Setting price controls for 2015-20

Final price control determination notice: policy chapter A6 – non-household retail costs and revenues
Contents

Overview 2
A6.1 Introduction 6
A6.2 Our methodology for companies operating wholly or mainly in England 11
A6.3 Our methodology for companies operating wholly or mainly in Wales 19
A6.4 Form of control 24
Overview

This non-household retail control represents the first separate price control for customer-facing ‘retail’ services for non-households. We have assumed that, in line with UK Government policy, non-household customers of companies operating wholly or mainly in England will have the ability to choose their retailer from 1 April 2017.

We are allowing £534 million of expenditure for non-household retail costs across the 18 water and wastewater companies for 2015-20. However, it should be noted that, based on industry feedback, we will now be setting the non-household retail control for two years not five. Companies will be able to propose new cost and margin allocations in 2016 to further ensure that they are ready for market opening. Beyond April 2017, we expect any allowed revenues that we set as part of our controls to be further constrained by competitive rivalry in the non-household retail market. Nevertheless, this determination represents an 11% reduction from the costs proposed in the companies’ revised business plans in June 2014, saving customers £68 million between 2015 and 2020 as a result of our interventions and changes by the companies.

This document sets out our approach in setting the final determinations for non-household retail price controls and summarises the results of our review of companies’ business plans and representations.

Our final determinations

Table A6.1 below shows total forecast revenues for the final non-household revenue controls for each company.
Table A6.1  Indicative non-household retail total revenue price control including net margins (£m, nominal)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anglian Water</td>
<td>15.2</td>
<td>15.5</td>
<td>15.7</td>
<td>16.0</td>
<td>16.1</td>
</tr>
<tr>
<td>Dŵr Cymru</td>
<td>9.6</td>
<td>9.1</td>
<td>8.7</td>
<td>8.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Northumbrian Water</td>
<td>9.7</td>
<td>9.9</td>
<td>10.0</td>
<td>10.2</td>
<td>10.3</td>
</tr>
<tr>
<td>Severn Trent Water</td>
<td>26.0</td>
<td>26.8</td>
<td>28.7</td>
<td>29.7</td>
<td>30.5</td>
</tr>
<tr>
<td>South West Water</td>
<td>5.2</td>
<td>5.3</td>
<td>5.4</td>
<td>5.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Southern Water</td>
<td>8.6</td>
<td>8.8</td>
<td>8.9</td>
<td>9.0</td>
<td>9.2</td>
</tr>
<tr>
<td>Thames Water*</td>
<td>29.3</td>
<td>29.9</td>
<td>30.2</td>
<td>30.7</td>
<td>31.1</td>
</tr>
<tr>
<td>United Utilities</td>
<td>35.9</td>
<td>36.5</td>
<td>37.2</td>
<td>37.8</td>
<td>38.4</td>
</tr>
<tr>
<td>Wessex Water</td>
<td>6.2</td>
<td>6.2</td>
<td>6.3</td>
<td>6.3</td>
<td>6.4</td>
</tr>
<tr>
<td>Yorkshire Water</td>
<td>10.4</td>
<td>10.8</td>
<td>11.8</td>
<td>11.8</td>
<td>12.1</td>
</tr>
<tr>
<td>Affinity Water</td>
<td>5.3</td>
<td>5.3</td>
<td>5.2</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Bristol Water</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Dee Valley Water</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Portsmouth Water</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>SembCorp Bournemouth Water</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>South East Water</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>South Staffordshire Water</td>
<td>2.7</td>
<td>2.6</td>
<td>2.6</td>
<td>2.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Sutton &amp; East Surrey Water</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
</tr>
</tbody>
</table>

**Note:**
There will be no direct indexation for retail price controls from this price base, although the net margin will apply to wholesale revenues that are indexed to the Retail Prices Index (RPI). Figures exclude retail services to developers and revenues associated with miscellaneous charges which are not subject to the ex ante price controls set out in this chapter.

* Retail revenue has for the purposes of calculating the retail margin been calculated using estimated wholesale revenue that includes estimated Thames Tideway Tunnel Infrastructure Provider wholesale revenue.
These forecast revenues do not assume any changes in customer numbers, or changes in prices, from the introduction of competition in 2017, so the numbers should be considered indicative. The actual controls are set for each customer type, and are set out in the relevant company-specific appendix. Total allowed retail revenue figures will also be affected by changes in the underlying wholesale charges, as the net margin is applied to both retail costs and wholesale revenues.

Consistent with ‘Policy chapter A5 – household retail costs and revenues’ (the ‘household retail policy chapter’), all figures are quoted in nominal prices.

In relation to the companies operating wholly or mainly in England, the key results of our review of the companies’ proposals are as follows.

- We challenged companies’ proposals where they had provided insufficient evidence to demonstrate that customers will continue to be protected. In total, we challenged companies’ non-household retail proposals by £50 million (9%) over 2015-20.

- Based on industry feedback, we will be setting the non-household retail control for two years, with a review in 2016.

In relation to the companies operating wholly or mainly in Wales, the key results of our review of the companies’ proposals are as follows.

- In line with our methodology, we have applied a regulatory efficiency challenge to ensure that, where customers do not have a choice of supplier, they remain protected. This is based on a comparison with equivalent costs in England.

- We have also included a non-household service incentive mechanism (SIM) to ensure that non-household customers in Wales will continue to receive high-quality service even though those that use less than 50 megalitres (ML) of water a year will not have a choice of supplier.

Our approach

This new non-household retail price control sets, for each company, separate binding revenue controls for retail services for different non-household customer types. The controls are set on the basis of an average revenue per customer, and are not automatically indexed to the Retail Prices Index (RPI) and, as such,
customers will benefit in the period 2015-20 because of the downward pressure we have brought on bills relative to general inflation.

Our proposals assume that, in line with UK Government policy, non-household customers of companies operating wholly or mainly in England will have the ability to choose their retailer from 1 April 2017. The default tariffs that companies set will protect customers for the two years ahead of that market opening and provide a comparison point for customers once it is open so that they can clearly see whether they would be better off changing their supplier, helping to maximise the benefits of the retail market reforms provided for by the Water Act 2014.

In line with Welsh Government policy, non-household customers of companies operating wholly or mainly in Wales using less than 50 ML of water per year are not expected to be able to choose their supplier during the next five years. As such, we have taken a different approach to companies operating wholly or mainly in Wales to protect non-household customers who will not be able to take advantage of competition.

Key changes since draft determinations

Following consideration of representations to our draft determinations and further analysis, we have made the following key changes since our draft determinations.

- We have set the retail controls based on companies’ 2013-14 costs (prior to any subsequent adjustments), consistent with ‘Setting price controls for 2015-20: final methodology and expectations for companies’ business plans’ (our ‘final methodology statement’).

