United Utilities response to Ofwat's consultation on wholesale and retail charges for 2015-16 and charges scheme rules

1 CONSULTATION QUESTIONS

Question 1: 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 generally support the proposed approach to the development of charging arrangements in the 2015-20 period, albeit that the published approach is very high level, and a number of ambiguities remain.

The timing and progression of this work over the next few years will be crucial in ensuring that the industry is prepared for the changes that will be implemented in 2017 in order to allow for successful market opening. As an industry we need to ensure that the risks of a phased approach are fully understood as well as any legislative implications of such an approach. This includes both the interactions between Ofwat and Defra's guidance – set out below – and the broader question of the conflicts between competing aims of cost reflectivity and management of incidence effects. On the latter point, it is unclear as to the relative importance attached to achieving each of these two conflicting aims at the present time and how this may change in the run up to market opening.

Defra's current proposal is to lay its final charging guidance before Parliament in March 2015, whereas Ofwat's consultation states that all companies are required to publish both their wholesale and end-user retail charges by 2 February 2015. Based on previous years' timetables, main billing would have commenced by March 2015. Accordingly, it does not seem possible for charges in 2015/16 to take account of the guidance to be laid before Parliament in March 2015; this would be possible only from the 2016/17 charging year. We are therefore interested to understand how Ofwat intends to enforce guidance published following the requirement to publish charges.

Whilst this consultation (and other documents such as the default tariffs guidance) provides information regarding overall principles and compliance at a "price control" level, the same level of detail has not been published in support of the separation of individual tariffs. The default tariff guidance provides numerous examples, but these are all at the level of "tariff bands", i.e. they represent income for a group of customers within a tariff band – there are no equivalent examples for individual tariffs. It therefore remains ambiguous if there is a requirement to ensure that wholesale charges plus the retail costs of serving plus the appropriate net margin, should equal the end user retail tariff, for each individual price component.

We are left to draw the conclusion that this cannot be a requirement for individual customers, since the consultation only refers to retail end-user prices (i.e. total charges for retail and wholesale) and wholesale charges. As such, and absent statements to the contrary, our interpretation is that there is no requirement to produce, or publish, retail service charges (i.e. charges just for the retail service, excluding wholesale). On this basis, we anticipate that compliance with the retail price controls will therefore be tested via the average revenue recovered from each tariff band for non-household retail, and via the regulatory accounts at a total company level for household retail - and not tested for individual customers. It would be helpful to understand in detail, at an individual tariff level, how wholesale tariffs and retail end-user tariffs should reconcile, and whether this requires:

- Consistency for each tariff, such that the wholesale tariff is a component of the end user price - with a defined retail-only price component added on to form the end-user price; or
- Consistency at a customer group level - e.g. all customers on a particular tariff, or within a

particular default tariff band - such that the difference in income recovered between end user charges for that group and that recovered from wholesale charges, reconciles to a fixed level of retail income.

In the case of both household and non-households, we currently assume that only the second of these two is required. However, as this is a significant charging compliance issue, we believe it is important that Ofwat should clarify its intended approach as soon as possible if it differs from the assumptions we have made, especially where these are made on inference

Finally, we note that Ofwat will require a spreadsheet submission of draft wholesale and retail charges, it would be useful to understand the timing of having to make this submission, its purpose and when and what level of feedback can be expected.

Question 2: 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 believe a nominal 5% bill change is too tight, given that this would have to absorb the impact of inflation and a 2.5% margin; it could lead to an excessive number of impact assessments. We suggest that a real 5% bill change threshold would be more appropriate.

We would support a real rather than nominal 5% bill increase as a threshold for undertaking impact assessments, as this would seem a more reasonable short term measure. Given the introduction of a 2.5% margin to non-household prices, and the impact of RPI on wholesale revenues, a nominal 5% bill change threshold appears far too trivial to breach through transitions made between current charging arrangements, charging separation in 2015/16 and any further requirements ahead of market opening in 2017.

We agree with the proposal in the consultation document that there need not be an equivalent threshold for bill decreases. However we do recognise that if some customers are experiencing large decreases there is a strong possibility that some are experiencing similar increases. Therefore the overall change needs to be carefully managed both from a customer experience perspective and also taking account of the wholesale revenue forecast incentive mechanism and the potential for penalties to be incurred.

Question 3: Do you agree with such a threshold being a short-term measure? If so, when should Ofwat remove such a requirement?

We agree that the threshold should be a short term measure and believe it should not last beyond 2017.

We agree with Ofwat that in the longer term a requirement for an impact assessment of all increases over a given threshold would be inappropriate and that companies themselves should identify when impact assessments are required. It would seem to make sense for this requirement to be removed by 2017 at the latest.

Question 4: Do you agree with the draft schedule for presenting standardised charging schedule presented in appendix 7? If not, please provide alternative proposals.

The draft schedule as presented is not capable of representing all elements of our charges scheme. The changes necessary to the schedule depend upon whether the schedule is meant to provide a summary representation or a fully comprehensive account.

We support the principle of publishing a standardised charging schedule, such as that included in appendix 7. However, it is not clear from the consultation whether this schedule is intended to represent all of the company's wholesale charges or merely indicative bands against which charges can be reported. The difference is significant.

