

Ofwat's consultation on charges scheme rules for 2016-17 and future developments

Southern Water's Response

September 2015



Southern Water's response to Ofwat's consultation on charges scheme rules for 2016-17 and future developments

Overview

We are pleased to provide you with our response to your consultation on charges scheme rules for 2016-17 and future developments.

We are generally supportive of the draft rules, but have some concerns regarding:

- Partial rebates for surface water drainage
- Area-based charges for surface water drainage
- The timing of the publication of wholesale charges for non-household customers

Our response to these matters, and to the other questions in the consultation, are provided below. We would be happy to discuss any aspect of our response with you if that would be helpful.

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?

Rule 8

Please see our response to question 3.

Rule 11

Please see our response to question 8.

Rule 21

Implementing and operating a system of partial rebates for surface water drainage would incur additional costs. There would be challenges in deciding and defining the circumstances in which partial rebates should be provided, and in calculating the appropriate value of the partial rebate.

Our standard charge for surface water drainage, which is paid by the vast majority of household and non-household customers connected for this service, has a relatively low value (£23 in 2015-16). Furthermore, for many customers we believe it would prove to be impracticable, or cost prohibitive, for them to install soakaway arrangements to mitigate or avoid the surface water drainage charge.

We recognise that there is a stronger case for operating a system of partial rebates for non-household customers where the basis of charge is impermeable surface area, but in other circumstances we believe the costs outweigh the benefits. Companies not offering partial rebates would explain the reason for their position in the course of responding to contact from individual customers regarding this matter. We would ask Ofwat to reconsider whether companies should be required to justify this position in their charges schemes.

Rule 22

In this charging year we introduced a fixed banded charge structure to recover the costs of trade effluent compliance monitoring, and we understand that a number of other WASCs also have similar charging structures to recover elements of their trade effluent costs.

We believe that these charges would be permissible under the proposed wording of Rule 22, but feel it would be helpful, for the sake of clarity, if the wording could explicitly state that some elements of trade effluent costs may be recovered via means other than the Mogden formula.

Rule 23 (a) (i)

We think it would only be appropriate for this rule to apply to companies who have area-based charges for surface water drainage.

Rules A1 (b) and A2 (a)

Please see our response to question 3.

Other rules to be considered for inclusion

We believe there should be an overarching rule that refers to the need for companies to observe an appropriate balance between Defra's four overarching objectives when setting charges (Section 2.1 of Defra's Consultation on Charging Guidance to Ofwat refers).

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 are pleased that Ofwat are currently not minded to set a requirement for non-household area-based charging for 2016-17. For companies who have not adopted this basis of charge to date, there would be insufficient time to consult with customers and their representatives, and design and implement such a scheme in time for 1 April 2016. Additionally, it would be difficult to cost-justify investment in company billing systems to bill and administer these charges to non-household customers in 2016-17, when this functionality would become redundant after one year when wholesale charges are calculated by the Market Operator's system.

The wording of the question presupposes that all WASCs will move to area-based charges in the near future. This appears to be at odds with Defra's position set out in their Consultation on Charging Guidance to Ofwat. We share the Government's views, as expressed in this consultation, that the introduction of area-based charging for surface water drainage requires discretion on behalf of Ofwat and companies, and that it should only be implemented if it would result in a recognisable benefit to customers as a whole.

We will be undertaking a study in AMP6 to understand the costs and benefits of implementing and operating area-based charges, but are concerned that for many non-household customers it will be impracticable, or cost prohibitive, for them to install soakaway arrangements to mitigate or avoid the surface water drainage charge. We therefore believe a more appropriate approach may be to identify sites where surface water drainage is causing, or has the potential to cause, significant flooding issues for the local area, and then prioritise

working with the customer at these sites to identify and install a more beneficial approach to surface water drainage. Such an approach would remove any charging cross-subsidy enjoyed by the customer, whilst alleviating flooding issues or risk for neighbouring properties.

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?

Wholesale charges, which typically form around 90% of end-user charges, are set with reference to the annual movement in RPI. However, fixing the threshold at 5% means that the threshold is not sensitive to the annual movement in RPI, and as such could be viewed as a blunt instrument.

We believe that the threshold should be set with reference to the value of RPI for the charging year. We propose that the threshold should be RPI + 3%.

Furthermore, we believe that the threshold rule should also incorporate a de minimis approach, by taking into consideration the level of bill increase in financial terms. Our experience is that, in some instances where we were faced with potential bill increases over 5%, the financial value of the proposed increase did not appear to be overly burdensome to customers. Under such an approach, different financial threshold values of bill increase could be set for different classes of customer, such as household/non-household, SME/large user, as appropriate.

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

Yes.

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

We consider that the Board assurance statement as currently proposed is sufficient in detail and breadth.

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

We agree in principle, but please note our response to question 3 regarding how the bill increase threshold is defined.

We note the requirement that the statement should be both provided to Ofwat, and published, at least three weeks before the publication of the charges schemes, and would make the following observations:

- The requirement for this statement to be provided to Ofwat at least three weeks before the publication of the charges schemes would appear to conflict with Ofwat’s stated desire to have charges schemes published earlier than the first working day of February.

- The requirement for this statement to be published at least three weeks before the publication of the charges schemes would mean that any subsequent changes in the company's approach, arising from dialogue with and challenge from Ofwat, would not be reflected in the published statement. We believe it would be more appropriate to publish the statement at the same time as the charges schemes, allowing time for Ofwat to review the statement and engage with the company where they felt this to be necessary. This would allow the published statement to be complete and accurate.

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?

With regard to sections 4.1.1 and 4.1.2, please see our responses to questions 8, 9 and 10 below.

With regard to special agreements (section 4.1.3), we would make the observation that for each agreement we can advise the wholesale multiplicative factor based on actual or forecast data, but that the value of this factor will not be constant year-on-year for some agreements. This is due to the nature of those special agreements; for example, where water volume is charged at a lower (special) unit rate up to a specified threshold, with all additional volume being charged at the standard unit rate.

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

We agree that, to ensure transparency, all charged services to retailers should be contained within the wholesale charges scheme or published as special agreements.

To make life easier for retailers, and to ensure that they are treated consistently by wholesalers, we believe there should be a standard list of non-primary charges that companies are required to include in their wholesale charges scheme if they wish to levy these charges.

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?

We understand the drivers of the requirement.

However, we would observe that the broad alignment of the publication of wholesale charges (no later than the first week of January) with the publication of the statement of significant changes (three weeks before publishing charges schemes) may result in wholesale changes having to be revised and republished in the circumstances described in the second bullet point of our response to question 6 above.

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

Whilst we understand the request for early sight of wholesale charges, we do not believe it is practical to publish meaningful indicative wholesale prices in July.

This would not allow sufficient time for any company seeking to re-structure or rebalance their tariffs, or seeking to introduce new tariffs, to properly reflect such impacts in their indicative prices. For example, they would have insufficient time to undertake the impact assessment, to conduct customer and stakeholder consultation, and to gain Board approval.

As Ofwat acknowledge, in setting charges companies also want to use the latest available data to inform their forecast of charge multipliers for the new charging year. This mitigates both the risk of over or under-recovery of revenues, and the risk of incurring a penalty under the WRFIM.

We therefore believe October would be a more reasonable publication date for indicative charges.