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Our ref:

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Dear Ynon

OFWAT CONSULTATION ON CHARGES SCHEME RULES FOR 2016-17 AND FUTURE DEVELOPMENTS

Thank you for providing the opportunity to comment on this consultation. South West Water supports Ofwat's intention not to introduce fundamental changes to the existing charging principles.

For the changes proposed in respect of site area based surface water drainage charging, disaggregating charges into components, and partial surface water drainage rebates, we think there are good reasons for further consideration, before any new requirements are included in the proposed charging rules.

We also think that further consideration of the timetable and the expectation for publishing wholesale charges is required.

Our detailed feedback on these points and the specific questions raised in the consultation paper are included as an Appendix to this letter.

Yours sincerely



Iain Vosper
Regulatory Director

APPENDIX

1. 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 agree with the rules in the round and only comment by exception.

Rule 18 should, for clarity, explicitly state that section 144A only applies to domestic premises, thus avoiding any implication that non-domestic premises may have a legal right to an assessed charge.

We do not believe that Rule 21 should require undertakers to explain why they do not provide partial surface water drainage charging. We feel that this requirement is inappropriate where there is no obligation on companies to provide partial surface water drainage charging, nor do we feel that it is clear how this would be beneficial to consumers as a whole. Where it can be demonstrated that no surface water drains into the public sewer it is appropriate to provide a 100% reduction of the surface water drainage charges component. However, where there is merely a decrease in the volume of surface water draining into the public sewer we do not believe it is appropriate to apply a partial reduction to the surface water drainage charge.

Whether the decrease in volume is due to installation of SuDs or by other means there are challenges and costs associated with assessing the impact that such schemes have on the amount of surface water draining into the public sewer and therefore determining what an appropriate reduction in charges should be. For the reason set out below we think further debate is required before such a charging rule is introduced.

Having reviewed Charges schemes we are not aware of companies who currently make partial surface water drainage rebates as described above. Our testing of the design of the "Open Water" retail market central settlement system indicates that this would not support partial surface water rebates. We make provision for a reduced return to sewer allowance for grey water recycling systems that can meter the amount of volume discharged to sewers. With our structure of charges (but this would not work for site area drainage charges), this monitoring would allow a partial discount on surface water drainage charge components and this can also be applied to SuDs. This provides suitable incentives for sewer volume and load reductions, including re-use of surface water drainage, but ensures that the benefit can be measured before a discount is applied.

We believe that Rule 23 should only apply if undertakers have such charges in their charges scheme, particularly as regards concessionary drainage charges as these only apply if have site-area based charging for surface water drainage has been introduced.

We do not believe that it is necessary for any other rules to be included. Companies will operate their own charging rules and constraints (e.g. Board pledges and customer specific policies), but there is no need for Ofwat to include other considerations in this set of rules.

2. 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 so far?

Our internal process that monitors and assesses cost-reflectivity continues to demonstrate that we do not currently require site area-based charging for surface water drainage in the South West. There is also no demand from our customers, stakeholders and other retailers for such a change. We believe that such an approach is unlikely to receive support from the majority of non-household customers and retailers. However, we will continue to keep this under review. We would caution Ofwat to avoid making recommendations or guidance that could be interpreted as requiring site area-based surface water drainage charges to be

introduced, as we do not feel this would reflect full company ownership of wholesale charging policies to end customers and non-household retailers.

It should be noted that the introduction of site area-based charging was previously supported by the Government Land Use Database which was last published in 2008. The passage of time means a significant increase in cost for ensuring that site area-based charges are themselves cost-reflective. Therefore we believe that, in the absence of further research, the current approach should be maintained whereby site area-based charging is not specifically required, but remains an option which companies should continue to consider.

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

We maintain our position as stated in the 2015-16 charges consultations. We believe that there are disadvantages to a fixed percentage threshold and would prefer there to be a linkage to the change in revenue controls to allow flexing commensurate with variations in the level of RPI. This would avoid impact assessments that merely stated that the level was proportionate because it was entirely consistent with the RPI+K wholesale revenue control. The household retail component (which is the element of the end user bill least linked to this) will not materially impact the validity of this approach to a threshold.