- We have accepted updated cost and net margin allocations between different customer types for ten companies. Ensuring robust allocations between different customer types helps avoid discriminatory charges. We have set out our decisions in the relevant company-specific appendices.

- We have re-run the Welsh efficiency challenge based on the above changes, and any other allowed cost allocation changes between the different controls.
A6.1. Introduction

In this policy chapter, we set out and explain the approach we have used in setting the non-household retail price controls from 1 April 2015. We summarise the results of our review of companies' business plans and how we have responded to the issues raised by representations to our draft determinations.

This introduction:

- sets out the structure of this policy chapter; and
- describes the development and refinement of our approach to setting non-household retail price controls.

A6.1.1 Document structure

In section A6.1.2 below, we describe the development and refinement of our approach to setting non-household retail controls.

In the remainder of this policy chapter, we then explain how we have reached our final decisions on the non-household retail controls.

- Section A6.2 discusses our methodology for companies operating wholly or mainly in England.
- Section A6.3 describes how our methodology differs for companies operating wholly or mainly in Wales.
- Section A6.4 discusses our decision on the form and duration of the non-household retail control.

Within each section, we outline:

- our proposed policy position, as set out in our August draft determinations;
- the key issues raised by the representations received to our draft determinations; and
- our final position.
Consistent with the final policy position set out in this chapter, our company-specific decisions on the non-household retail price controls for each company are set out in the relevant company-specific appendices. The controls are built up using the non-household retail feeder model (R006). This will be published in the week following the final determinations.

We set out our approach to the household retail controls in the household retail policy chapter. This chapter also explains our approach to the allocation of costs between the retail and wholesale price controls as well as the household and non-household retail price limits.

We explain how we have arrived at the outcomes we are requiring from companies in the period from 2015-20 in 'Policy chapter A2 – outcomes' (our ‘outcomes policy chapter’). For the non-household retail control these are only relevant for companies operating wholly or mainly in Wales.

We set out our methodology for establishing the net margin we have used in deriving these non-household retail controls in 'Policy chapter A7 – risk and reward' (the ‘risk and reward policy chapter’).

### A6.1.2 Our approach

In July 2013, we modified companies’ licences\(^1\) to allow separate binding revenue controls for wholesale water and wastewater services and household and non-household retail services. The licences specify a maximum duration of five years for retail controls, but do not specify how we will regulate these retail activities. One reason for these changes was to facilitate the retail market reforms in England that form part of the wider industry reforms set out by the Water Act 2014. This marked a move away from the single price control framework in place at previous reviews.

We set out the key features of our proposed approach to setting price controls for retail services to non-household customers in July 2013 in our final methodology statement. These are as follows.

---

\(^1\) See 'Modification of the conditions of appointment (licences) of all water only and water and sewerage companies' for further details.
• Separate binding retail controls for each company for household and non-household customers.

• That automatic RPI indexation of the price controls is not appropriate for the less asset and capital-intensive retail businesses\(^2\). This is more consistent with the arrangements you would expect elsewhere in the economy where retailers do not see prices automatically indexed to RPI.

• That we will set average revenue controls per customer type for the non-household retail price controls.

• That companies must offer default tariffs which comply with these average retail revenue controls - customers choosing not to switch will remain on those default tariffs.

• That non-household customers served by companies operating wholly or mainly in Wales, who will not be able to take advantage of competition, will still be subject to a regulatory efficiency challenge and a service incentive to protect them in the absence of choice.

Companies first submitted their business plan proposals to us in December 2013. However, there were a number of issues with the cost and margin allocations proposed for the non-household retail prices in these business plans. As we stated in IB 28/13, ‘Change to Ofwat’s price review process’, because of the widespread nature of these issues, we decided to remove non-household retail controls from the risk-based review (RBR). In IN 14/01, ‘Adapted approach for default tariffs’ (our ‘note on our adapted approach’) we set out our adapted process to setting the relevant price controls. As part of this, we sought further details from companies on the basis of the non-household proposals they had put forward in their December 2013 business plans by 1 March 2014.

We further stated that the non-household retail draft determinations for all companies (including enhanced companies) would be published on 29 August 2014, in line with the timetable for standard draft determinations. This would follow analysis of further information, including allocated actual 2013-14 non-household retail costs for which information only became available from companies in July and which form the basis of the price controls concerned, in line with our final methodology statement.

\(^2\) It should be noted that the formula for calculating allowed non-household retail revenues includes reference to wholesale revenues, for example in the calculation of the retail margin, wholesale costs clearly do have a more capital intensive nature (in both scale and asset life terms) and have been automatically indexed at RPI.
Having considered the additional business plan information that companies provided on 1 March 2014, we issued further guidance in April 2014 in ‘Setting price controls for 2015-20 – guidance for companies on producing default tariffs’ (our ‘default tariffs guidance’) and ‘Setting price controls for 2015-20 – guidance on revised data table requirements following Ofwat's risk-based review’ to guide the provision of the revised R4 business plan table by companies on 27 June 2014, to inform our August 2014 draft determinations.

Since we published our final methodology statement, and in light of the new approach to setting price controls in this area, we have issued the following additional policy documents to provide further guidance and explain our approach in more detail as shown in the table below.

**Table A6.2 Additional policy documents published relevant to non-household retail costs and revenues**

<table>
<thead>
<tr>
<th>Document name</th>
<th>Publication date</th>
<th>Description / policy content</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘IN 14/01: Adapted approach for default tariffs’ (our ‘note on our adapted approach’)</td>
<td>January 2014</td>
<td>Set out our next steps for setting default tariffs following their removal from the RBR.</td>
</tr>
<tr>
<td>‘Setting price controls for 2015-20 – risk and reward guidance’ (our ‘risk and reward guidance’)</td>
<td>January 2014</td>
<td>Guidance on non-household net margin.</td>
</tr>
<tr>
<td>‘2014 price review cost allocation for retail and wholesale price controls’ (our ‘guidance on cost allocation’)</td>
<td>March 2014</td>
<td>Sets out a standard set of cost drivers for allocating 2013-14 costs between both the wholesale and retail and the household retail and non-household retail parts of the business.</td>
</tr>
<tr>
<td>‘Setting price controls for 2015-20 – guidance for companies on producing default tariffs’ (our ‘default tariffs guidance’)</td>
<td>April 2014</td>
<td>Further guidance on the data all companies should provide and the approach they should take in developing their default tariffs.</td>
</tr>
<tr>
<td>‘Service incentive mechanism (SIM) for 2015 onwards – conclusions’ (our ‘SIM conclusions paper’)</td>
<td>April 2014</td>
<td>Summary of consultation responses received and resulting conclusions on the SIM for 2015 onwards.</td>
</tr>
</tbody>
</table>
Final price control determination notice: policy chapter A6 – non-household retail costs and revenues

