



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

Strategy & Regulation

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Dear Sir or Madam

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

We welcome the opportunity to respond to your consultation document.

We have summarised our views, as outlined below, on the key areas under consideration in the consultation and include in the attached appendix a response to the specific questions posed.

[Charging arrangements in the 2015-20 period](#)

The movement to a significantly different pricing structure and the opening up of markets, proposed for the middle of AMP6, will require a pragmatic approach to be taken to the development of charging arrangements across the 2015-20 period.

The need to avoid major incidence effects will mean that the move to more cost reflective prices (with the exception of non-household default tariffs which are required to be cost reflective from the start of AMP6) should to be undertaken carefully using the phasing of changes in charges where necessary.

It is recognised that given the expected timetable for Ofwat setting 'charging rules', dependent upon Defra laying guidance before Parliament as required under the Water Act 2014, is not expected to take place until March 2015 at the earliest. On this basis companies will need to set 2015/16 charges based on draft charging rules and charging principles as set out by Defra in their November 2013 charging document.

Within 2015/16 charges it is expected it will be necessary to bundle wholesale activities within volumetric charges. These will need to be split out and separately

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priced (activities to be identified under the Open Water programme) in time for market opening in April 2017.

Bill change threshold for undertaking impact assessments

The move to four price controls in AMP6 will inevitably result in some degree of incidence effect on customer bills, particularly as tariffs become more cost reflective over time.

Guidance from the Secretary of State, issued under section 4 of the Water Industry Act 1999, covered "stable and predictable charges". Section 2.24 of the guidance stated that "Charges Schemes should ensure that, under existing charges, changes to individual bills should not diverge significantly from the average for each company without changes in demand". Under this measure 'the average' would have included inflation plus Ks set under price limits. This has worked well over the past ten years and should be regarded as a suitable model for going forward.

The consultation proposal for a 'nominal 5%' as a threshold for undertaking an impact assessment is considerably less flexible. We appreciate that the 5% threshold is not a cap - the consultation states that "For the avoidance of doubt, the 5% significance level does not mean that charges cannot increase above that level (providing they comply with price controls)". In our view this may result in the requirement to carry out an impact assessment every year.

We believe that the 5% threshold should be relative to the allowed average increase/decrease, including inflation, set by the price control (otherwise there is a sense in which the 5% acts as an additional price control).

Can you confirm what consequences could flow from the position where a company has undertaken an impact assessment, demonstrating to Ofwat that they have mitigated the price increase as far as they are able, but that it remains above the 5% threshold? I assume it is envisaged that, under those circumstances, prices would be permitted to rise by more than the 5% threshold.

For Thames Water the impact of the Thames Tideway Tunnel is forecast, on its own, to increase wastewater bills on average by circa 5% per annum during AMP6 (before inflation). We consider that this effect should be excluded from the 5% threshold calculation as it would automatically trigger the requirement for an impact assessment to be undertaken every year, without any real benefit.

In conclusion we suggest that the threshold to carry out an impact assessment should exclude the impact of the Thames Tideway Tunnel and be set at 5% above the average price increase/decrease (including inflation) set under price limits, has been taken into account.

We believe that this revised threshold should apply to household and small business customers throughout AMP6. For other non-household customers its

application should be limited to 2015/16 and 2016/17 after which a review should be undertaken to determine whether there would be a benefit to continue post market opening.

Presenting standardised charging

We note that Ofwat are not enforcing standardisation of charging structure at this time. A position that we strongly support, as we believe that it is for companies to decide how they structure their charges both now and in the future.

The draft charges schedule including in the consultation only includes wholesale charges on a metered basis. This may not be the case particularly in respect of household customers where, for example, the majority of households in the Thames Water area still pay on the basis of rateable values. Wholesale charges may be set to reflect this position. In addition we also have a number of customers, both household and non-household, that pay on an assessed basis, where metering was not economic / practical.

If a schedule is deemed necessary, and we have some reservations whether one is actually needed, it should be comprehensive and include the provision to charge on an unmeasured basis. A comprehensive template (utilising companies 2014/15 principal statements) might be an appropriate starting point.

Charges associated with Open Water and market readiness costs

We consider that it is appropriate to include charges in respect of costs associated with Open Water and market readiness within the non-household volumetric wholesale tariffs. This treatment will have the effect of charging these costs proportionally in relation to customer size. However, we do not perceive any real value in actually setting charges at this level of granularity or in disclosing these as a separate increment within the wholesale charging schedule.

The publication of wholesale and retail charges

Ofwat have indicated that for 2015/16 both wholesale and retail charges will be required to be published by 2 February 2015.

Wholesale charges include the Retail Price Index (RPI), published during December each year, in their calculation. The RPI to be used in setting 2016/17 wholesale charges has a provisional ONS release date of 15 December 2015. On this basis we would expect that wholesale charges could be made available to retailers (through published charge schemes), by the middle of January 2016.

This should facilitate retail prices to be set and billing systems updated in order to allow retail billing for unmeasured customers (both household and non-household) to start in early February if required.

The breakdown of retail and wholesale charges on bills

Ofwat have stated in the consultation document that they are not proposing to require companies to present separate wholesale and retail charges on customers' bills for 2015/16, which we welcome.

Going forward we are of the view that the breakdown of retail and wholesale charges on household customers' bills, post 2015/16, would be of very limited value and only serve to cause confusion, resulting in increased complaints and unwanted contacts for water companies.

For eligible non-household customers the case could be made for separately identifying retail and wholesale charges on bills to stimulate market activity. This may be sensible to put in place for market opening, scheduled for April 2017.

Please do not hesitate to contact me if you have any questions or comments on our response.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'P. Morris'.

