

Ynon Galbinger
Ofwat
City Centre Tower
7 Hill Street
Birmingham
B5 4UA

Direct dial: 01225 526348
email: andy.pymer@wessexwater.co.uk

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Dear Ynon

Wessex Water response to consultation on charges scheme rules for 2016-17 and future developments

Thank you for the opportunity to respond to your consultation on the 2016-17 charging rules and future developments in charging. There are many positive aspects of the new charging rules; in particular we welcome the fact that they are broadly consistent with previous guidelines.

We continue to strongly support the key purpose of a move away from Ofwat's ex-ante approval of charges to a rules based approach: For companies to own and be accountable for their charges.

We understand that charging rules will need to change moving forward however to retain company ownership and accountability under the new framework it is important that rule changes proposed are subject to a full and transparent assessment of their impact (indeed this is required for any material change according to Defra's recent guidance to Ofwat). Together as an industry we need to make sure that where changes in the rules are proposed we are clear on:

- the outcome that is desired,
- the external driver for that outcome, (e.g. has there been new guidance from Defra, or is a company wishing to do something differently in future)
- the likelihood that the change in the rules will deliver the desired outcome,
- why a change in the charges rule is the best way to deliver that outcome, and
- how companies are able to reflect local circumstances while complying with the new rules.

This means that every year, Ofwat should provide:

1. An affirmation of Ofwat's strategy for charges, including the onus on companies to deliver for customers,
2. A clear statement of changes in rules to companies compared to the previous charging rules,

3. A clear explanation of what has driven the change in approach, in particular what is the desired outcome of the change in rule,
4. A proportionate impact assessment depending on the materiality of the change.

Over time this process will lead to set of charging rules that deliver for customers and the environment while retaining company ownership and accountability.

Charging for drainage

The proposed 2016-17 charging rules include a material change to charging policy: to provide partial surface water drainage rebates. Alongside this there is a discussion of how to encourage companies to move to an area-drained basis of charging for surface water and the piloting of separate highway drainage charges. Rather than approaching this in a piecemeal way we propose that a full review of surface water and highway drainage charging is undertaken by the industry before any changes in this area are made. The review should:

- Reassess the benefits and costs of moving towards area-based charging for surface water as a number of companies have charged in this way now for a number of years.
- Review the costs of surface water drainage on both an historic cost and forward looking basis, and consider what this should mean for the level of charges (and abatements available) to different customer groups.
- Review infrastructure and other developer services charges to see where there are other opportunities to create incentives for sustainable drainage approaches without causing incidence effects across the customer base
- Assess the benefits of providing rebates for partial connection to the sewer system
- Assess the benefits of separating waste water charges
- Survey current and future technology to assess the possibility to move away from using inaccurate proxies to charge for drainage towards flow meters.

We would expect such a review to result in changes in charges rules around drainage that companies can own moving forward.

Statement of changes

We support Ofwat's general preference to regulate on an ex-post basis, and this would be the natural consequence of the new legislation around charging rules rather than Ofwat approving charges.

We do not support the requirement to provide a Statement of Changes to Ofwat three weeks prior to publication. This would be a return to ex-ante style regulation, but would not give you enough time to intervene to protect customers or for us to make changes and gain our own Board's approval of them if you do so.

As a key stakeholder we would expect to engage with you as a matter of course well in advance if we were to make material changes. We feel this fits much better into the overall vision for the sector, and would make the proposed Statement of Changes unnecessary red-tape, the reduction of which was also a key objective of the recent changes to legislation.

Forecasting wholesale tariffs

We understand that retailers will look for certainty as early as possible on wholesale charges and we should all look to help facilitate an effective retail market, but the proposed lack of flexibility after publishing in October will cause difficulty.

Our Licence requires the Board to aim to recover our allowed revenue and not show undue preference to any customer group – meanwhile the Competition Act imposes similar obligations on cost reflectivity to avoid margin squeeze. Your proposal to fix wholesale charges in October to only allow changes for RPI may mean that the Board will be in a position where it cannot take new information into account when approving the company's end-user charges later in the year – which could in theory impact amongst other things on the retail margins available.

We are content to publish indicative wholesale charges in October but would expect to retain some additional flexibility over and above a difference in the November RPI value.

Publishing firm indicative wholesale charges also brings forward the date that Ofwat will need to consult on and confirm both end-user and any wholesale charges rules for the following year – with confirmation of charges rules needed in July.

We also may want to consider replacing the link between November RPI and wholesale charges with an earlier month for future price control periods, and we note that the Water 2020 programme already includes a review of price control indexation.

We have responded to your questions in the appendix which follows. I hope this is helpful.

Yours sincerely

Andy Pymer
Director of Customer and Retail Services

Appendix - Wessex Water responses to Consultation Questions – September 2015

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 support the reduction in the amount of guidance contained in the charging rules compared to previous years' charging guidelines. We think this is in line with a more proportionate approach to regulation and at the same time builds on the strengths of the successful assurance processes for charging policy in previous years.

We welcome the fact that you provided an early view of the draft charging rules and gave us the opportunity to comment on them in your pre-consultation. We support the changes you have made as a result of this pre-consultation.