<table>
<thead>
<tr>
<th>Document name</th>
<th>Publication date</th>
<th>Description / policy content</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Setting price controls for 2015-20, Draft price control determination notice: technical appendix’</td>
<td>April 2014</td>
<td>Our approach to non-household retail price controls as part of the draft determinations for enhanced companies.</td>
</tr>
<tr>
<td>‘Consultation on wholesale and retail charges for 2015-16 and charges scheme rules’</td>
<td>May 2014</td>
<td>Set out our expectations for charging rules relevant to companies setting separate wholesale and retail charges in 2015-16, and our expectations for further changes in charging over the next five years and beyond.</td>
</tr>
<tr>
<td>‘IN 14/14: 2014 price review – non-household customer engagement ahead of draft determination representations’</td>
<td>August 2014</td>
<td>Sets out our initial observations on incumbent companies’ proposals for their non-household retail price controls ahead of our draft determinations.</td>
</tr>
<tr>
<td>‘Setting price controls for 2015-20, Draft price control determination notice: technical appendix A5 – non-household retail’ (‘the non-household retail technical appendix to our August draft determinations’)</td>
<td>August 2014</td>
<td>Restatement of our approach to household retail price controls including calculation of allowed retail household price control revenue as part of the August draft determinations.</td>
</tr>
</tbody>
</table>

Details of company-specific non-household retail interventions in our draft determinations can be found in the relevant company-specific appendices to our August draft determinations or, for the four companies who received a draft determination in April or May 2014, in ‘Non-household retail controls: draft determinations for Affinity Water, South West Water, Dŵr Cymru and Northumbrian Water’.

Our approach to the non-household retail controls has been developed in line with the above published guidance, and in consultation with the sector. For example, before issuing our default tariff guidance we held an industry workshop, and we then held a subsequent industry workshop after the guidance had been published to ensure our approach was well understood.
A6.2. Our methodology for companies operating wholly or mainly in England

A6.2.1 Our draft determinations

We outlined our proposed approach to the non-household retail controls in section A5.2 of the non-household retail technical appendix to our August draft determinations.

In our draft determinations, we proposed setting the controls to be in the general form of an allowed average cost per customer \( r_c \), and a net margin \( m \) in line with our final methodology statement. This means for each customer type, for a given forecast of the customer numbers of that type on the default tariff in a given year, the forecast total allowed revenue from default tariffs offered to those customers will then be defined in the following formula.

**Calculating forecasted total allowed revenue for a given customer type**

\[
R = \left[ (r_c \times c_n) + w \right] / (1-m)
\]

Where:

- \( R \) = the estimated total allowed revenue for a given customer type
- \( r_c \) = the allowed average retail cost component for a given customer type
- \( c_n \) = the forecast customer numbers for a given customer type
- \( w \) = the forecast wholesale revenue for a given customer type
- \( m \) = the allowed net margin for a given customer type

The customer numbers and wholesale revenues in each year will vary, while the allowed average retail cost component and margin will not. Accordingly, the forecast and actual allowed non-household retail revenues will vary each year. For further details see our default tariffs guidance.

We set out these proposals for each company in annex 2 to the non-household retail technical appendix to our August draft determinations and in the draft determinations for Affinity Water, South West Water, Dŵr Cymru and Northumbrian Water for those companies that had already received early draft determinations in relation to the other price controls.
By continuing to require a package of regulated price and associated service safeguards, we will provide a backstop level of protection for customers in the market that do not choose to switch.

For the August draft determinations, we used each company’s proposed customer types as submitted in June 2014, to determine the different customer types for the average retail revenue controls that we set. This was considered simpler and more proportionate than Ofwat requiring companies to use national customer types or tariffs, and reflecting these in our average retail revenue controls. This is because it would minimise any initial incidence effects on prices (that is, bills significantly changing in value from one year to the next), given that in some areas existing local prices vary considerably. It would also encourage company ownership of their business plans, avoiding our direct intervention.

From 1 April 2015, companies will need to set charges for all non-household customers that, as a minimum, comply with the annual allowed average retail revenue controls for each customer type (determined using the allowed average retail cost per customer and net margin, as well as forecasts of wholesale revenue and customer numbers in each year). We call these charges ‘default tariffs’. They reflect the maximum allowed average revenue per customer. Default tariffs must be available to all customers of each type in each undertaker’s area of appointment.

However, subject to the requirement to offer default tariffs, we expect the tariffs that companies offer to their customers increasingly to vary over time, as competition develops. For example, if companies wish to offer tariffs to customers that did not comply with the average revenue controls, then they are free to do so either by:

- setting default tariffs which do not take up their full allowed average revenue limit for that customer type (while ensuring that they stay compliant with all of their regulatory and legislative obligations) – for example, by discounting below the maximum default tariff level that would be implied by the price controls; or
- offering alternative types of tariffs to customers, as well as offering at least the default tariff for the customer type concerned – in such circumstances, customers would need to choose to switch away from the default tariffs to an alternative tariff if it is offered by the company (rather than the company unilaterally transferring them).

We assessed all company plans using a common methodology, which involved a review of:
• **companies’ proposed categorisation of customer ‘types’**, including consideration of the companies’ assurance that their proposals would not unduly discriminate between customers in a given customer type or between customer types;
• **companies’ proposed costs**, intervening where the proposals were not supported by sufficiently compelling evidence or were not consistent with our guidance on pension deficit repair costs (in line with our overall approach to pension deficit costs); and
• **companies’ proposed net margins** and whether these were consistent with our risk and reward guidance – that is, net margins of 2.5% for customers that are able, or will be able, to choose their supplier.

In our draft determinations, we confirmed our view that automatic RPI indexation is not appropriate for the non-household retail controls. In other words, we did not propose to make any automatic additional allowance in the controls (outside of the net margins) to reflect future general inflationary cost increases for the costs of providing retail services to non-household customers before the next review period.

In section A5.3 of the non-household retail technical appendix to our August draft determinations, we outlined our assessment of companies’ revised business plan proposals. We set out further details of our proposed interventions based on these business plan proposals in the relevant company-specific appendices of the August draft determinations and in the draft determinations for Affinity Water, south West Water, Dŵr Cymru and Northumbrian Water.

At the draft determinations we intervened where companies proposed that the non-household controls reflect material cost increases from 2013-14 (the ‘base year’) that were not sufficiently justified. We also identified a number of areas where companies’ base-year actual 2013-14 costs appeared to be high in comparison to previous years, and requested companies to provide further detail in their representations to explain why these increases should not be treated as exceptional one-off events. In assessing the materiality of companies’ proposed cost increases over 2015-20, we compare companies’ 2015-20 cost proposals to the companies’ base-years. It is therefore important that the base year is of an appropriate magnitude otherwise cost increases may appear immaterial when they actually represent significant increases.

