gives the corresponding avoidable net ARROW costs.
- 6.35 Anglian Water initially provided us with a total for sub-activities **a, b, c, d, e** and **f** equal to £169.50 (50% of £339). Given that sub-activities **d** and **e** are of operational nature, we have deducted the expenses associated with them from the total, taking the view that they contribute equally to the total of £169 (See table 3). As a result, the expenses associated with R3 are reduced from £339 to £214.70. See table below for the associated ARROW costs savings of £152.55.

Table 4: Maintenance of customer account information (R3) – breakdown of expenses and avoidable costs

Retail Category (Activity) from Table 2	Anglian Water's allocation of expenses per sub-category	Ofwat estimates of how much expense is ARROW costs	Avoidable costs
R3 a, b, c, f	50% (£169 – (169/6)*2 = £113)	75%	£84.75
R3 g	10% (£33.90)	50%	£16.95
R3 h	10% (£33.90)	50%	£16.95
R3 j	10% (£33.90)	100%	£33.90
	£214.70	71.05%	£152.55

R4 – Payment handling

6.36 Anglian Water's view is that even if a single payment were received from Aquavitae for the total sum previously paid by four customers, Anglian Water would still need to allocate the revenue to each of the four premises, as it currently does. We are unclear why Anglian Water would need to allocate the revenue to each premise as long as the total is correct. We have therefore assumed that Anglian Water's expenses are 75% lower than its ARROW costs for R4, since four customers are being aggregated to one.

R5 – Handling and resolving customer calls, correspondence and complaints

6.37 Anglian Water has argued that there are no savings arising for this category because the issues arising from the four premises will continue to arise when Aquavitae takes over their supply. Anglian Water pointed to its existing customers with multiple sites who do not receive any reductions in charges.

6.38 We questioned Anglian Water's view and asked Anglian Water to explain what activities it had included in R5, so that we could judge whether they were operational activities. Anglian Water stated that it had included the following activities in R5:

- Account management function, advising and responding on customer account information;
- Communicating tariff changes;
- Communicating MDD exceedances and exceptions;
- Billing and payment queries, refunds, rebates and error corrections;
- Dispute resolution, escalation, legal and regulatory interface;
- Growth facilitation, contribution calculations;
- Operational incident support including:
 - Supply interruptions
 - Water quality
 - Water pressure

6.39 Anglian Water said that all of these activities were expected to continue when the licensee took over the customers because the activities are premises-related or because Anglian Water would have no choice but to continue the

activity (e.g. billing and payment queries, refunds, rebates and error corrections). Anglian Water considered that it might receive additional calls, correspondence and complaints from a licensee but Anglian Water had not increased costs to reflect this.

6.40 We challenged Anglian Water's view that there were no net avoidable costs in the category R5. We suggested that we might assume that all costs in R5 are avoidable with no offsetting expenses. Anglian Water disagreed with this suggestion and made the same comments as it did on R3 (as R3 and R5 have tended to be grouped together in the correspondence).

6.41 Anglian Water set out in a table an explanation of its activities under R5 and the consequences for the customer if Ofwat assumed all costs under R5 were avoidable with no offsetting expenses.

Table 5 - Anglian Water's analysis of the activities it provides under R5 and the consequences of no longer providing those activities

Activity	What we do now and why	Impact if we stop doing this
a) Account management function, advising and responding on customer account information	We respond to customer queries, letters and complaints and manage customer accounts either through visits or telephone. This is mainly site specific as most issues relate to the site rather than the customer. We expect overall advice to licensees to increase. This is essential for any service provider.	No face to face visits or services from office based customer support agents. We will not respond to calls, correspondence or complaints. This means issues raised by the licensee or customers will not be responded to by Anglian Water.
b) Communicating tariff changes	Tariff changes are explained to customers at least annually to support their financial and operational planning. This may be customer specific if all sites are on the same tariff. This is an essential service.	We will implement tariff changes without any communication to the licensee or customer in advance. This will have a detrimental impact on their financial and operational planning.
c) Communicating MDD exceedances and exceptions	As a result of MDD monitoring, we contact customers to inform them of any unauthorised exceedances. We also contact customers to confirm agreed exceptions. This is site specific and an essential service.	We will implement increases in the MDD without any communication to the licensee or customer. This will be in the form of an increased and permanent MDD.
d) Billing and payment queries, refunds, rebates and error corrections	We manage any billing and payment queries and implement refunds, rebates and error corrections as appropriate. This is site specific and an essential service. Withdrawal of this service is untenable.	We will not respond to any billing or payments queries and will not make any refunds, rebates or error corrections.
e) Dispute resolution, escalation, legal and regulatory interface	We manage any disputes through to resolution, escalating within Anglian Water as necessary and acquiring legal and regulatory advice as appropriate. This might be site specific or customer specific and is an essential service. Withdrawal of this service is untenable.	We will make no attempt to resolve disputes with licensees and may need to amend the WMA to reflect this.
f) Growth facilitation, contribution calculations	We manage the processes within Anglian Water which facilitate the growth requirements of customers including financial contributions.	We will not respond to growth related enquiries which may impact on customer's growth plans and viability in their respective markets.