We believe a legitimate approach for these charging rules would be to retain the 5% threshold with an exception where a company can demonstrate that a higher threshold is consistent with the relevant determination. In addition, we believe that a de-minimis, per customer impact (e.g. £20) would be consistent with a proportionate impact assessment.

We do not believe that such thresholds are consistent with customers' views of bills, in that they should be no higher than necessary. It is for companies and regulation to define what bill changes are fair (and therefore proportionate) in this context. We believe that SIM, and the equivalent non-household retail choice, and pressure on wholesalers along with the requirement to review charges and consult with CCWater in advance of publication, provide sufficient consumer protection mechanisms for changes to charges.

Our preferred approach would be for companies to define their own criteria and provide this with any impact assessments within the Board assurance statement. SWW took this approach for 2015-16 charges and we believe it merits consideration. We are happy for Ofwat to continue to use the 5% threshold for 2016-17 as long as the degree of proportionate impact assessment required is accepted as flexible to circumstances, and may merely in some cases merely require the Board assurance statement to set out the company justification for their approach and the factors they have taken into account, which is a necessary requirement of the Charges process in any case.

4. Do you agree with our current preference of companies publishing their Board's assurance statements?

We agree with the approach taken to require publication of Board assurance statements no later than publication of charges schemes.

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

We agree with the proposed content of Board assurance statements.

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

SWW agrees with this approach, we also think that consideration should be given to whether forecast average bill information and other useful tariff indicators, such as the volume assumed in assessed charges, could also be provided.

7. 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?

Regarding disaggregation of wastewater charges into separate components, we believe that this proposal requires separate and detailed consideration and consultation first, rather than a pilot. It should be noted that, as was clarified through discussion at the DEFRA Charging Principles workshop in June, there is no change in Government policy towards highway drainage.

We agree that the retail element of special agreements must be contestable and that this information should be available on the special agreement register. Where companies have a standard default tariff for special agreements then this can be noted on the register rather than in detail. Similarly where companies have separate wholesale and retail charges and this has allowed for non-default tariffs, only the wholesale element is required on the register. This allows for where companies incumbent retailers have published standard non-default tariffs in the end user non-household charges schemes (to avoid these being classified as special agreements as the standard wholesale charge applies). In both cases (default tariff for special agreements and standard published non-default tariffs), transparency of both the wholesale and retail charge components is available in the charges scheme itself without this been necessary on the special agreement register.

8. Would it be practical and/or desirable to include all non-primary charges in the wholesale charges scheme?

We think wholesale charges schemes should include all non-primary charges to retailers that are associated with the provision of water and sewerage services where these can be fixed as standard amounts per "event". Companies should also publish details on how cost reflective activity charges (e.g. ones that are specific to each retailer/customer request) are calculated. This could include standard hourly rates for typical examples.

It should be noted that where retailers request non-regulated market services from wholesalers (e.g. meter reading) this should not be a requirement for the wholesale charges scheme as is a separate commercial decision. The wholesale charges scheme should state what services the wholesaler may offer and who to contact, but it is not practical to include any other details. Any wholesale charges rule will need a very clear definition of what a non-primary charge is in order to be effective.

9. 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?

SWW agrees that final wholesale charges schemes for non-household customers should be published early in January. We believe that this should be set as the end of the first full working week. This then allows retailers sufficient time to prepare their end user charges.

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

Parameters such as summer usage and customer numbers are available **after** October. The consultation does not take into account that companies need time after financial year end (in the case of July) and half year turnover analysis (up to 30 September) in order to prepare indicative wholesale charges. We also think the additional regulatory burden of draft wholesale charges in July and October is difficult to justify. The assumption that charges only change slightly for RPI also does not reflect the complexity in applying the tariff rules

that Ofwat set out – small changes can result in rebalancing wholesale charge components in order to meet customer policy objectives (e.g. the 5% indicative threshold).

We suggest that companies should publish indicative wholesale charges by 15 October each year, consistent with the current condition R Licence requirement for indicative access prices (essentially the same thing for the retail market). Wholesalers could not introduce a different structure of wholesale charges from this draft, and would set out what their approach to final charges may be and the factors that might change the proposed tariffs.

We do not agree Ofwat should specify the forecast of RPI – it is useful information for retailers and stakeholders for companies to expose and justify their own forecasts, consistent with other approaches to risk based regulation.