We also intervened where companies included input price pressures in their non-household retail cost forecasts after 2013-14, and where their business plan submission was not presented in the specified 2012-13 price base for the draft determinations.
For the companies operating wholly or mainly in England, we did not intervene to amend their proposed cost and net margin allocations between customer types for the draft determinations. We did, however, highlight a number of areas where we had concerns.

We stated that not intervening in this area in our draft determination proposals was consistent with our policy of leaving the accountability for compliance with obligations, including competition law, with the companies. But we also stated that we may intervene for the final determinations if we considered, following further representations, that such concerns remained, and if there was significant risk to customers in consequence.

To inform representations, a series of sector-wide comparisons were included for information in annex 1 to the non-household retail technical appendix to our August draft determinations.

### A6.2.2 Company obligations under competition law

The water sector is subject to UK and, where relevant, European competition law as well as sector-specific requirements. At a high level, one of the reasons for the legal framework is to ensure that there is a level playing field such that a new entrant (in this instance into the non-household retail market) would face no unreasonable barriers in trying to compete on its merits with the incumbent service provider.

While these obligations have existed in the sector for some years, Ofwat’s new primacy obligations (where it must give primary consideration as to whether to use its concurrent competition powers before exercising its direct regulatory powers) together with the opening of the non-household retail market in April 2017 will place a greater focus on these issues than the sector has experienced in the past.

---

³ For example, companies’ licence condition R, which prohibits companies showing any undue discrimination against, or undue preference towards, customers or potential customers of a licensed water supplier or a licensed water supplier.

⁴ Effectively, Ofwat must consider whether it would be more appropriate to proceed under the Competition Act 1998 before making enforcement orders or imposing financial penalties under the Water Industry Act 1991.
For the avoidance of doubt, although there may be some general guidance available from the CMA and/or Ofwat, compliance with these obligations is always a matter for companies and each company will need to consider the right approach for them and bear the risks of that approach. This is both because there is no single approach that will ensure absolute compliance with competition law in all circumstances\(^5\) and because of the wide variance in company sizes and structures – a one-size fits all approach is unlikely to fully address these risks for everyone in the sector. Accordingly, although our assessment of companies’ non-household retail submissions in PR14 has been ‘light touch’, this is not reflective of the importance of the issues, merely the fact that the ownership of these risks under competition law remains with companies and their boards.

### A6.2.3 Issues raised by representations

For details on specific representations on our draft determination proposals for individual companies, please refer to the company-specific appendices for these final determinations. Below, we set out an overview of the general nature of the representations we received.

**Table A6.3 Representations on our approach to non-household retail controls for companies operating wholly or mainly in England**

<table>
<thead>
<tr>
<th>Company</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANH, SEW, SRN, TMS, UU and WSX</td>
<td><strong>Price base</strong>: stated that 2013-14 costs should not be deflated to 2012-13 prices (as they were in the draft determinations).</td>
</tr>
<tr>
<td>DVW, NES, PRT, SES, SEW, SRN, SSC, TMS, UU, WSH, WSX and YKY</td>
<td><strong>Cost and net margin allocations</strong>: proposed revised cost and net margin allocations between their non-household retail customer types.</td>
</tr>
<tr>
<td>AFW, ANH, SES, SSC, SVT, SWT and UU</td>
<td><strong>Base-year costs</strong>: provided further explanations of their base-year (2013-14) costs, following our request at draft determinations.</td>
</tr>
</tbody>
</table>

\(^5\) There are different approaches that may minimise these risks for companies see chapter 2 of the MAP document for further information: [http://www.open-water.org.uk/media/1142/map-main-document-2.pdf](http://www.open-water.org.uk/media/1142/map-main-document-2.pdf)
A6.2.4  Our final determinations

A6.2.4.1  Price base

Companies were required to submit their June business plan retail tables in 2012-13 prices. This was consistent with our requirements for companies’ December 2013 business plans, as set out in our July 2013 business plan guidance.

In the draft determinations we set the retail controls using companies’ actual reported 2013-14 costs deflated by the difference between 2012-13 and 2013-14 price levels. This helped provide a degree of comparison between the retail and wholesale controls, as the draft determination proposals for the wholesale controls were presented in 2012-13 prices.

As stated in our final methodology statement, we have set the final retail controls based on companies’ (non-deflated) actual 2013-14 costs (prior to any subsequent adjustments).
A6.2.4.2 Cost and net margin allocations

With the exception of United Utilities – where we had specific concerns with some proposals (see the company-specific appendix for further details) – we accepted all of the updated allocations proposed by companies based wholly or mainly in England. This is consistent with our approach to leave the accountability for compliance with obligations, including competition law, with the companies.

A6.2.4.3 Base-year costs

Six of the seven companies from which we requested further information were either able to sufficiently demonstrate, through their representations:

- the validity of their base-year 2013-14 costs as a basis for setting the non-household price controls; or
- supplied information that allowed us to confirm that the use of an alternative historical year as the basis would have no effect on the 2015-20 cost allowances.

Consequently, we have accepted these companies’ representations for using 2013-14 as the base year for their non-household retail price controls in our final determinations. United Utilities is the only company where we have intervened to reduce the actual 2013-14 costs for the purpose of setting its non-household retail average revenue controls (see the company-specific appendix for further details).

A6.2.4.4 Input price pressures

None of the three companies that provided representations on our draft determination proposals in respect of input price pressures for the non-household retail price controls provided sufficient evidence that an additional cost allowance was required for their controls. We have therefore maintained our approach of allowing no specific uplift to the actual historical costs for input price pressures – so that input price pressures and risks will solely be remunerated through the non-household retail net margin.
A6.2.4.5 Material cost increases

Three companies provided representations on expected material cost increases (relative to the actual 2013-14 cost base year) not being allowed in the draft determinations of non-household retail price controls. None of them provided sufficiently compelling evidence for us to change our draft determination position (see the company-specific appendices for further details). We have therefore not allowed provision for any material (using our materiality threshold of 5.3%) cost increases in our final determinations. In reaching our decisions, we have given due consideration to the effect that allowing or not allowing these new costs could have on creating a level playing field for new entrant retailers. Our decisions reflect our concern that incumbent companies do not have additional costs allowed through the price review which would give them an unfair advantage over new entrants who are not subject to a similar price control process.
A6.3. Our methodology for companies operating wholly or mainly in Wales

A6.3.1 Our draft determinations

Our draft determinations set out the differences in our approach to setting non-household retail price controls for companies operating wholly or mainly in Wales, in line with our final methodology statement. This reflected the different policy position of the Welsh Government such that those customers in Wales using less than 50 ML of water a year are not expected to be able to choose their supplier during the next five years. As such, these companies will continue to need additional regulatory service and price protection, with the companies’ investors needing different remuneration for the different retail service risks concerned. The key differences in our approach are listed below.