Paul Morris
Regulatory Reporting Manager

Appendix 1 – Detailed responses

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.

The movement to a significantly different pricing structure and the opening up of markets proposed for the middle of AMP6 will require a pragmatic approach to be taken to the development of charging arrangements across the 2015-20 period.

The need to avoid major incidence effects will mean that the move to more cost reflective prices (as required) needs to be undertaken carefully using phasing of changes where necessary. The exception being non-household default tariffs which should be cost reflective from the start of AMP6.

It is recognised that given the expected timetable for Ofwat setting 'charging rules', dependent upon Defra laying guidance before Parliament as required under the Water Act 2014, is not expected to take place until March 2015 at the earliest. On this basis companies will need to set 2015/16 charges based on draft charging rules and charging principles as set out by Defra in their November 2013 charging document.

Within 2015/16 charges it is expected it will be necessary to bundle wholesale activities within volumetric charges which will need to be split out and separately priced (activities to be identified under the Open Water programme) in time for market opening in April 2017.

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?

The move to four price controls in AMP6 will inevitably result in some degree of incidence on customer bills particularly as tariffs will need to be made more cost reflective over time.

Guidance from the Secretary of State, issued under section 4 of the Water Industry Act 1999, covered "stable and predictable charges". Section 2.24 of the guidance stated that "Charges Schemes should ensure that, under existing charges, changes to individual bills should not diverge significantly from the average for each for each company without changes in demand". Under this measure 'the average' would have included inflation plus the K set under price limits. This has worked well over the past ten years and should be regarded as a suitable model for going forward.

The consultation proposal for a 'nominal 5%' as a threshold for undertaking an impact assessment is considerably less flexible. We appreciate that the 5% threshold is not a cap - the consultation states that "For the avoidance of doubt, the 5% significance level does not mean that charges cannot increase above that level (providing they comply with price controls,)". In our view this may result in the requirement to carry out an impact assessment every year.

We believe that the 5% threshold should be relative to the allowed average increase/decrease, including inflation, set by the price control (otherwise there is a sense in which the 5% acts as an additional price control).

Can you confirm what consequences could flow from the position where a company has undertaken an impact assessment, demonstrating to Ofwat that they have mitigated the price increase as far as they are able, but that it remains above the 5% threshold? I assume it is envisaged that, under those circumstances, prices would be permitted to rise by more than the 5% threshold.

For Thames Water the impact of the Thames Tideway Tunnel is forecast, on its own, to increase wastewater bills on average by circa 5% per annum during AMP6 (before inflation). We consider that this effect should be excluded from the 5% threshold calculation as it would automatically trigger the requirement for an impact assessment to be undertaken every year, without any real benefit.

In conclusion we suggest that the threshold to carry out an impact assessment should exclude the impact of the Thames Tideway Tunnel and be set at 5% above the average price increase/decrease (including inflation) set under price limits, has been taken into account.

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

We believe that a revised threshold, as suggested above, should apply to household and small business customers throughout AMP6. For other non-household customers its application should be limited to 2015/16 and 2016/17 after which a review should be undertaken to determine whether there would be a benefit to continue post market opening.

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

We note that Ofwat are not enforcing standardisation of charging structure at this time. A sentiment that we strongly support, as we believe that it is for companies to decide how they structure their charges both now and in the future.

The draft schedule appears to assume that wholesale charges will be on a metered basis. This may not be the case particularly in respect on household customers where, for example for Thames the majority of households still pay on the basis of rateable values. Wholesale charges may reflect this position.

We also have a number of customers both household and non-household that pay on an assessed basis. For households the charges are based on single occupier/ number of bedrooms. For non-households the assessed bands are based on business type and number of employees (full time equivalent).

If a schedule is required, and we have some reservations whether one should be needed or not, it would need to be comprehensive and include the above circumstances. A comprehensive principal statement format (using companies 2014/15 charges) might be the appropriate place to start.

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

We consider that it is appropriate to include within the non-household volumetric wholesale tariffs (for water and wastewater) charges in respect of costs associated with Open Water and market readiness. This treatment will have the effect of allocating these costs in relation to customer size. However, we do not perceive any real value in setting charges at this level of granularity or in disclosing these as a separate increment within the wholesale charging schedule.

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.

We recognise that wholesale charges will need to be published early enough to give sufficient time for retailers to set end user charges in advance of the start of the charging year. With retail billing for unmeasured customers (household and non-household) expected to start as early as the first/second week in February for some companies, retailers will need to be informed of wholesale charges with sufficient time to enable retail charges to be set and updated in billing systems.

Owat have indicated that for 2015/16 both wholesale and retail charges are required to be published by 2 February 2015.

Wholesale prices cannot be finalised until the Retail Price Index (RPI) is published during December. For price setting in 2016-17 the ONS has a provisional release date of 15 December for the indices used in setting wholesale prices. On this basis, and assuming that Ofwat would not undertake any significant validation checks of companies prices on an ex ante basis (instead relying on companies' annual risk and compliance statements for assurance of the price setting process), we would envisage that wholesale prices could be

made available to retailers (through published charge schemes), by the middle of January, in advance of the publication of retail prices in early February.

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

Ofwat have stated in the consultation document that they are not proposing a requirement for companies to present separate wholesale and retail charges on customers' bills for 2015-16.

A breakdown of retail and wholesale charges on customers' bills, post 2015/16, would be of no value and may only serve to cause confusion for household customers resulting in increased complaints and unwanted contacts for water companies.

For eligible non-household customers the case could be made for separately identifying retail and wholesale charges on bills. This may be sensible to put in place for market opening scheduled for April 2017.