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Consultation on charges scheme rules
for 2016-17 and future developments
Ynon Gablinger
Ofwat
21 Bloomsbury Street
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Re: Consultation on charges scheme rules for 2016-17 and future developments

We welcome the opportunity to respond to this consultation.

This letter, at Annex 1, sets out our views on the ten 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 sincerely,

Jean Spencer
Regulation Director

Annex One – Consultation question responses

Q1 Do you have any specific views on the draft rules for 2016-17 included in appendix 2? Are there any other rules that you consider should be included?

We have two general points to make on the draft rules for 2016-17. First the consultation paper gives the impression that Ofwat is planning to revise the rules annually. We do not think that this is desirable, because frequent revisions undermine the principle of stability and predictability. We acknowledge that a new set will of rules may need to be developed next year, reflecting feedback on this and future consultations, to come into effect for 2017-18 charges. Thereafter, however, we think it would be good for the industry and its customers, especially with market opening scheduled for April 2017, if the rules stayed in place for a few years, certainly until the end of this price control period.

Second, as we noted in our e-mail of 30th July to Ynon Gablinger, the draft rules are part of a new legal framework that includes significant "powers of direction" for Ofwat in the event that it considers that a company is not complying with the rules. At present, Ofwat has not explained how it sees these new powers fitting into a framework that already gives it enforcement and other powers both under the Water Industry Act and competition legislation. Powers of direction are potentially quite draconian and raise the prospect of changes to charges schemes having to be made after a charging year has come into effect, which could be extremely costly for an undertaker. Without a clear statement from Ofwat as to how it intends to use these powers, therefore, there is a risk that undertakers will be encouraged to be ultra-cautious in approaching charging policy, making changes only when prompted by Ofwat, which would undermine the objectives of light touch regulation and encouraging innovation.

We have the following specific points on the rules:

- In relation to rule number 21, we do not think that the case has been made for site-area charging, and in our view the arguments against it outweigh the potential benefits. We therefore believe that it is premature for Ofwat to be requiring undertakers to implement partial rebates. In addition, whilst we agree that companies should be accountable for their charging policies, we think that the charges scheme is the document to set out the prices that will apply, and is not the appropriate place to set out policy reasons for not including a particular charge or discount.

- We do not agree with the proposed publication of the statement of changes set out in rule A2. We note, rather, that the main text under

section 3.2 refers to submission to Ofwat, which we would expect and support. However, we do not think that publishing such a statement serves any useful purpose, and could undermine companies' handling strategies, especially in relation to difficult transitional changes that are being managed. The rationale for charging on one basis or another is best set out in other literature or clearly sign-posted on the company website.

- Since new appointees are required to publish charges schemes by 22nd February, and other undertakers are required to publish them by the first working day in February, the requirement in rule A2 to issue statements of changes three weeks before charges scheme publication only gives new appointees at most one day to calculate their charges following receipt of information from incumbents. The draft of this document, circulated in July, appeared to recognise this problem by making it explicit that new appointees would not have to provide their statements until the date of publication for the charges scheme. We think this needs to be clarified in order to ensure that the overall timetable for January and February is workable.

Q2 How best can site area-based surface water drainage charges be adopted? And what lessons can be learned from how companies have moved to this basis so far?

We do not agree with the premise of this question, because it takes as a given the presumption that site area-based surface water drainage charges are necessarily a desirable development, especially from the point of view of customers. We believe that any significant tariff change should be subject to a careful analysis of the benefits and the costs. In this case, we can see that site area-based charges would re-allocate bills from those with smaller impermeable areas to those with larger, which might be considered to delivery a benefit in terms of fairness. However, whether or not such a move would generate economic signals that would lead to better resource allocation is an empirical question, and we have seen no evidence to the effect that significant changes in behaviour would occur.

On the cost side, implementation of such an initiative would entail material information and transactions costs, which would ultimately fall upon customers to pay. In addition, the incidence effects associated with increases for some customers and reductions for others would have to be managed. In short, we are not opposed to site area-based surface water drainage charges as a matter of principle, but we do not think that a case has been made yet for their introduction in our region. As Defra's draft charging guidance stated, "area-based charging should result in a recognisable benefit to customers as a whole...". We are already undertaking some empirical research into this issue and will continue to investigate possible options and their likely effects, but if we find that

there is no benefit for customers from area-based charging we will argue against its introduction in our region.

Q3 Do you agree with our proposed threshold for "significant" bill increase? If not, is there evidence for a more suitable threshold? And how this can be assessed for different customer types?