- **Protecting prices – Welsh efficiency challenge.** As only a minority of non-household customers would be able to choose their retail supplier in Wales, we set an up-front non-household efficiency challenge for companies operating wholly or mainly in Wales, by comparing their costs at a customer-type level in Wales with equivalent non-household retail costs for companies operating wholly or mainly in England. Where applying the challenge did not result in net savings (because the company’s proposed business plan implied lower costs than seen in England), then we proposed to accept the company’s business plan proposal. Where we needed to intervene, the challenge was phased in over a number of years, with 25% of the challenge applying in 2015-16, 50% in 2016-17, 75% in 2017-18, and 100% thereafter. This approach aligned with our glide-path approach for applying the efficiency challenge to household retail costs for all affected companies.

- **Remunerating risk – net margins.** As only a minority of non-household customers are expected to be able to choose their retail supplier in Wales, we have proposed to set a different net margin in the non-household retail controls relevant to customers who use less than 50 ML of water a year who are expected to continue not to have a choice of supplier. As we stated in our January risk and reward guidance, we consider a net margin of 1.0% to be appropriate to remunerate the capital employed and the risks that companies bear in supplying such customers, aligned with the allowed margins for supplying household retail customers.
• **Protecting service – service incentive mechanism (SIM).** Non-household customers served by companies operating wholly or mainly in Wales would continue to receive service level protection through a version of the SIM (a mechanism designed to improve the level of service that water companies provide).

As with the companies operating wholly or mainly in England, our draft determinations for the two companies operating wholly or mainly within Wales set allowed average retail revenues for each company’s proposed customer types. This comprises a retail cost per customer, and a net margin. The net margin is to be applied to both retail costs and wholesale charge revenues relevant to supplying that customer type.

We outlined our approach to the non-household retail controls in section A5.2 of the non-household retail technical appendix to our August draft determinations.

For Dee Valley Water, we set out our specific proposals in annex 2 to the non-household retail technical appendix to our August draft determinations. For Dŵr Cymru (who had already received early notice of our proposals in relation to the other price controls), we set out the proposals in the draft determinations for Affinity Water, South West Water, Dŵr Cymru and Northumbrian Water.

In section A5.3 of the non-household retail technical appendix to our August draft determinations, we outlined our assessment of companies’ proposals against this overall framework. Further details of our proposed interventions, following consideration of the companies’ proposals, were provided in:

- the relevant company-specific appendices in our August draft determinations;
- the non-household retail technical appendix to our August draft determinations; and
- the draft determinations for Affinity Water, South West Water, Dŵr Cymru and Northumbrian Water.

Our assessment framework and basis for interventions for companies operating in England, outlined in section A6.2.1 above, was also consistently applied to our assessment of the business plan proposals of Dee Valley Water and Dŵr Cymru for this purpose. However, we summarise some additional issues that we raised in our draft determinations, specific to these two companies, below.
• **Interventions on cost and net margin allocations for customer types.** Dee Valley Water was the only company in the sector where we intervened on the cost allocations it proposed in its revised business plan. The company had not provided separate cost allocations for customers above and below the 50 Mi threshold. This meant that, had we not intervened, we would not have been able to apply an efficiency challenge and different net margins in line with whether or not the customers were contestable, as set out in our final methodology statement.

• **Net margins interventions.** Unlike other companies, Dee Valley Water did not accept our risk and reward guidance on the net margins appropriate for the non-household retail controls in its revised business plan. Nor did it provide sufficient evidence as to its proposals, so we therefore intervened in our draft determination proposals to bring the assumed non-household retail net margins in line with those envisaged in our risk and reward guidance.

• **Welsh efficiency challenge.** We applied an efficiency challenge for Dee Valley Water in line with our methodology, as its revised business plan cost forecast was less challenging than the forecast implied by our assessment of English companies’ revised business plan proposals.

**A6.3.2 Issues raised by representations**

Both companies operating wholly or mainly in Wales provided updated cost and net margin allocations in response to our draft determination proposals (see the relevant company-specific appendices for further details).

**A6.3.3 Our final determinations**

**A6.3.3.1 Price base**

As stated in section A6.2.3, we have set all companies’ non-household retail controls based on companies’ actual 2013-14 costs (prior to any subsequent adjustments).
A6.3.3.2 Cost and net margin allocations

For the draft determinations we considered that there were significant issues with the cost and margin allocations provided in Dee Valley Water’s revised business plan. Dee Valley Water was the only company where we intervened in the allocation proposals between non-household retail customer types in order to ensure that customers were suitably protected. Following the draft determinations, the company provided updated allocations in its October representations. We consider that these represent an improvement in approach, and have therefore accepted the updated proposals.

For the draft determinations, we accepted the cost and margin allocations provided in Dŵr Cymru’s revised business plan. However, following the draft determinations, the company provided updated allocations in its October representations that we had significant concerns over. We have therefore not accepted Dŵr Cymru’s proposed updates for our final determination, and have instead retained its revised business plan proposals (see the relevant company-specific appendix for further details).

A6.3.3.3 Welsh efficiency challenge

In order to ensure that the customers of the two companies that operate wholly or mainly in Wales are suitably protected in the absence of choice, we have maintained our approach of applying a regulatory efficiency challenge.

Since companies’ October representations, we have re-run the Welsh efficiency challenge based on the above changes and the revised cost assumptions used for setting our final determinations for the English companies’ non-household retail controls. Since the draft determinations both companies have updated their approaches to allocating costs between the household and non-household retail controls. This has led to an increase from Dŵr Cymru’s proposed non-household retail costs of £8.6 million and a decrease from Dee Valley Water’s of £0.4 million over 2015-20.

This has resulted in an efficiency challenge being applied to Dŵr Cymru of £4.6 million and no challenge being required for Dee Valley Water, as the company now appears relatively efficient compared to companies operating wholly or mainly in England (see the relevant company-specific appendices for further details).
A6.3.3.4 Protecting service for non-household customers wholly or mainly in Wales

Non-household customers served by companies wholly or mainly in Wales will continue to receive service level protection through the SIM, which has proved to be an effective incentive for companies to offer good and improving service levels to customers. We have adapted this incentive to ensure that it continues to respond to customer preferences, and encourages poor performing companies to improve in the service they offer to customers. In ‘Service incentive mechanism (SIM) for 2015 onwards – conclusions’, we set out how we propose to regulate using the SIM in the future, including for non-household customers of companies wholly or mainly in Wales.

