

Wholesale and Retail Charges for 2015-16 and Charge Scheme Rules

Business Stream response

Business Stream welcomes the opportunity to comment on Ofwat's current consultation on wholesale and retail charges for 2015-16. The publication of separate wholesale and retail charges for the first time is an important step towards full market opening, and we are encouraged by the general approach being taken with this.

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.

While the separate price controls have provided much clarity on cost allocations within the incumbent companies, we believe that a limitation of the current set-up is that there is no publication of how each of the two wholesale price controls are allocated between household and non-household customers. Without this, it is more difficult to understand how customer charges in each sector are expected to evolve over the price control period, and retailers cannot undertake detailed planning in terms of how these will affect the retail tariffs. This in turn will make it more difficult to strike longer-term deals with customers, as it will not be possible to offer them any degree of certainty over what their charges will be.

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?

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

We agree that a nominal 5% change would be a reasonable threshold, and are not aware of any reason why the same threshold should not apply to all customers. We are concerned, however, that it appears that this rule will only relate to the end-customer's charges and therefore it would only be the retailer and not the wholesaler that would be required to carry out the impact assessment. While this may not be a significant issue for 2015-16, given the small number of customers that have switched, and the lack of a previously published wholesale price to compare to, we believe that beyond this year it will be important for wholesalers to have this requirement as well. This is particularly important because wholesale costs make up a large majority of the final bill, and thus there is a limited amount that a retailer can do to mitigate any significant increases. This is something that will not change over time, and therefore we feel that there is a need for an ongoing responsibility of this type for wholesalers.

This issue may also be made more problematic by the point raised above in relation to the wholesale price controls. As things stand, we are not clear on what would prevent a wholesaler choosing to make a change in the way it approaches cost allocation and thereby causing a significant change in the wholesale price. The

process of market reform means that wholesale units will no longer have a direct relationship with the end customer, and therefore may be less aware of the impact of their charge increases on them. While we appreciate that the companies have extensive experience of understanding how price changes will affect customers, and this will certainly inform their decisions, we feel that it would be sensible to maintain a rule until Ofwat feels fully confident that it is no longer needed.

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

In relation to the comment that Ofwat will not require any form of standardisation of wholesale charges at this time, we are not clear whether this applies only to 2015-16, or to the whole 2015-19 period. We would prefer that the option to increase standardisation from 2016 onwards should be kept open, as we believe this would be of significant benefit to retailers in being able to offer more harmonised tariffs across regions, something that customers have often expressed a desire for. We are not convinced that constraining innovation in wholesale charges is a problem, as this inevitably limits retailers' ability to do the same, and we believe that it is preferable to encourage innovation at the retail tariff level.

We strongly agree with the approach being taken to create a standardised charging schedule, and feel that draft version presented provides a good step towards this. Given that the schedule will provide the basis for the future market operator's settlement algorithms, it may make sense to "over-engineer" it at the outset, in the sense of providing more options (in terms of meter size brackets, volume categories etc) than are specifically needed at this point, as building these into the algorithm from the start would make it easier for wholesalers to develop their charges over time.

We are not entirely clear whether each wholesaler would be expected to capture all of their wholesale charges within a single version of this schedule, or whether they might create more than one depending on which tariffs applied. We assume the former is the case, and would strongly agree with this approach, but feel it would be useful to have confirmation that this is the intention.

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 are not clear whether companies will be expected to recover these costs on an annual basis (in which case there could be significant fluctuations from year to year), or whether they should be recovered at a consistent rate over the full 5 year period. We would also like to see greater transparency around what market readiness costs will be considered as reasonable, as if these can all be recovered from the customer then companies may be encouraged to spend more than they would do otherwise.

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 is appropriate.

Yes. We believe that this is essential for retailers to have adequate time to analyse wholesale charges and assess how they will translate these into retail tariffs. Ensuring there is a suitable gap between publication of the two sets of charges will lead to keener competition, as it will allow retailers to use a more sophisticated

approach toward tariff design; without this, retailers would generally have to adopt tariff structures that simply replicate those of the wholesale charges. In terms of length, there is no fixed period in Scotland, but the gap is typically at least 6 weeks; we would see this as a minimum in England, as retailers there will face a greater challenge in tariff design due to the larger number of wholesalers in the market. A sensible rule might be to require publication of wholesale charges by the end of the calendar year.

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

We do not feel that a requirement like this would be helpful. A compulsory breakdown like this might be as likely to confuse the end customer as to provide them with useful additional information. It would also seem to go against the general move towards a risk-based regulatory model.

We hope that the above comments are useful, and would be happy to provide further detail or discussion on any of them if this is needed.