<p>g) Operational incident support including; Supply interruptions, Water quality and Water pressure</p>	<p>We provide support to customers in the event of an incident bringing knowledge of the customer's business and operations into Anglian Water incident planning and support. This is site specific and an essential service. To withdraw this service is likely to be unacceptable to customers.</p>	<p>BCS will not provide incident support therefore licensees will only be supported by general incident support who will have little or no knowledge of the customer's requirements. This could mean that the customer's ability to continue operations throughout the incident may be put at risk.</p>
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6.42 We have carefully considered the above information relating to the R5 sub-activities, as well as Anglian Water's comments on our estimates for activity R5, set out in the draft determination. These are summarised below, along with our final position on the sub-activities in R5. We have assigned ARROW cost savings to many of the sub-activities, taking the view that Anglian Water should not completely cease the provision of these sub-activities, but should be able to reduce its involvement.

- Account management function – Anglian Water has provided no justification as to why there should be no net savings associated with this sub-activity. In our view there should be savings associated with this sub-activity, since this is a service that the licensee would be in a position to provide. We agree that the appointed water company will need to deal with the licensee on some, but not all, issues. Hence, we have assigned 60% ARROW costs to this sub-activity.
- Communicating tariff changes – in its response to the draft determination Anglian Water has not commented on our assignment of ARROW costs associated with this sub-activity. Licensees should pass tariff changes information on to their customers. The licensee should be aware of tariff changes (through appointed water company website). Hence, we have assumed 75% reduction in expenses. We have based this assignment of ARROW costs on the assumption that Aquavitae will provide this service. If the final agreement between the two parties changes, then the access price will need to reflect the new updated conditions.
- Communicating MDD exceedances and exceptions – Anglian Water appears to have double counted this activity. The same activity with exactly the same justification, word for word, has already been outlined in the R3 sub-activity “Maintenance of MDD”, where Anglian Water states that in the case of MDD increasing, an investigation is undertaken to identify whether there was an acceptable reason that would not warrant an increase in the MDD charge, for example, water used for fire fighting. Hence, we have assumed 100% reduction in expenses.
- Billing, payment queries, refunds, rebates and error corrections – Anglian Water disagrees that there should be any net savings associated with this sub-activity. However, it has provided no justification as to why this should be the case. In our view, while Anglian Water will continue to provide this service, the licensee can represent the original four customers so Anglian

Water will need to communicate less, i.e. with the licensee only. On this basis, we have assigned 75% ARROW cost savings to this sub-activity.

- Dispute resolution, escalation, legal and regulatory – in its response to the draft determination, Anglian Water states that our discount of 75% implies only customer-related, not site-specific disputes. It argues that this is incorrect as site related issues (e.g. leakage) can arise, which also need resolving. We disagree with Anglian Water's view. Leakage allowances are very small and leakage work is not carried out on a routine basis. Should any disputes arise, Anglian Water will need to deal with the licensee as opposed to the original four customers. Hence, we have assigned 75% ARROW costs savings to this sub-activity.
- Growth facilitation, contribution calculations – Anglian Water states that Aquavitae may identify the customers' growth requirements, but it will still need to liaise with Anglian Water to facilitate them. It argues there should be no net savings associated with this sub-activity. We disagree that there are no net savings. Anglian Water does not need to communicate with the original four customers but only with the licensee to identify growth requirements. Anglian Water disagrees with our reasoning but has provided no justification as to why our estimates should be revised. We think that Anglian Water need not completely cease to provide this sub-activity, but that its role will be reduced due to Aquavitae's involvement. On this basis, we envisage 50% ARROW cost savings associated with this sub-activity.
- Operational incident support – having determined that this is an operational activity, we have removed the associated expenses. We have not assigned any ARROW costs to this sub-activity.