For details on companies’ specific performance commitments please refer to our company-specific appendices.
A6.4. Form and duration of control for all companies

A6.4.1 Our draft determinations

In section A5.4 of the non-household retail technical appendix to our August draft determinations we sought views on changes to the form of the non-household retail control. In particular, we sought views on the length of the control, which was originally envisaged to last for five years.

Despite the intervening work since December business plans were submitted, we noted (as part of our August draft determinations) that there were continuing significant differences in the approach to cost and net margin allocations across companies’ revised non-household retail business plan proposals.

These differences may make it more difficult for companies to assess their compliance with their duties and obligations, including competition law. We therefore recognised that some companies could benefit from having further time to consider and address any such issues ahead of the introduction of more competition into the non-household retail market in April 2017.

Given this background, we invited views on whether companies should seek for us to:

- set their non-household retail control for five years, retaining the duration envisaged in our final methodology statement; or
- change the form of control in some way to allow them greater time to consider and address any issues we had highlighted. For example, through a shorter duration control or a form of reopener to the price control within the originally-proposed five years.

As part of their representations on our draft determinations, we asked for companies to provide evidence of customer engagement and support in relation to their proposals on this matter.

A6.4.2 Issues raised by representations

All but one of the companies (Dee Valley Water) provided specific views on the non-household retail form of control in their representations.
Through their representations and query responses, all companies showed support for some form of review in 2016 before the new market arrangements in 2017, although some considered that such a review should be optional.

Dee Valley Water later stated in a query response that a review of the non-household retail control after two years would be appropriate.

Many companies made specific proposals (see section A6.4.4 below for further details).

In many cases we received responses from the companies’ customer challenge groups (CCGs) directly (see section A6.4.4 below for further details).

A6.4.3 Our final determinations

Although we were not expecting a common, sector-wide solution to emerge from companies’ representations, a clear preference arose for a further review of aspects of the non-household retail controls in 2016 before the changes in market arrangements in 2017.

While there is a clear rationale for companies operating wholly or mainly in England to be covered by such a review in 2016, there may be a question about whether or not companies operating wholly or mainly in Wales should be included given, for example, the difference in the policy positions of the Welsh and UK Government with respect to introducing further retail choice and competition in the sector. Both of the Welsh companies supported a review in 2016 and both currently have a small number of customers that are and will continue to be contestable under the Water Supply Licensing framework that the new Water Act is amending (customers using over 50 ML of water per year), so we see the scope of a review as still being relevant for appointees operating wholly or mainly in Wales. It is possible that the opening of the English market in 2017 could increase the intensity of competition for those currently contestable customers in Wales, thus placing an even greater focus on robust cost allocations.

A number of companies and their CCGs proposed that any adapted approach should be applied sector-wide to ensure a level playing field, and to ease communication with customers. Furthermore, given the concerns we had with Dee Valley Water’s cost allocations in the draft determinations, and Dŵr Cymru’s revised allocations submitted in October (as set out in section A6.3.3.2), there may be scope for improvement in both companies’ approaches to cost and net margin allocations.
We therefore consider that there would be benefits of having a sector-wide approach to such a review, to ensure that all companies are on a level playing field when the English non-household retail market fully opens, and to give the companies operating wholly or mainly in Wales further opportunity to improve their allocation approaches.

Thus, as no company provided convincing justification to have a bespoke form of control (see section A6.4.4), we have decided that the basic form of control set out in our final methodology statement should be implemented for all companies, but with a two-year initial duration, and with a review carried out in 2016. This will apply a consistent approach across the sector.

We have already set out our expectations that companies may need further time to review the structure of their 2015-16 charges before market opening. Giving the companies the opportunity to review the cost and margin allocations between non-household customer types reflected in non-household retail controls and default tariffs before market opening may also help companies manage compliance with their duties and obligations, including competition law. It is therefore consistent with our approach of leaving such accountabilities with the companies, while recognising the need for responsiveness to the evolving market and regulatory landscape.

A number of companies proposed for such a review to be optional. However, they did not provide any specific proposals on how such optionality would align to their current licence requirements. We have therefore (and for the reasons stated above) applied a consistent approach across the sector. However, if, in 2016, companies consider that their allocation approaches are still robust, they may have the option not to update their allocations.

For the avoidance of doubt, we are not proposing for the scope of the 2016 review to include new non-household retail cost claims from the companies. The costs we have set out in the company-specific appendices are expected to remain the basis of our controls throughout the period from 2015 to 2020.

---

6 See ‘Consultation on wholesale and retail charges for 2015-16 and charges scheme rules’ and IN 14/14, ‘2014 price review – non-household customer engagement ahead of draft determination representations’ for further details.
Also, we do not expect the allowed net margin in aggregate across non-household customer types to change from that set out for non-household retail services in our risk and reward guidance. The review will focus only on non-household retail controls and hence will not result in changes to the wholesale and household retail controls included within our final determinations.

Accordingly, we expect the 2016 review to focus only on the cost and net margin allocations between different non-household retail customer types covered by the non-household retail controls relevant for default tariffs. The review may also consider the duration of controls set from April 2017. The existing company licences allow us to set retail controls of different durations, and it may be appropriate to seek views on whether the next control should last for three years (to 2020) or for some other period of time. However, as noted above, we do not expect controls for a period to 2020 to vary the overall levels of allowed non-household retail costs and net margins from those set out in these final determinations.

It should be noted that, although the companies’ licences have been amended to allow retail controls to be set for different periods (with each year of the control to be expressed as a ‘charging year’), there is some misalignment in the drafting of the interim determination of controls\(^7\) in Part 4 of licence condition B. The licences state that any necessary adjustments to price controls must be calculated up to “the first of the charging years for which the next Periodic Review falls to be carried out”.

Our decision to set two year controls and carry out a sector-wide periodic review of non-household retail controls in 2016 therefore creates a degree of consequential complication in relation to these pre-existing licence provisions for interim determinations, namely:

- any company applying for an interim determination in 2015 would probably receive less money (regardless of which price controls were affected by the costs concerned) because only the 2015-16 and 2016-17 charging years will be relevant for the purposes of calculating any necessary adjustments to the level of price controls; and
- interim determinations would not be possible in 2016 (regardless of which price controls were affected by the costs concerned) because the level of price controls could only be changed for the 2015-16 and 2016-17 charging years before 2017.

\(^7\) These issues do not apply to the substantial effects clause.
This may not be an issue in practice if an interim determination was not sought in the first two years of the control period (applications are normally made in the third and fourth years).