We strongly support much of the most important content in the charging rules – for example, companies should have robust common principles for determining the magnitude of their charges, they should engage with CCWater and other relevant groups in a timely and effective manner, manage any incidence effects to minimise the impact on customers, and have strong internal and Board assurance processes. We do however have some concerns on which we elaborate below.

Partial drainage rebates

As we mentioned in our response to the pre-consultation on the draft charging rules, we think there should be a wider review of drainage charging policy as a decade has passed since the last one and there have been many innovations in this area since then.

In this particular area we are of the view that:

- partial rebates are likely to be costly to assess and administer accurately, and
- partially connected assets (which an undertaker has no control over) must be maintained to ensure their continued effectiveness, failure to do so would not meet our Board's strategy for fairness in charges.

We think that this area should form part of a wider review, and there is an opportunity to revisit the possibility of measuring flows into the sewer rather than using a proxy. We elaborate on this in our response to Q2 below.

Statement of changes

We do not agree with the requirement to submit and publish a statement of changes three weeks prior to publication, as we consider that this will add to red-tape (contrary to government intentions) without in reality protecting customers. We elaborate on this further in our response to Q6.

Default tariffs

Thank you for revising the wording in paragraph 25. However we think it could still benefit from being a little clearer. If the aim is to ensure companies' charging schemes reflect the PR14 default tariffs we think an improved wording would be "consistent with" or "comply with" instead of "must include".

The current wording could be read as a requirement for us to set out the retail default tariffs in a separate table in our charges scheme. This would not be helpful to end-user customers as in our view it would increase complexity for customers who will primarily be focused on their end-to-end charges.

We suggest you specify exactly what you require in terms of compliance to ensure companies understand fully and can provide a consistent approach.

Publication of wholesale charges scheme

For transparency we think that the requirement to publish a final wholesale charges scheme three weeks before the end-customer schemes should be part of the 2016-17 charging rules. We can however adapt our assurance processes to fit with this new requirement. We elaborate further on this in our response to Q9.

Disaggregating waste water charges

We welcome that you have removed the requirement from the 2016-17 charging rules to separate waste water charges. However it is unclear what you mean when we are required to publish “pilot” charges. If we are required to publish disaggregated charges in our 2016-17 wholesale charges scheme, we think this is a material change to charging policy and should be part of the charges scheme rules. It also should be part of a wider review of drainage charging. We elaborate further on this in our response to Q7.

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 welcome an opportunity to comment on area-based surface water charging. We do not think it should be mandated without a wide-scale consultation. Companies will not be able to own and be accountable for their charges if changes are imposed without a transparent and evidence based process for their adoption.

A material and far-reaching change in policy which has significant incidence effects for customers such as this must be considered, taking all available evidence and stakeholders’ views into account. Defra’s draft guidance to Ofwat states:

“...any new regulatory drivers that may result in marked swings in charges should be carefully considered through a published Impact Assessment.”¹

Over a decade has passed since Ofwat’s last review of drainage charging policy. Area-based charging has been adopted by a number of companies for a significant period of time now, and there is an opportunity to learn from their experiences and understand the costs and benefits of moving to an area-based method. If it is the best way of charging for drainage, those companies that have made the change should be able to demonstrate:

- reduced operational costs and avoided capital costs,
- environmental benefits from reduced flooding,
- customer benefit from receiving a potentially more cost-reflective drainage charge, giving them a greater incentive to disconnect from the incumbent’s sewerage system, and

¹ https://consult.defra.gov.uk/water/water-industry-charging-guidance-to-ofwat/supporting_documents/Consultation%20on%20Charging%20Guidance%20to%20Ofwat.pdf

- lower customer complaints and improved customer satisfaction.

We are also mindful that an area-based charging is still a proxy – it does not reflect the actual volume of surface water discharged to the sewer. Technology has moved on since Ofwat’s 2003 review. We have been working to develop a reliable, cheap waste water meter that will make the imperfection of using a proxy to charge for drainage a thing of the past.

We propose that a full review of surface water and highway drainage charging is undertaken by the industry before any changes in this area are made. The review should:

- Reassess the benefits and costs of moving towards area-based charging for surface water as a number of companies have charged in this way now for a number of years.
- Review the costs of surface water drainage on both an historic cost and forward looking basis, and consider what this should mean for the level of charges (and abatements available) to different customer groups.
- Review infrastructure and other developer services charges to see where there are other opportunities to create incentives for sustainable drainage approaches without causing incidence effects across the existing customer base
- Assess the benefits of providing rebates for partial connection to the sewer system
- Assess the benefits of separating waste water charges
- Survey current and future technology to assess the possibility to move away from using inaccurate proxies to charge for drainage towards flow meters.

We would expect such a review to result in changes in charges rules that companies can own moving forward.

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 think that a 5% threshold for a “significant” bill increase is a reasonable assumption in a period of subdued inflation as we are currently experiencing. However Ofwat must keep this value under review.

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

We agree.

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

We are happy with your requirements for the content of the proposed Board assurance statement. We expect to provide a description of what the Board considered in approving its charges to add transparency on the process but this shouldn’t be mandated in the charging rules.