6.43 Following our analysis of Anglian Water's arguments we disagree with Anglian Water's view that there are no net avoidable costs in R5. Anglian Water has argued that some of the activities in R5 are necessary for operational reasons. It is not clear to us that such operational costs should be included in the June Return line for customer services. We can see that there might be some overlap between customer services and operational issues, hence we have removed the associated expenses and have assigned no ARROW costs.

6.44 For most of the activities Anglian Water has identified above we consider there should be some net avoidable costs. We would expect the licensee to deal with all customer calls, correspondence and complaints instead of the appointed water company and to resolve most of them without involving Anglian Water.

6.45 Table 6 presents Ofwat's avoidable costs calculations for category R5. In the second column of the tables, Anglian Water has provided us with the breakdown of percentage of the ARROW costs associated with each sub-activity of R5. The third column represents our estimates of the percentages of the ARROW costs which should not be allocated to expenses and column four gives the corresponding avoidable net ARROW costs.

6.46 Anglian Water provided us with the following expenses for R5 (a total of £403). We have carefully considered each of the sub-activities and having defined that some are operational, we have removed the associated expenses. We have assigned no ARROW cost savings to these. Having subtracted sub-activity g, the total expenses associated with R5 has reduced from £403 to £382.85. See table 6 below for the associated ARROW costs savings of £255.91.

Table 6: Handling and resolving customer call, correspondence and complaints (R5) – breakdown of avoidable costs

Retail Category (Activity)	Anglian Water allocation of expenses per sub-category	Ofwat estimates of how much expense is ARROW costs	Avoidable Costs
R5 a	35% (£141.05)	60%	£84.63
R5 b	5% (£20.15)	75%	£15.11
R5 c	10% (£40.30)	100%	£40.30
R5 d	10% (£40.30)	75%	£30.23
R5 e	15% (£60.45)	75%	£45.34
R5 f	20% (£80.60)	50%	£40.30
	£382.85	66.84%	£255.91

R6- Debt collection & debt procedures

6.47 Anglian Water has argued that there might be savings if it is assumed that each of the premises will pay Aquavitae and, as a result, Anglian Water would only have to pursue one company, Aquavitae, to recover debt. However, Anglian Water argued that if non-payment by the end customer is the cause of non-payment by Aquavitae, Anglian Water would still need to pursue the end customer with respect to non-payment of sewerage and / or trade effluent services. In practice, Anglian Water argued, this might mean it would have to pursue both the end-customer (for sewerage services debt) and Aquavitae (for water debt) whereas previously it would have pursued only the end customer (for both debts).

6.48 We are not persuaded by this argument. Anglian Water has no contractual relationship with the end customer for water services, and Aquavitae would do at least some of the debt collection in relation to its customers, which would cause Anglian Water to incur fewer expenses. Anglian Water retains its contractual relationship with its sewerage customers. We have assumed 75% ARROW cost savings for this activity, given that Anglian Water will need to deal only with the licensee rather than the original four customers.

R7 - Doubtful debts

- 6.49 Anglian Water has taken the 3-year average of actual doubtful debt for eligible customers as the basis for identifying the ARROW cost. We think that this is a reasonable approach.
- 6.50 However, we have assumed that the undertaker will reduce its expenses for this category when customers transfer to a licensee (see our Access Codes Guidance, July 2007, page 68). This is because the undertaker will no longer bear a direct risk from the individual customers that transfer to the licensee. There is no longer any contract between the undertaker and the customer. The responsibility for paying the undertaker is a commercial issue for the licensee. It is not for Ofwat to assume the licensee will default on payments that become due to the undertaker. We recognise that some risk remains, although it is highly improbable that all four customers, along with the licensee will default on their payments at the same time. We think that a licensee will be able to continue to pay the appointed water company if a small proportion of its customer base defaults on payments to it.
- 6.51 Taking all this into account, we consider that 75% of the attributable doubtful debt costs should be ARROW costs, given that Anglian Water will have to deal with the licensee only as opposed to the original four customers.

