

United Utilities welcomes the opportunity to comment on the Ofwat consultation on charges scheme rules for 2016-17 and future developments.

We consider that the consultation raises the following key issues, which are set out in more detail in our response:

- Statement of significant changes – we support the requirement to submit this statement but do not support the requirement to publish it prior to publication of charges;
- Separate charges for highway drainage – we support this requirement and believe that it is appropriate to include as a rule for 2016-17, even if it is only as a pilot;
- Site area based charges – we agree that this is the most appropriate basis of charging for surface water drainage. However, there are currently large differences between companies in the balance of charges between different services and therefore the income recovered from each service. It is important that these differences are understood and resolved as part of or prior to further moves to introduce site area charging;
- Sewerage cost allocation – in allocating costs to both foul and surface water services there needs to be recognition of both loads and volumes, in particular the impact of peak volumes when allocating capital costs between services; and
- Wholesale charges 2017-18 – we have reservations and question the value that can be derived by publishing indicative wholesale charges in July.

Consultation questions

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 welcome the publication of the rules and appreciate that these rules are supplementary to other relevant statutory provisions.

We strongly support the requirement to include details of the wastewater charges in charges schemes as set out in section 4.1.5. It is important that there is transparency of the services that customers are being charged for. Further, we believe that it is important that this requirement, even on the initial pilot basis, should be set out within the charging rules.

Our main concerns with the draft rules relate to:

- Rule 17 – we strongly believe that this rule is incomplete as it currently stands, as the balance of sewerage charges should take account of more than simply pollutant load. This is particularly true of charges for surface water and highways drainage, where the main driver of cost is volume rather than load, and more specifically peak volume rather than annual average. We have proposed an alternative wording for rule 17 below.
- Rule A2 – we support the requirement to submit the statement of significant changes but not the requirement to publish the statement. The company must consider the most appropriate and timely manner in which to communicate changes with the customers concerned. This could take many different approaches, depending on the scale of impact and the particular customer groups involved. Being required to publish this three weeks prior to publication of the charges schemes could unduly harm any specific customer communication plans and trigger customer concerns prior to (for example) training has been completed for customer advisors to be able to adequately respond to any customer queries. We recommend that Ofwat amends this rule to require companies to provide

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details of its customer communication plans for all customers / customer types affected by more than 5%, but that the statement of significant changes is not published. Our views on this are set out in response to question 3.

We have set out below other rules that we consider should be included:

- The Defra guidance suggests that there is a requirement to publish charges schemes for household customers and charges schemes for non-household customers. This draft guidance does not stipulate if this is a requirement, nor does it reference any requirement for a wholesale charges scheme. We believe that it would be helpful for customers and retailers that Ofwat set a rule regarding the provision of separate schemes, to ensure a consistent approach is taken by all companies.
- The rules do not reflect the Defra requirement to protect certain groups of customers e.g. individuals living in rural areas (*section 2.4 of Consultation on Charging Guidance to Ofwat – July 2015*).
- There has previously been a requirement (*Consultation on wholesale and retail charges for 2015-16 and charges scheme rules published in May 2014 – This would mean that those customers who are likely to gain the most in absolute savings from Market reform would contribute more to its development*) to ensure that the additional costs incurred in managing market opening are only recovered through those customers that will benefit. This requirement is not listed in this document.
- There has previously been a requirement (*IN 13/19: Allocation of social tariffs and surface water drainage concessions cross-subsidies – companies should administer social tariffs through the household retail controls (that is, not reflected in wholesale prices)*) which prescribes which price controls should be used to recover revenues related to allowed concessions and social cross-subsidies.
- Rule 15 appears to reflect only the differences in the provision of a water service to large users. Similar differences also apply in the provision of sewerage services and therefore the rule should be amended to reflect this.
- There is currently no rule requiring there to be comparability between a charge levied for domestic foul effluent and trade effluent that is of the same strength as domestic effluent.
- Defra has included a requirement to have due regard for the broad diversity of non-household customers (*page 19 of the document issued in July 2015*), this is not clearly reflected within the draft rules.
- There is nothing set out within the rules on expectations of up to date cost allocation models for tariff setting purposes. Previously there has been a requirement that companies models should have up to date models and that they should have been updated sometime in the last five years. We believe that there should be a rule which requires companies to have an up to date model which supports the preparations of their tariffs.

We have also set out below some suggested re-wording of one of the rules with the aim of removing any ambiguity:

- Rule 17 should be amended as follows to reflect the different volumes – particularly peak volumes to reflect the cost of providing surface water and highways drainage services - as well as the different load of the various types of effluent:

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*In relation to charges for sewerage services, sewerage undertakers must take into account the different pollutant loads **and volumes** associated with household foul sewage, non-household foul sewage, trade effluent, surface water draining from premises and surface water draining from highways. **They should also take into account peak characteristics, particularly when allocating capital costs between foul and surface water and highways drainage, to account for requirements to provide appropriate network capacity.***

This is particularly important when considering the most appropriate way to apportion the costs to be recovered by the charges for each of these services.

