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Wholesale and Retail Charges for 2015-16
Charges Scheme Rules Consultation
Markets and Economics Division
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4AU

2 July 2014

Dear Sirs,

Re: Consultation on wholesale and retail charges for 2015-16 and charges scheme rules

We welcome the opportunity to respond to this consultation.

This letter, at Annex 1, sets out our views on the seven specific questions as set out in the consultation document.

If you wish to discuss any points raised in this response please do not hesitate to contact us.

Yours faithfully,

**Jean Spencer
Regulation Director**

Annex one – Consultation question responses

Q1 Do you agree with the proposed approach to the development of charging arrangements in the 2015-20 period? If not, please explain and provide evidence for your view.

We support the proposed approach as set out in the consultation paper. It provides a “direction of travel” in very general terms within the framework provided by the new legislative arrangements. We think that stakeholders will find it helpful, especially as it provides for sufficient flexibility to enable an evolutionary approach to be adopted as new information arises and as markets develop.

Q2 Do you agree with the nominal 5% bill change as a threshold for undertaking impact assessments? If not, please set out an alternative threshold and provide evidence for this view. Should the same threshold apply to all customer types.

We do not think the proposed threshold is either necessary or desirable. No doubt like other companies, whenever our charges are subject to any re-balancing we carefully consider the justification for relative movements and their impacts, and we take into account a number of factors in deciding whether to implement changes in full or phase them over a period. For example, as Ofwat is aware, we began a staged process to roll out our “MDD charges” to customers using in excess of 10MI per annum in 2012-13. Despite the fact that we have been phasing in this change, some customers have seen annual bill increases somewhat in excess of 5%. Nevertheless, we have been able to manage these impacts without any significant difficulties. In effect we always carry out what Ofwat refers to as “proportionate impact assessments” because these are embedded in our internal processes. As we set out in our letter of 7 March responding to Ofwat’s document “Wholesale and Retail Charges – a consultation”, we do not think that an externally-imposed “checklist” is necessary, or consistent with “light touch regulation”.

Were Ofwat to go ahead with the implementation of a threshold we would be concerned that the impression would be created that increases that came in below the threshold were somehow “acceptable”. In our experience, the impact of all types of re-balancing has to be considered carefully, and an increase of 4% that has no justification can pose greater management challenges than an increase of 6% that does. Rather than relying upon what would be an arbitrary threshold of 5% we think Ofwat should continue, as it has done in the past, to challenge companies to ensure that they are giving all the potential impacts of tariff re-balancing due consideration in all circumstances. We believe that CC Water, having also played a significant role in the past, will provide a significant and

important influence on company decision-making in relation to 2015-16 charging and into the future as well.

Q3 Do you agree with such a threshold being a short-term measure? If so, when should Ofwat remove such a requirement?

Please see above. However, if there is to be a threshold we believe that it should be removed as soon as possible.

Q4 Do you agree with the draft for presenting standardised charging schedules presented in Appendix 7? If not, please provide views.

We agree with the proposed draft.

Q5 Should charges associated with Open Water and market readiness be included as a separate increment to the volumetric charge in the wholesale charging schedule?

We do not agree with the assertion that larger customers (by volume) will benefit from the new market arrangements proportionately more than smaller customers. The position is more complicated than this, and so we believe that an increment to volumetric charges would be over-simplistic. It could also be viewed as unfair between customers of different companies, e.g. many of our largest customers pay the majority of their bills on our MDD charge rather than volumetric rates, and it would also raise practical design issues for other tariff classes, such as unmeasured non-household properties and trade effluent customers. If the levy is to be structured in a way that is correlated to the size of a customer, it should be expressed as a straight percentage of the wholesale bill, i.e. taking into account all tariff components.

However, we believe that a stronger argument can be made for allocating it on a per customer basis, i.e. having no size-dependent element at all. If the market is going to deliver efficiencies in retail functions such as billing costs, these will be enjoyed by smaller customers to the same degree as the larger ones. The additional charge based on pro rating by customer is not significant.

Q6 Beyond 2015, do you agree that wholesale charges should be published in advance of retail charges? If so, please provide views on how far in advance.

We agree that wholesale charges can be published in advance of retail charges. However, it is worth bearing in mind that the earlier the wholesale charges are fixed, the less information the company will have about current demand patterns and connection rates, and therefore the greater the likelihood that its forecasts of revenue in the charging year

will prove to be inaccurate. We would favour publishing wholesale charges in December, once November RPI is known, and then retail charges in February.

Q7 Do you consider that Ofwat should require retail water bills to provide a breakdown of retail and wholesale charges?

We can see that showing separate charges can have some advantages in certain circumstances. On balance, however, we do not think that there is a sufficiently compelling case for requiring this of companies at this stage, for the reasons set out by Ofwat. In particular, it is not clear to us that it would be to the overall benefit of customers to have the additional information.

Other

Finally, there is an additional issue we wish to raise regarding the timetable in particular for 2015-16 charges. Ofwat refers to the issuing of the spreadsheet submission that will enable it to have appropriate discussions with companies "before final charges schemes come into effect". We think that a more advanced and programmed timetable is required: although schemes come into effect on 1st April 2015, we are required to publish them by 2nd February 2015, and in practice board approval of final charges is provided somewhat earlier. We therefore think it would be helpful if Ofwat endeavored to publish the spreadsheet before 29 August, and then hold such discussions during the autumn in order that any changes that are required can be planned and considered properly. It could consider doing this on a "first come first served" basis – i.e. the sooner a company submits a draft spreadsheet submission (on the basis of its draft determination) the earlier it received appropriate feedback from Ofwat.