R8 - Advice on water efficiency and quality

- 6.52 Aquavitae has said it will provide water efficiency services itself. Anglian Water's access prices have therefore not included any expenses for providing such services to Aquavitae.
- 6.53 The R8 ARROW costs for each customer are calculated as the average across all eligible customers. We questioned whether the average cost was a good measure of the specific costs for each customer. Anglian Water explained to us that R8 includes providing advice to eligible customers on water for domestic use and recommending actions for customers to improve their water processes. Anglian Water offers water efficiency audits to eligible customers annually, although not all customers accept them. Some customers pro-actively request advice on water efficiency and ways in which their processes can be improved. Anglian Water explained that it has used an average cost approach to water efficiency activities to take account of the variances in activity that occur between customers and between years. In Anglian Water's view, the average cost for eligible users provides an accurate cost for most eligible customers. We have therefore accepted the use of the average ARROW cost as a proxy for customer-specific ARROW costs for R8.

R9 – Sales, marketing and provision of information to customers

- 6.54 Anglian Water stated that it does not provide any sales and marketing information to customers. Anglian Water explained that R9 included monitoring whether customers comply with supply agreement terms, information on adverse effects arising from consumption profiles and provision of logging data. Anglian Water believed that customer accounts will require the same level of support, given that Aquavitae will not have direct access to this information.

6.55 We think that this service is not essential. We do not believe that Aquavitae will be unable to provide it. Our view is that the 'information' driving the charges is available to the licensee, making any intervention from Anglian Water unnecessary. Hence we have assumed no expenses for dealing with the licensee for R9.

R10 – Account management activities

6.56 Anglian Water considers R10 "Account management activities" to be a relatively imprecise, generic heading. Instead it chose to allocate the costs of their Key Account Managers, who support their larger customers, to the more specific categories in the analysis, namely: R3 "Maintenance of customer account information", R5 "Handling & resolving customers calls, correspondence & complaints", R6 "Debt collection & debt procedures", R8 "Advice on water efficiency & quality" and R9 "Sales, marketing & provision of information to customers".

6.57 Although we asked for this information, Anglian Water did not supply us with details for activity R10. Nor did it provide us with any figures which we can subtract from each of the above identified activities R3, R5, R6, R8 and R9 so that we can arrive at the ARROW costs associated with this activity. We have had to make assumptions and have used industry data on indicative access prices from 2005 that was reviewed by companies Reporters, in order to estimate the potential extent of Anglian Water's R10 costs. We have taken the average for all appointed water companies' that identified R10 allocations (and hence the figure is not skewed by, for example, taking into consideration only the outliers). This estimate is equivalent to 31.45% of the cost of activities R3, R5, R6, R8 and R9 that we have assumed can be allocated to R10. Strictly speaking, different percentages may be appropriate for subtraction from the different activities. However, as we are not in a position to know how much exactly should be subtracted from each of these activities, and we needed to derive a number for R10 on the basis of amounts coming from the identified retail activities, this simple approach is pragmatic.

6.58 The additional saving associated with this reallocation to R10 is **£77.37** per customer. A 100% discount is applied to R10 but lower discounts apply to some of the other retail activities from which costs have been reallocated (i.e. 71%, 66.84%, 75%, 100% and 100% for R3, R5, R6, R8 and R9 respectively). The additional discount from reallocation is arrived at by subtracting the discount of **£1324.73** (See Table 7) based on Anglian Water's original expenses associated with categories R3, R5, R6, R8 and R9 from the new discount of **£1402.10** (See Table 8) based on the expenses associated with retail categories R3, R5, R6, R8, R9, as well as R10.

Table 7: Redistribution of expenses to R10

Allocation before reallocation of 31.47% to R10			
Activity	Expenses	Discount (%)	Discount (£)
R3	214.70	71.05	152.55
R5	382.85	66.84	255.91
R6	226.97	75	170.23
R8	389.63	100	389.63
R9	356.41	100	356.41
Total	1570.56	Weighted 84.3	1324.73

Table 8: Redistribution of expenses to R10

Allocation of 31.47% to R10			
Activity	Expenses (reduced by 31.47%)	Discount (%)	Discount (£)
R3	147.14	71.05	104.54
R5	262.38	66.84	175.38
R6	155.54	75	116.66
R8	267.01	100	267.01
R9	244.25	100	244.25
R10	494.26	100	494.26
Total	1570.58	Weighted 89.3	1402.10

Additional R10 discount after reallocation	£77.37
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R11 – Cost of customer credit

6.59 Anglian Water considers that there are no savings on R11 because the credit terms offered to Aquavitae are the same as the credit terms for large users. Whilst we agree with this broad view, we consider there is a small ARROW cost because the access price payable by a licensee is slightly lower than the retail price paid by the customer. As a result, Anglian Water needs to extend slightly less credit to the licensee than it would otherwise do to the customer. We have reduced Anglian Water's expenses by 0.43%, 1.66%, 0.35% and 1.88% respectively for each of the four customers, to take account of this effect. In calculating the cost of customer credit, we have initially estimated the discounts associated with each of the four customers, excluding retail activity R11. Therefore proportionate discounts need to apply to R11.