For example, we have many more meter standing charges (for different meter sizes) than is represented on the table. The consultation states that Ofwat is not seeking to enforce standardisation of charging structures at this time. On this basis, it appears that our expected wholesale charges should drive the format of the standard schedule, rather than the other way round. Given this, it is unclear whether:

A. We are expected to represent our more granular charges as some form of weighted average, just for the purpose of publishing this schedule – in which case there would need to a standard method applied by all companies for transposing their (more granular) charges into such a table;

B. The table should contain all of our charges, for all of our size bands; or,

C. We should include a note to say that details of other additional tariffs are available in our company's published (wholesale) charges scheme

Given this ambiguity, it is difficult to comment definitively on required changes to the table, other than to say that the table as presented is not capable of reflecting the full range of wholesale charges we expect to implement for 2015/16. We can also comment that in the case of surface water and highways drainage charges, it may be better to present these charges as a list rather than in tabular form. UUW currently has 15 bands for site area charging, which apply separately to each of surface water, highways drainage, and combined surface water & highways drainage. This results in 45 distinct tariffs. The table (as it stands) does not differentiate between charges for surface water and highways drainage.

Regarding our own charging structure, we note the following key differences to the table:

- Our meter standing charges do not align with those in the schedule as they additionally reflect the following splits:
  - 20-22mm
  - 25-35mm
  - 40-42mm
  - 50-54mm
  - 80mm
  - 100mm
  - 150mm+

- Farm troughs

- For measured water our large user water tariffs are on different tariff bands, with additional bands as set out below:
  - 100–180Ml
  - 180–250Ml
  - 500–750Ml
  - 750Ml–1,000Ml
  - 1,000Ml–3,000Ml
- For trade effluent charges, the following additional splits would be required in order to specify our wholesale charges:
  - Minimum charge
  - Reduced R element
- We also have some tariffs which do not appear to be reflected in Ofwat's proposed templates. These are:
  - Non-potable tariffs
  - Optional tariffs such as the Swimming Pool Sewerage Tariff
  - Reservation charges
  - Unmeasured non-household charges

Question 5: Should charges associated with Open Water and market readiness be included as a separate increment to the volumetric charge in the wholesale charging schedule?

As customers do not have to be metered in order to benefit from Open Water arrangements, we believe that if such charges are to be separately listed then they should be applied across all unmetered and metered tariffs in the wholesale charging schedule.

We support the principle that those that are benefitting from Open Water and market readiness should incur the additional costs incurred.

If these costs are recovered via a separate increment to the volumetric charge in the wholesale charging schedule, then it would only be the metered non-household water customers that contributed to these costs.

As both water and sewerage customers that are either metered or unmetered have the potential to benefit, it would be more appropriate that an equivalent element is added to all the unmetered and metered non-household customer tariffs in the wholesale charging schedule.

The costs of this change could be prorated between the two groups of customers based on the forecast level of revenue to be collected from them for each of the services they receive.

Question 6: 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.

We believe that this is desirable post 2017, and that a view on the 2016 position should be taken following the publication of tariffs for 2015/16. Based on price review determinations being published in December, wholesale tariffs could be published in mid-January.

We support the principle of publishing wholesale charges in advance of retail charges following market opening.

However, in the short term, it appears that bill stability and successful transition is a key aim and the management of incidence effects is likely to take more than one year as envisaged in Ofwat's consultation (see, for example, the text box on p21.) We therefore consider that the principle of whether wholesale charges should be published in advance of retail charges should be reviewed following the publication of all wholesale and end user tariffs for 2015/16. It will only be at this point that there will be a clear understanding of how charges will need to change in preparation for 2017.

If, as suggested in Appendix 4 of the consultation, bill stability and incidence effects should be managed through wholesale charges, the principle of publishing wholesale tariffs and retail end user tariffs at the same time may need to continue up to 2017. Otherwise, it is difficult to see how the wholesaler could manage bill stability and incidence effects through wholesale charges - as Ofwat proposes – absent knowledge of the retail charges that would apply.

Once the management of the incidence effects has been completed, we would suggest that wholesale charges should be published by mid-January. This would appear to be the earliest possible date if, consistent with the approach taken the current price review, Ofwat publishes wholesale price control determinations in the month of December.

Question 7: Do you consider that Ofwat should require retail water bills to provide a breakdown of retail and wholesale charges?

We do not believe that retail water bills should include a breakdown of retail and wholesale charges as there is little evidence that it is to the benefit of customers, but certainty that publishing such a breakdown would drive higher systems costs.

For a household customer this would be an added complexity, presenting a bill which is not intuitive and would follow an approach which is not being taken in respect of other utility bills (eg: energy.) There would also be significant additional cost in the form of implementing billing system changes to facilitate this, with a significant time lag.

As there is no date yet proposed for household market opening, and as the application of the retail household price control will ensure that companies are only able to charge a pre-determined amount for the costs of retailing to household customers, there appears to be no obvious customer benefit for such additional investment.

To require a breakdown for non-household customers would introduce inconsistency between the Water Industry in England and Wales and the market already operating in Scotland. As this has not been a requirement in Scotland and the market appears to be operating with numerous customers having already switched supplier it would appear that this breakdown is not required for the successful operation of the a non-household retail market. As with the introduction of such a breakdown with household customers, there would be system change costs incurred in providing the breakdown for non-household customers, with no obvious corresponding customer benefit.