Below we have drafted some suggested amendments to the definitions:

- “Mogden formula” – **the formula which is applied to calculate the charge payable by those discharging trade effluent into public sewers.** Including the formula as it currently stands has the potential to stifle innovation and companies may be reluctant to develop new elements of the (e.g. phosphate or ammonia) mogden formula to better reflect the costs of treating effluent in its region.
- “service” includes the supply of water **and the provision of sewerage services, including the provision of surface water and highways drainage.**

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 agree based on our experience that site area based charging is the most appropriate way for charging customers for surface water drainage. The benefits are that customers do consider the implications that drainage on their site can have both on the level of their charges and on the environment.

The principal issue with any change in the basis of charging is the impact on customers’ bills. Even when no additional income is being recovered, a change in charging basis will result in increases to charges for some customers and decreases for others. It is essential that those customers experiencing an increase are managed appropriately. For example:

- Communication with adversely affected customers as early as possible about the impact on their bills, the reasons why the bill is increasing and the opportunities and support available to them in reducing their surface water drainage charges before bills increase.
- Use of the concessionary scheme, as set out in Defra’s guidance.
- Phasing in of such a change over a period of time.

Clearly, if a decision is taken to phase in changes to bills over a period of time then there is a balance to be struck between, on one hand, giving customers a period of time for adjustment in which they can take steps to manage the impact on their bills, versus, on the other hand, ensuring that all customers are fully charged on an appropriate basis without undue delay.

In seeking to minimise transitional issues, some companies might be tempted to try and avoid the full impact on customer bills by failing to adequately allocate an appropriately cost reflective amount of revenue to be collected from site area charges. This could be through either not fully allocating costs to surface water drainage (and hence the amount of income recoverable from

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surface water charges) or by limiting the services charged for on a site area basis (e.g. not charging for highways drainage on site area basis).

Costs allocated to Surface Water Drainage

Currently, there are large differences between companies in the balance of charges between different services and therefore the income recovered from each service. The move to site area charging by some companies has raised awareness of these differences by some of the most affected customer groups. It is important that these differences are understood and resolved as part of or prior to further moves to introduce site area charging.

One way to achieve this would be:

- For Ofwat to require that companies make enhanced disclosures in their regulatory accounts to explain allocations of wholesale costs to upstream services. This would help to identify material differences in assumptions;
- For Ofwat to require that companies report income for foul, surface water and highways drainage, for each of household and non-household customers. This would help to increase transparency of the balance of income implied by company charges; and
- For Ofwat to expand the definition of rule 13 to explain further how companies should interpret that charges (not just charging structures) should reflect the long run costs of providing a service. In instances where assets are shared (e.g. sewers, which are used for both foul and surface water drainage) capital costs and return should be allocated on a basis that reflects how each service contributes to the capacity requirements of the asset.

We also note that rules 15 and 16 only mention peaking characteristics in relation to large users, and rule 17 only requires that differences in foul and surface water take into account differences in pollutant load. The implication of that is that annual load should be the only driver determining the balance of charges. However, the asset and operational costs associated with surface water and highways drainage are primarily driven by providing capacity to manage peak storm flows. Ofwat's guidance should recognise the different cost drivers which apply between foul (which is reasonable to allocate on the basis of pollutant load) and surface water drainage (whereby peak characteristics are the primary driver of network capacity), and require that these are taken into account by companies when setting charges.

It is essential that customers are able to have trust and confidence in the charges levied by their water company. If these are applied on a different underlying basis of allocating recoverable costs, then this is likely to generate unnecessary customer complaints and dissatisfaction. Resolving these cost allocation and revenue allocation differences between companies is essential if site area is to be accepted as being the most appropriate basis of charging customers for surface water drainage in the long term.

Highways drainage

There are a number of ways that companies could potentially recover the costs of dealing with highway drainage:

- Rateable value
- Volume of wastewater discharged
- Standing charge
- Apportionment across all services received
- Site area

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There are also differing degrees of transparency between companies of how the costs of providing this service are recovered through customers' charges. We welcome the reference in paragraph 4.1.5 which requires separate distinct charges for foul sewage, highway drainage, and surface water drainage on a pilot basis, but believe that this requirement, albeit on a pilot basis, should also be included as a charging rule.

We think there is arguably a stronger correlation between the size of a customer's site and the use of the highways than there is with the volume of effluent that they are likely to discharge. On this basis we consider that site area based charging is the most appropriate basis of charge to recover the costs of highway drainage.

Recovering the costs in this way also ensures that there is transparency of the costs recovered in the provision of these two services (surface water drainage and highway drainage).