Whenever Anglian's charges are subject to any re-balancing we carefully consider the justification for relative movements and their impacts, and take into account a number of factors in deciding whether to implement changes in full or phase them over a period. In effect we always carry out what Ofwat refers to as "proportionate impact assessments" because these are embedded in our internal processes. It is in our interests to do so given the negative impact that can result if we miss-calculate incidence effects and the reaction of customers. On this basis the proposed 5% threshold provides a useful benchmark to calibrate the degree of both the proposed change and the impact assessment proposed in response.

However, the impression could be created that increases that came in below the threshold were somehow "acceptable" whereas 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. Ofwat should challenge companies to ensure that they are giving all the potential impacts of tariff re-balancing due consideration in all circumstances.

Equally, the threshold shouldn't create an artificial barrier or ceiling for companies to rebalancing charges where the increase is necessary or particularly where the monetary increase may be relatively modest, even though the percentage increase is above 5%. The relative monetary increase should be considered when formulating handling strategies as part of the accompanying impact assessment.

In proceeding with the proposed threshold, then it would be useful and appropriate that the rules included the caveats set out in the consultation document on charges rules issued in May 2014. This on page 22 made clear that charges could increase above the threshold as there may be justifiable reasons why this is supportable. It would equally be useful that the focus and scale of the proportionate impact assessments is clarified, as was set out on page 21 of last year's consultation document.

Q4 Do you agree with our current preference of companies publishing their Board's assurance statement?

We agree that Board assurance statements should be published, as this would enhance the transparency of the charge-setting process.

Q5 Do you consider that the Board's assurance statement should cover anything else than what we propose above?

We are happy with the assurance statement as it stands.

Q6 Do you agree with our current preference for companies to submit a statement of significant changes?

Please see above. We are happy to provide Ofwat with a statement of changes, but we do not agree that publication is desirable, because this has the potential of undermining handling strategies when difficult charging issues are being managed.

Q7 Do you have any specific views on the proposals included in chapter 4? Are there any other rules or issues that you consider should be consulted on next year?

Please see our answer to question 1 above. We think Ofwat should aim to issue a revised set of rules next year that remains in place at least until the end of this AMP period. It should also set out a statement setting out how it sees the new power of direction fitting into the existing regulatory framework, and clear policies as to what regulatory tools will be used in different circumstances, in order to avoid unnecessary uncertainty and regulatory risk. In addition, we believe Ofwat should give priority, over the next 12 months, to addressing itself to the potential conflicts within the charging rules, and how it will resolve them. For example, there is a potential tension between bill stability and the objectives of cost reflectivity, which themselves will evolve as new data becomes available, so it will be necessary for guidance to be provided as to where Ofwat's priorities lie.

Q8 Would it be practicable and/or desirable to include all non-primary charges in the wholesale charges scheme?

We agree that all non-primary charges should be published, and would support a requirement on undertakers to do this. However, at present companies have different approaches as to the balance between what goes into their charges schemes and what is otherwise available e.g. through customer leaflets. Also, some charges schemes, as legal documents, are quite dry and technical and are not necessarily the best place to try to communicate simple information on applicable charges. Accordingly, we think that it should be left to undertakers where and how they publish information on non-primary charges, provided they do so somewhere.

Q9 Do you have any specific views on the requirement to publish final wholesale charges for non-household customers no later than the first week of January?

No. We are content with this proposal.

Q10 Do you agree with our outline proposal that indicative wholesale charges be published in July and October?

We do not agree with the proposal to publish indicative wholesale charges in July and to "lock down" charges in October other than in relation to updated information on RPI, because we do not think it is in the interests of customers or, indeed, retailers.

Charges are set each year using full year-end information from the previous year that determines the balance of target revenue recovery going forwards, and information from that part of the current year that has elapsed on movements in charge multipliers (volumes, numbers of customers, etc). Final information from the previous year would not be available in time to go through the governance processes for a July wholesale charges submission, so those figures would give retailers no better idea as to the likely charges for the following year than the ones currently in place.

Similarly, given the lead time necessary for the pre-submission processes, including consultation with CCW and due consideration by the board and the associated assurance requirements, an October submission would be primarily based on operational data for period 4 (July). We think this is too early in the year, because at this stage likely out-turns for the year are still subject to a wider margin of uncertainty. This will introduce a greater margin of "error" into the charge-setting process (which we believe would warrant a re-calilbration of the WRFIM) and would dilute the value of the assurance that boards were able to give.

We propose, instead, that wholesalers should communicate potential charging policy changes through Open Water by July, and circulate indicative wholesale charges to retailers in October. This would be similar to the timetable that Ofwat put in place for charges scheme approval purposes in 1999, which we believe worked well over the course of the following ten years or so.