Companies are well aware of their licence conditions, and no company proposed an early licence change to address this licence drafting issue as a consequence of their support for a 2016 review of aspects of the non-household retail control.

If a company were now to propose a licence amendment to address the slight misalignment in the drafting of the interim determination provisions given our decision on the duration of the non-household retail control, we would consider the company’s proposal based on the particular merits of its proposal.

We have set out below a proposed timeline for the 2016 review.

**Table A6.4 Proposed timeline for the 2016 non-household retail control review**

<table>
<thead>
<tr>
<th>Date</th>
<th>Milestone</th>
</tr>
</thead>
<tbody>
<tr>
<td>29 July 2016</td>
<td>Companies submit their cost and margin allocations following publication of their audited 2015-16 regulatory accounts and regulatory report. The total proposed non-household retail cost levels for the years 2017-18 to 2019-20, and the aggregate non-household net margin for the relevant customer classes, must comply with the levels set out in the final determination company-specific appendices.</td>
</tr>
<tr>
<td>16 September 2016</td>
<td>Following consideration of relevant evidence, Ofwat issues draft non-household retail determinations for the period after April 2017 for consultation.</td>
</tr>
<tr>
<td>28 October 2016</td>
<td>Companies respond to Ofwat’s draft determinations with representations, further evidence and revised proposals if required.</td>
</tr>
<tr>
<td>16 December 2016</td>
<td>Ofwat publishes the final non-household retail determinations for the period from 1 April 2017.</td>
</tr>
<tr>
<td>1 April 2017</td>
<td>New charges come into effect and the retail market opens.</td>
</tr>
</tbody>
</table>

We will issue the relevant data submission templates for companies to complete ahead of 29 July 2016, to facilitate an orderly review process.
We may also issue a consultation in advance, to gain wider views on whether the next control should last for the three years to 2020 or for some other period of time.

A6.4.4 Companies’ specific proposals

As described above, there was broad support for a review in 2016; however, there was variation in the exact approach proposed. Companies’ specific proposals are set out below.
### Table A6.5 Companies’ specific proposals for the form and duration of the non-household retail control

<table>
<thead>
<tr>
<th>Company</th>
<th>Proposal</th>
<th>Our determination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anglian Water</td>
<td>The company proposed for the non-household retail control to be re-opened once for the industry as a whole, to allow retail charges to be re-set as appropriate based on new cost data for the charging year 2017-18.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry. Although for the avoidance of doubt, the new cost information will only inform cost allocations between non-household retail customer types, it will not form the basis of new cost claims by companies.</td>
</tr>
<tr>
<td>Dŵr Cymru</td>
<td>The company proposed an optional review in 2016, with the review being triggered by a notice sent either from Ofwat or the company by 30 June 2016.</td>
<td>Beyond there being a review in 2016, we do not consider the company’s specific proposal to be appropriate. A notice sent on 30 June 2016 would not be appropriate as companies’ accounts will not be published by then, therefore there would be limited new information to base a decision on whether a review should take place. Furthermore, based in part on the feedback from companies, we now consider that there may be benefits in having an industry-wide review. If in 2016 the company considered that its allocations were still robust, then it could restate its allocations in the 2016 review.</td>
</tr>
<tr>
<td>Northumbrian Water</td>
<td>The company proposed an optional review in 2016.</td>
<td>Beyond there being a review in 2016, we do not consider the company’s specific proposal to be appropriate as we consider that there may be benefits in having an industry-wide review. If in 2016 the company considered that its allocations were still robust, then it could restate its allocations in the 2016 review.</td>
</tr>
</tbody>
</table>
Company | Proposal | Our determination
---|---|---
Severn Trent Water | The company made a series of proposals as to the form of control, including:
1) Changing for the form of control to be a total revenue control with individual modification factors (like the household retail control) for each of the different non-household customer types.
2) Annual tariffs to be set by the company through the annual charges process.
3) Specified levels of over-recovery that would trigger a review, including a review in 2016 if required. | Beyond there being a review in 2016, and tariffs to be set by the company through the annual charges process, we do not consider the company’s specific proposal to be appropriate.

The company’s first proposal would represent a major change to the form of control very late into the process. The company does not appear to have engaged with its customer forum on this feature of its proposals.

The company’s second proposal represents no change from the existing process. As stated in the default tariff guidance, throughout 2015-20 companies will be able to change the charging variables associated with the default tariffs (providing they comply with the average revenue controls and companies’ other duties and obligations).

The company’s third proposal does not appear to offer any protection to customers in the event of the company overcharging. Under the existing framework, if companies do not comply with our controls, we can pursue enforcement action under a breach of licence. However, with the company’s proposals, over-recovery of less than 10% would go un-penalised, with over-recovery above 10% only being addressed through a backward-looking NPV-neutral adjustment. Furthermore, it is not clear how such an adjustment could be applied in practice, as its application could have the effect of setting controls significantly below the costs the company incurs, thus creating a significant risk of margin squeeze.
<table>
<thead>
<tr>
<th>Company</th>
<th>Proposal</th>
<th>Our determination</th>
</tr>
</thead>
<tbody>
<tr>
<td>South West Water</td>
<td>The company stated that it considered it may be beneficial to have a review within the next five years.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Southern Water</td>
<td>The company proposed a two-year control.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
</tbody>
</table>
United Utilities

The company proposed a control where there could be annual adjustments in allocations, and a re-opener for new costs and changing allocations between household and wholesale. The company also proposed that should an overall level of margin guidance, at 2.5%, be deemed incompatible with competition law then controls should also be re-opened. The company proposed for the approach to be industry-wide.

Beyond there being an industry-wide review in 2016, we do not consider the company’s specific proposal to be appropriate. For the following reasons:

- Having an annual review would create a significant degree of regulatory burden, and potential uncertainty for customers.
- We can see no benefit to customers from companies making new cost claims so close to market opening when we will have already determined appropriate costs for the period 2015-20. We have made specific allowances for market opening costs through the wholesale control, and have not applied an efficiency challenge to companies’ non-household retail controls (for companies operating wholly or mainly in England). As no company has been able to sufficiently demonstrate that material new costs will be incurred, we consider that companies should be able to manage any new costs within the overall revenue allowance.
- Changing allocations between retail and wholesale would equate to a re-opening of the wholesale control. Not only is this currently incompatible with companies’ licences, but could have some serious implications for regulatory stability.
- We consider the 2.5% margin to be appropriate in size for companies to manage their competition law risk. Furthermore, any complaints would be made on an individual basis, not on the aggregate 2.5% net margin. Therefore, there will be no case law that will determine the aggregate margin that companies have adopted to be incompatible with competition law.
Final price control determination notice: policy chapter A6 – non-household retail costs and revenues