At present, it is not only difficult for customers to understand what they are being charged for highways drainage, but also difficult for them to understand and reconcile differences between companies that charge for the same service on entirely different bases. It would be helpful if Ofwat could provide guidance on its preferred method of charging for highways drainage (similar to its view that surface water drainage is best charged on the basis of surface area).

Any desire to normalise the basis of charging for surface water drainage should equally apply to highways drainage. This should then allow for direct comparisons to be made between companies, and also with their regulated accounts, for both costs and income.

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?

We believe that the 5% threshold is appropriate for 2016/17 tariff setting, due to the current levels of inflation. However if inflation was to start to rise as is currently forecast, it may be appropriate to increase the threshold. We recommend that the threshold is reviewed on an annual basis, or alternatively, restated so that it adjusts for the impact of RPI inflation.

It is unclear whether the guidance intends to refer only to a "customer type" in total, or to individual customers. For example, if charges were rebalanced between fixed and variable charges (say, to increase a fixed charge and reduce the corresponding volumetric charge), then whilst some individual customers at the extreme end of the customer type may see increases of over 5%, the customer group as a whole may not. In such instances, we believe that all customers experiencing increases of over 5% should be subject to the proportionate impact assessment – the guidance should therefore refer to "customers" rather than to a "customer type".

Consideration should also be given to the monetary value of any increase in charge. Some customers receive very low bill, for example £100, and increases of £10 would clearly exceed the 5% threshold, but a £10 increase for that particular type of customer may be considered affordable.

Companies should be expected to understand the characteristics of customers that increases are being applied to, this then allows the companies to make an informed judgement of affordability and if the level of increase is acceptable.

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

We support the publication of the Board's assurance statement.

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

We do not think there is anything else that needs to be included in the assurance statement.

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

We support the requirement to submit the statement of significant changes but not the requirement to publish the statement as set out in rule A2.

As a company identifies any issues of significant change it must consider the most appropriate - and timely – manner in which to communicate that change with the customers concerned. This could take many different approaches, depending on the scale of impact and the particular customer groups involved.

Being required to publish this document prior to any direct communication with the customers concerned would not be considered to be good customer service. The timing would likely trigger customer concerns/contacts prior to company communication plans having been executed, and before training has been completed for customer advisors to be able to adequately respond to any customer queries.

Simple publication in early January seems too blunt a requirement to appropriately manage customers through such a change in charges.

We recommend that Ofwat requires that the company provides the statement of significant changes to Ofwat, along with details of its customer communication plans for all customers/customer types affected by more than 5%, but that this should not be published. The only justifiable reason for publication could be in the event that Ofwat is not convinced that the company has sufficient measures in place to communicate the changes to affected customers. Even in those circumstances then it should be published at the same time as the company publishes its charges schemes, not before.

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?

We generally support the proposals included in chapter 4, in particular we fully support the aim of transparency for the disaggregation of wastewater charges into separate components of foul water, surface water drainage, and highways drainage. We recognize the importance to the environment of providing customers with appropriate price signals which encourage them to consider the services that they take and how they can influence the level of their bill.

We also support Ofwat's proposal that charges schemes are complete. Completeness should lead to ease of comparability which should continue to be a driver for the opening up of the market in April 2017. A list of all non-primary charges that should be included for completeness with a charges scheme would be helpful, as set out in our response to question 8 below.

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We recognise the need to understand how much of a special agreement is to be classed as contestable. This issue should be addressed ahead of the non-household re-opener and should be included in that consultation to ensure that the split of the charge, and compliance with the non-household price control, is consistent.

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

Whilst it is essential that all primary charges are listed in wholesale charges schemes, we consider that it is less essential for all non-primary charges.

There are some categories of non-primary charges which we agree should be listed. These include charges for the use of standpipes, meter exchange or checks, which will not vary from one customer/retailer to the next. However, there will be other charges which can significantly differ dependent on requirements and it would be inappropriate to determine a standard charge for. This may include, tankering water, stop-tap location, repair or damage to company assets etc. Whilst it may be inappropriate to list such charges, it would be appropriate to state that charges may be applicable and that quotes will be provided on request, based on recovery of costs.

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?

Based on the draft rules, we believe that we will be able meet this requirement. However, we recommend that Ofwat seeks views on this again, following the publication of the final charging rules – given the impact of any potential changes.

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

Whilst we understand the rationale for the proposed approach, it is important to understand that the level of assurance which could be applied to the wholesale charges published in July cannot be anywhere near as rigorous as that applied to those published in October. Furthermore, charges published in July will most likely not be capable of reflecting any changes in cost reflectivity derived from prior year accounts.

Therefore, we question what value can be derived from such early publication – given that retailers could, if required at such an early stage of the financial year, estimate wholesale prices for the following year by applying wholesale price determinations simplistically to prior year wholesale prices. Given the significant additional regulatory burden, we do not consider it is necessary to publish wholesale charges on three separate occasions during a single financial year, and recommend retaining only the October and January publication dates.