

## **OFWAT**

Wholesale and retail charges for 2015-16 and charges scheme rules  
- a consultation

Severn Trent Water response  
4 July 2014

## Our response to your specific questions

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

We agree with Ofwat's proposed approach to the development of charge arrangements in the 2015-20 period. The programme covers an ambitious scope of work. We would suggest focusing the access pricing work initially on three areas: large scale bulk supplies including reservoir agreements; NAV bulk supply pricing and sludge trading where we expect the highest degree of upstream contestability. It would be useful for the Open Water upstream reform programme to work out the interrelation between average and marginal costs; the usage of the value chain for each of these cases, how pricing principles differ between these cases and worked examples of how to set access pricing for this end of the value chain.

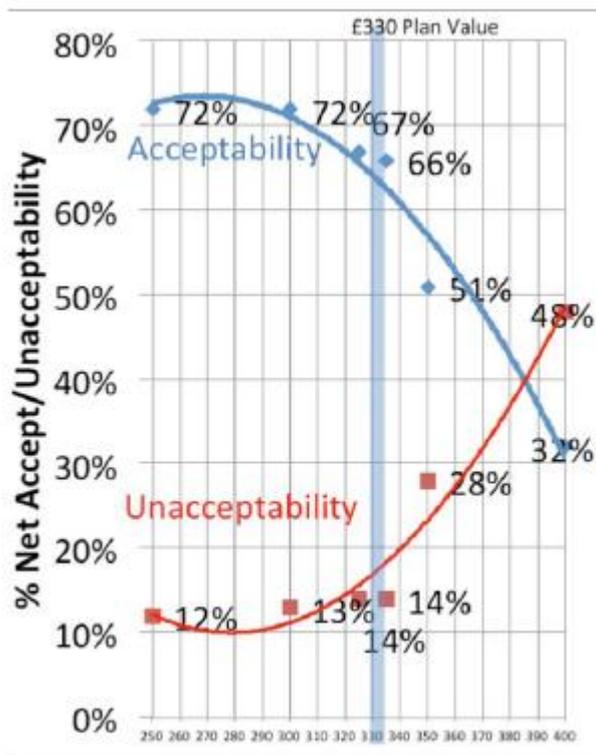
- 2. Do you agree with the nominal 5% bill change as a threshold for undertaking impact assessments? If not, please set out an alternative threshold and provide evidence for this view. Should the same threshold apply to all customer types?**

We agree that changes in customers bills from one year to the next need to be managed carefully so as to maintain a reasonable degree of bill stability.

As noted in the consultation, there will need to be some adjustment to bills so that charges reflect the cost allocations between different customer groups for retail and wholesale activities. As such, we are concerned that a nominal 5% bill change as a threshold for undertaking an impact assessment may, particularly in the early years of the 2015-20 period, be unrealistic. Based on the data in Table A3.1 pg 20 of the consultation, at least 25% of tariffs each year would need to have had an impact assessment. This appears a disproportionate regulatory burden. The table also notes that unmeasured charges tend to rise at a higher rate than measured which is a function of moves to metered charging over time requiring rebalancing of charges. As all companies have plans to increase meter penetration over AMP6, we would expect this effect to continue and the threshold needs to be set at a level that accounts for this effect.

The market research evidence in our PR14 customer acceptability research indicated that a 3% real terms increase made virtually no difference to acceptability – this suggests that a threshold of 6.3% nominal increase (based on PWC's forecast of 3.3% inflation over AMP6) would be more appropriate.

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Source: Severn Trent PR14 plan; Willingness to Pay annex pg 40

We agree that the same threshold ought to apply to all household customer groups. However the introduction of default tariffs for non-household customer means that wholesale charges rebalancing may be required. Would the threshold change apply to the end user charge, the retail component, the wholesale component or all three components separately? We think being clear on this is important and would advocate applying a threshold only to the end user charge based on the default retail tariff.

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

We agree that any threshold should be a short term measure and believe that it should be reviewed and potentially removed no later than the first year of 2020-25 period.

**4. Do you agree with the draft schedule for presenting standardised charging schedule presented in appendix 7? If not, please provide views?**

We support in principle the concept of providing a standardised charging schedule to facilitate the debate on standardisation in the future and to provide a degree of transparency to existing retailers. However, given the different charging structures adopted by individual companies the limitations of any such schedule need to be recognised as companies will need to make assumptions about how to complete the schedule and some figures will need to be viewed as indicative rather than actual.

**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?**

We agree that the costs associated with Open Water and market readiness should be included as a separate increment to the wholesale element and that the most appropriate place to do this is via the volumetric charge.

**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.**

We do not agree that beyond 2015 wholesale charges should be published in advance of retail charges. We believe that wholesale and default retail charges should be published at the same time. Companies in a competitive market should be able to flex and change their tariffs at any time during the year. The annual cycle sets wholesale charges and default retail tariffs and then incumbents and new entrants are able to decide their pricing structures against this. We do not think that forcing retail companies (incumbents and new entrants) to publish their competitive tariffs and discounts on a set day is a desirable or necessary outcome for competition to be effective.

**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 Ofwat should require retail water bills to provide a breakdown of retail wholesale and retail charges at this time. We are not aware of any functioning competitive market where displaying the retail vs wholesale component of bills is a requirement. We believe however that information on a company's wholesale and retail charges should be readily accessible to customers should they require it and this is where consumer organisations like CCWater can provide useful cross-industry comparisons to facilitate transparency in the market.

**Contacts:**

Please do not hesitate to contact us if you wish to discuss the above further.

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