R12 – Other services provided to specific customers

6.60 R12 is designed to capture all the services commonly provided free of charge to customers such as a number of days free leakage detection work, free water sampling and analysis, and other value added free services. Anglian Water allocated no costs to R12. We questioned whether Anglian Water was providing any such services free of charge and Anglian Water confirmed that it was not.

R13 – ‘Other’ retail costs

6.61 R13 is designed to capture any retail costs not specifically allocated elsewhere under R1 to R12 or R14. Anglian Water allocated no costs to R13.

R14 – Competition related capital maintenance charges

6.62 R14 includes any capital maintenance charges for new or upgraded systems being implemented to facilitate entry into the new competitive markets. Anglian Water allocated no costs to R14. We questioned whether Anglian Water had undertaken any extra activities than incur capital charges in relation to competition and Anglian Water confirmed that it had not undertaken any such extra activities.

Ofwat views on Step 7

6.63 Step 7 is a purely arithmetic step: deducting the expenses from the ARROW costs to calculate the discount for each retail activity and adding them up to calculate the discount due to the licensee for taking over the supply to each of the eligible customers.

The effect of Ofwat's analysis on Anglian Water's wholesale access prices

6.64 The following table summarises the wholesale discounts offered to Aquavitae which Anglian Water provided to Ofwat.

Table 9: Anglian Water's discounts offered to Aquavitae

Retail activity	Customer A (£)	Customer B (£)	Customer C (£)	Customer D (£)
R1	0	0	0	0
R2	32	120	24	0
R3	0	0	0	0
R4	0	0	0	0
R5	0	0	0	0
R6	0	0	0	0
R7	0	0	0	0
R8	390	390	390	390
R9	0	0	0	0
R10	0	0	0	0
R11	0	0	0	0
R12	0	0	0	0
R13	0	0	0	0
R14	0	0	0	0
Total	422	510	414	390
Retail margin (%)	0.10	0.50	0.08	0.50

Source: Anglian Water data supplied to Ofwat, price base 2006/07

6.65 Table 10 below shows our estimates of the levels of discount that should be offered to Aquavitae.

Table 10: Ofwat's Retail Margins

Retail activity	Customer A (£)	Customer B (£)	Customer C (£)	Customer D (£)	Discount (% of total ARROW costs)
R1	28.93	28.93	28.93	28.93	75
R2	50.68	171.72	39.68	0	75
R3	104.54	104.54	104.54	104.54	71.05
R4	1.44	1.44	1.44	1.44	75
R5	175.38	175.38	175.38	175.38	66.84
R6	116.66	116.66	116.66	116.66	75
R7	229.41	58.70	282.99	46.67	75
R8	267.01	267.01	267.01	267.01	100
R9	244.25	244.25	244.25	244.25	100
R10	494.26	494.26	494.26	494.26	100
R11	7.88	7.78	7.91	7.01	0.43; 1.66; 0.35; 1.88
R12	0	0	0	0	-
R13	0	0	0	0	-
R14	0	0	0	0	-
Total	1720.44	1670.67	1763.05	1486.15	
Retail Margin (%)	0.43	1.67	0.36	1.89	

Source: Anglian Water Data Supplied to Ofwat, price base 2005/06

Conclusions

- 7.1 This is our first determination under section 66D(2)(b) WIA91 and is the first opportunity we have had to apply the Costs Principle using actual data provided by parties. We have undertaken a comprehensive process to ensure we understand as far as possible the basis for the wholesale prices offered by Anglian Water. We have asked both parties for information during the process, and given both parties opportunity to comment on our draft and final determination. We have shared with Aquavitae detailed cost information provided to us by Anglian Water. And we have given Aquavitae the opportunity to provide its own cost information and cost estimates.
- 7.2 In determining price terms, we are required to apply the Costs Principle as set out in section 66E WIA91. We have done so, using our interpretation as set out in our Access Codes Guidance. On the basis of this detailed assessment, we conclude that the discounts offered by Anglian Water to Aquavitae should

be higher. Our determination of the access charges applicable for the four customers is summarised in table 11.