<table>
<thead>
<tr>
<th>Company</th>
<th>Proposal</th>
<th>Our determination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thames Water</td>
<td>The company stated that it would be supportive of a review in advance of or after the first year of market opening.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Wessex Water</td>
<td>The company proposed for there to be a review for 2017.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Yorkshire Water</td>
<td>The company proposed an option of a re-opener when better information becomes available. However, the company did not state how such a re-opener could work in practice, given the existing licence conditions. In a query response the company stated that it would prefer a planned review during 2016-17 with the flexibility to re-open controls in the first two years of the period to help manage incidence effects.</td>
<td>Beyond there being a review in 2016, we do not consider the company’s specific proposal to be appropriate as setting a control for a single year would not provide a full year’s worth of data of the new controls to base new determinations on. Furthermore, it is not clear how having an additional review would help manage incidence effects (as per the company’s stated intention), as companies would always need to allocate their non-household retail costs on a cost reflective basis. In addition, for a given customer type, providing that the company complies with its duties and obligations, the company could consider pricing below the average revenue controls to help manage incidence effects, and we discussed alternative ways of managing incidence effects in our ‘Consultation on wholesale and retail charges for 2015-16 and charges scheme rules’.</td>
</tr>
<tr>
<td>Affinity Water</td>
<td>The company proposed for controls to be fixed for two years and then reviewed.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Company</td>
<td>Proposal</td>
<td>Our determination</td>
</tr>
<tr>
<td>-------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Bristol Water</td>
<td>The company proposed a two year and then a three year non-household retail</td>
<td>Beyond there being a review in 2016, we do not consider the company’s specific proposal to be appropriate. That is, we can see no benefit to customers from companies making new cost claims so close to market opening when we will have already determined appropriate costs for the period 2015-20. We have made specific allowances for market opening costs through the wholesale control, and have not applied an efficiency challenge to companies’ non-household retail controls (for companies operating wholly or mainly in England). As no company has been able to sufficiently demonstrate that material new costs will be incurred, we consider that companies should be able to manage any new costs within the overall revenue allowance.</td>
</tr>
<tr>
<td></td>
<td>price control as the most appropriate way forward, to allow for reconsideration of known market opening costs and customer preferences for tariff structures ahead of market opening in 2017</td>
<td></td>
</tr>
<tr>
<td>South Staffordshire</td>
<td>The company proposed for there to be a two-year control.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Water</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dee Valley Water</td>
<td>The company did not provide views on the form of control in its representations. This is disappointing as we had requested companies to engage with their customers on the form of control, and had given companies notice ahead of the draft determinations that this would be the case through ‘IN 14/14: 2014 price review – non-household customer engagement ahead of draft determination representations’.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Company</td>
<td>Proposal</td>
<td>Our determination</td>
</tr>
<tr>
<td>----------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Portsmouth Water</td>
<td>The company proposed for there to be a two-year control.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>Sembcorp Bournemouth Water</td>
<td>The company proposed for there to be a two-year control.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td>South East Water</td>
<td>The company proposed to re-open price controls either in 2015-16 or 2016-17.</td>
<td>We consider this to be consistent with the approach we have set out above that will apply to the whole industry.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Although for the avoidance of doubt, the re-opening will only inform cost allocations between non-household retail customer types, it will not enable new cost claims by companies.</td>
</tr>
<tr>
<td>Sutton &amp; East Surrey Water</td>
<td>The company proposed for controls to be set for a maximum of two years, with the facility for controls to be re-opened for 2016-17 if significant issues emerge.</td>
<td>Beyond there being a review in 2016, we do not consider the company’s specific proposal to be appropriate as setting a control for a single year would not provide a full year’s worth of data of the new controls to base new determinations on.</td>
</tr>
</tbody>
</table>
We requested companies to engage with their customers on the form of control, and gave companies notice ahead of the draft determinations that this would be the case through IN 14/14, ‘2014 price review – non-household customer engagement ahead of draft determination representations’.

In many cases we received responses from the companies’ customer challenge groups (CCGs) directly. The table below summarises responses we received.

**Table A6.6  CCG representations on the form and duration of the non-household retail price control**

<table>
<thead>
<tr>
<th>CCG</th>
<th>Summary of response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anglian Water Customer Engagement Forum</td>
<td>Supports the idea of reopening the tariffs once in 2017-18. Considers that the approach should be consistent for all water companies.</td>
</tr>
<tr>
<td>Customer Challenge Group, Dŵr Cymru Welsh Water</td>
<td>Company’s proposal seems sensible, especially should there be changes in Welsh Government’s current position and impacts from the implementation of the recommendations of the Silk Commission, although do not feel able to provide an informed view on the proposed non-household retail plan.</td>
</tr>
<tr>
<td>Northumbrian Water Forum and the Essex &amp; Suffolk Water Forum</td>
<td>Considered the company’s proposal to be reasonable, but did not feel well qualified to comment.</td>
</tr>
<tr>
<td>Southern Water Customer Challenge Group</td>
<td>Supports the engagement that the company has undertaken with customers. The results of the research suggest customer support for the company’s proposals.</td>
</tr>
<tr>
<td>The Customer Challenge Group on behalf of United Utilities</td>
<td>Supports the company’s proposals.</td>
</tr>
<tr>
<td>Wessex Water’s Customer Scrutiny Group</td>
<td>The CSG is satisfied with the robustness and effectiveness of the company’s research. The results of which supports the company’s approach.</td>
</tr>
<tr>
<td>CCG</td>
<td>Summary of response</td>
</tr>
<tr>
<td>-----------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Yorkshire Water Customer Forum</td>
<td>Considers this to be a complex issue, and that given the time constraints there was limited scope for meaningful research with small and medium size businesses.</td>
</tr>
<tr>
<td>Affinity Water Customer Scrutiny Group</td>
<td>Content with the company's proposals.</td>
</tr>
<tr>
<td>Bristol Water’s Local Engagement Forum</td>
<td>Believes that a two-year control, followed by a three-year control represents the best compromise and a logical way forward.</td>
</tr>
<tr>
<td>South Staffs Water CCG</td>
<td>Supports a shorter-term price control.</td>
</tr>
<tr>
<td>Customer Engagement Planning Forum (for Sembcorp Bournemouth Water)</td>
<td>Support a two-year control.</td>
</tr>
<tr>
<td>South East Water Customer Challenge Group</td>
<td>For the option of a re-opener to be there should it be detrimental to customers if the controls were not re-opened, with the re-opening criteria set out clearly in advance.</td>
</tr>
</tbody>
</table>

In most cases, the CCGs supported the companies' proposals – our determinations on which are set out above. However, some CCGs considered that they were unable to provide a well-informed opinion.
Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water sector in England and Wales provides customers with a good quality and efficient service at a fair price.