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

No we disagree. We support Ofwat's general preference to regulate on an ex-post basis, and this would be the natural consequence of the new legislation around charging rules rather than Ofwat approving charges.

The requirement to provide a statement of changes to Ofwat three weeks prior to publication is therefore curious as it appears to be a return to ex-ante style regulation. However we don't think that providing a statement of changes three weeks prior to publication of end-customer Charges Schemes either gives you enough time to intervene or for us to make changes and gain our own Board's approval of them if you do so.

As a key stakeholder we would expect to engage with you as a matter of course well in advance if we were planning to make material changes. We feel this fits much better into the overall vision for the sector, and would make the proposed Statement of Changes unnecessary red-tape, the reduction of which was also a key objective of the recent changes to legislation.

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?

Disaggregation of wastewater charges

As we stated in our response to the pre-consultation, we would like to understand the rationale for the proposal to disaggregate wastewater charges, the expected benefits of doing so, and how this contributes to Defra's charging guidance, as we think this is a material change to charging policy. Such an assessment could be included in a wider review of drainage charging policy. While we agree there are benefits from transparency in charging, we also see risks to trust and confidence if customers are presented with bills that they are unable to control or influence.

Additionally, with the change from the pre-consultation requiring companies to disaggregate their waste water charges formally in the 2016-17 charging rules, we are concerned over the wording of the proposal for companies to publish disaggregated charges on a "pilot" basis. How will this be published? If it is to be included in companies' wholesale charging schemes we consider it a material change and should be part of the 2016-17 charging rules. It should also require a formal impact assessment. However we are not averse to providing our disaggregated charges to Ofwat directly to shape their thinking in this area.

Special agreements

We agree that if a customer has a historic special agreement they should benefit from competition in the retail market. However we request some clarity over the proposed rules. For example we have a number of historic special agreements which involve free water up to a limit – some of these customers end up not paying a charge as they never breach the threshold at which they stop receiving free water.

We would welcome clarity over how we charge these customers in a competitive market, as last year's rules prohibited negative wholesale charges, but there is no mention of them in this latest set of charges rules.

Our view for special agreement customers is that negative wholesale charges would be the most appropriate solution if this is necessary to allow these customers to take part in the competitive retail market while honouring the terms of the existing contracts - we expect to develop 2016-17 charges on that basis. If in your view this is not in accordance with your charging rules we would request early notification of this so we can avoid inadvertent non-compliance.

Charge standardisation

We agree with your view that any standardisation should be thought about carefully; we await your consultation.

Developer services

We agree that work on charging for developer services should commence later this year, and the results should feed into future charging rules.

Access pricing

We agree with your view that access pricing is a critical area, and agree with your views on it so far shared through your Water 2020 programme. It is a complex area, and we welcome further work and consultation later in 2015.

Other areas

As described more fully in the responses to Q8-10, our opinions on specific questions are as follows:

- We are happy to include all non-primary charges in the wholesale scheme for 2017-18 but do not want to stifle innovation as a response to competitive pressure as a result of burdensome rules for what can or cannot be a non-primary charge.
- While we are content to publish our wholesale charges scheme earlier than expected, we think that it should be included in the 2016-17 charging rules as it is a material change.
- While we are not opposed to providing indicative wholesale prices (if there is a need from retailers) in both July and October, we are strongly opposed to any requirement which restricts the company to use outdated forecasts in its final charges.

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

We don't object to a required minimum list of non-primary charges as long as they are not exhaustive. This should be introduced as a charging rule at market opening for the 2017-18 charging year. We think that companies should be able to provide non-primary services as a result of competitive pressure from retailers and this should not potentially be restrained by rules that are over specific and complex.

Finally we note that the changes to developer services charging are progressing outside of this consultation and agree that these can feed into future charging rules when proposals become clear and are agreed.

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 can adapt our Board assurance process to ensure the charges sign-off is completed by the proposed date to fit with this new requirement. For transparency, we do however think it should be part of the 2016-17 charging rules.

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

We understand that retailers will look for certainty as early as possible on wholesale charges and we should all look to help facilitate an effective retail market, but the proposed lack of flexibility after publishing in October will cause difficulty.

Our Licence requires the Board to aim to recover our allowed revenue and not show undue preference to any customer group – meanwhile the Competition Act imposes similar obligations on cost reflectivity to avoid margin squeeze. Your proposal to fix wholesale charges in October to only allow changes for RPI may mean that the Board will be in a position where it cannot take new information into account when approving the company's end-user charges later in the year – which could in theory impact amongst other things on the retail margins available.

We are content to publish indicative wholesale charges in October but would expect to retain some additional flexibility over and above November RPI changes.

Publishing firm indicative wholesale charges also brings forward the date that Ofwat will need to consult on and confirm both end-user and any wholesale charges rules for the following year – with confirmation of charges rules needed in July.

To give greater price certainty to retailers it may be more effective to consider replacing the link between November RPI and wholesale charges with an earlier month for future price control periods, and we note that the Water 2020 programme already includes a review of price control indexation.