Table 11: Anglian Water and Ofwat Retail Margins (%)

Customer	A	B	C	D
Anglian Water's offer	0.10	0.50	0.08	0.50
Ofwat determination	0.43	1.67	0.36	1.89

- 7.3 We are disappointed with the level of discounts that have resulted from our determination. Although these discounts are higher than those offered by Anglian Water, the determination confirms (using real data) our existing theoretical analysis of the Costs Principle. In particular, a licensee is required to pay the incumbent's unavoidable retail costs as well as its own entry costs, which can reduce significantly the net discounts available. We continue to believe that the Costs Principle remains one of the most significant barriers to the development of effective retail competition.
- 7.4 As set out in our consultations in July and December 2007, on the Review of Competition, we are undertaking further work on alternatives to the Costs Principle. Our paper in spring 2008 will look in more detail at different methods of setting prices and what results might occur from those methods. We will also be examining carefully how companies address what costs can be avoided or reduced, using what we have learned during this determination process.

Annex A

Retail activity definitions for table A2.1 in appendix 2 and A3.1 in appendix 3

Ref.	Retail activity	Definition
R1	Customer billing	Billing, calculation processing, printing, fulfilment and dispatch. Include here stationary costs and bill inserts. Include here manpower costs, materials and contract services, fees and overheads.
R2	Meter reading	Meter reading including ad hoc read requests, cyclical reading, scheduling, transport, physical reading, reading queries, read processing costs and customer read costs. Include here manpower costs, materials and contract services, fees and overheads.
R3	Maintenance of customer account information	Activities to update and maintain customer account records for changes in customer name, billing address, phone numbers, tariff, payment method, special needs information, change of occupiers. Include here manpower costs, materials and contract services, fees and overheads.
R4	Payment Handling	Payment handling including mail receipt, processing, banking, maintenance of cashbook records, bank reconciliations and bank charges, processing to account for all types of payment. Processing of and bank charges for bounced cheques and returned direct debits. Letters to customers. Ad hoc customer refunds, calculation, account maintenance, BACS transmissions or cheque production and mailing. Include here manpower costs, materials and contract services, fees and overheads.
R5	Handling and resolving customers' calls, correspondence and complaints	Activities to receive distribute and process all customer contacts and complaints. Liaison with other internal operating departments of the water undertaker. Investigations. Provide holding and substantive replies. Include call centres, customer outlets and face-to-face facilities. Include manpower costs, materials and contract services, fees and overheads.
R6	Debt collection and recovery procedures	Overdue debt follow up, including reminders, letters, outbound calling, site visits, debt collection agency costs, field collectors, disconnection process costs and court fees. Negotiation and monitoring of payment arrangements and settlements. Include here manpower costs, materials and contract services, fees and overheads.
R7	Doubtful debts (not customer specific)	This should be based on (an allocation of) the value from table 21, line 18 of the June return.
R8	Advice on water efficiency and quality	Water efficiency advice: this activity will become the responsibility of the retailer for its customers under the WA03 and may therefore largely become an avoided cost. Water analysis services provided free of charge should also be included here. Include here manpower costs, materials and contract services, fees and overheads.
R9	Sales, marketing and provision of information to specific customer	Include here all marketing, sales and promotional activities intended to grow the customer base. Include here manpower costs, materials and contract services, fees and overheads.
R10	Account management activities	Include staff costs for maintaining relationships with eligible customers, periodic meetings, advice, travel costs and entertainment. Include here manpower costs, materials and

		contract services, fees and overheads.
R11	Cost of customer credit	Include here the financing cost of providing credit to customers. This may be calculated by considering “average” supply dates compared to “average” payment dates.
R12	Other services provided to specific customer	Include here all the services commonly provided free of charge such as a number of days free leakage detection work, free water sampling and analysis, and other value added free services. Include here manpower costs, materials and contract services, fees and overheads.
R13	‘Other’ retail costs	Include here all other retail costs not specifically allocated elsewhere under references R1 to R12 or R14. Include here manpower costs, materials and contract services, fees and overheads.
R14	Competition related capital maintenance charges	Include here capital maintenance charges for new or upgraded systems being implemented to facilitate entry in to the new competitive markets.
R15	Total ARROW	

Source: Access Codes Guidance, Ofwat, 2007, p.87