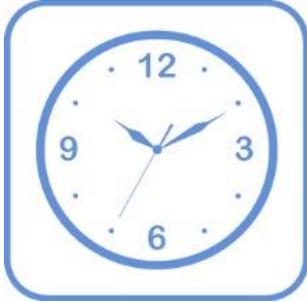




Access pricing working group

Meeting 1
21 March 2014

Agenda



Introduction (10 mins)

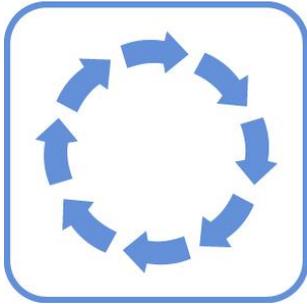
Main issues (25 mins)

Other sectors (25 mins)

Bulk supplies (20 mins)

Retail access (20 mins)

Actions and next steps (20 mins)



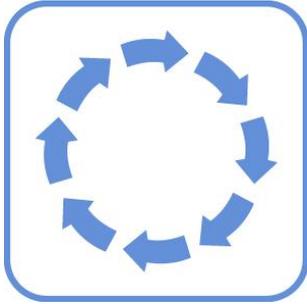
The government's Water Bill will allow for new entrants to become licenced providers of certain wholesale services.

In providing such services, the entrants will need to interact with the incumbents. For example, the entrant may need to transport water through an incumbent's network, for which there will need to be an associated charge.

While the government does not envisage implementing the upstream reforms until 2019 and beyond, developing an effective access pricing framework is a complicated endeavour, and will take time.

There are also linkages to a number of other areas of regulatory policy, such as network plus, charges schemes, market codes, licences, AIM, and the next price review.

Background



In setting rules, Ofwat will have regard to any guidance issued by the Secretary of State for Environment, Food and Rural Affairs, and Welsh Ministers.

So far Defra has published a set of charging principles.

Main issues

Preventing monopoly abuse

Incumbent companies will remain vertically integrated. Therefore charges will need to be set on a non discriminatory basis for third parties

Selecting the right level of cost information

The more detailed the cost information used, the more effective the price signals that access pricing could send. But asking companies to collect more data bears a cost

De-averaging

Effective price signals for access will require some consideration of local costs. There are a number of approaches that could be used to limit the effect on end customers' bills

RCV discount

The industry's RCV is about 12% of net MEAV. This creates challenges in setting cost reflective access prices that enable competition on a level playing field

Main issues

<p>Helping the environment</p> <p>Access pricing will need to stay flexible to future abstraction reform</p>	<p>Interactions with the 2014 price review</p> <p>Access pricing will need to suitably align to our price control incentives, so that there are no unintended distortions in the incentives that companies face</p>
<p>Interactions with the Open Water programme</p> <p>The Open Water programme will facilitate the implementation of market reform. Any processes or systems it develops will need to enable the new access pricing framework</p>	<p>Are there any other key issues?</p>

Approaches to access pricing



There are a number of precedents from other industries, including:

Post – uses an ex ante margin squeeze test. LRIC models to be used.

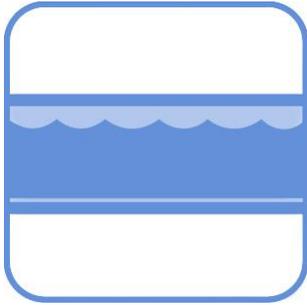
Rail – uses SRMCs plus mark-ups.

Telecoms – top-down LRIC-based models adjusted to take account of bottom-up engineering models. DLRIC floors and DSAC ceilings used to test cost orientation.

Gas & electricity – separate transmission and distribution pricing. Standardised methodologies reached through industry forums.

Does the working group consider any particular precedents to be more appropriate for water?

Bulk supplies



The Water Bill also seeks to provide Ofwat with the ability to set charging rules for bulk supplies.

It may be desirable for Ofwat to consider the charging approach for bulk supplies alongside access pricing, as there are many similar issues to be resolved across these two areas.

Do working group members have any views on bulk supplies being included within this forum?

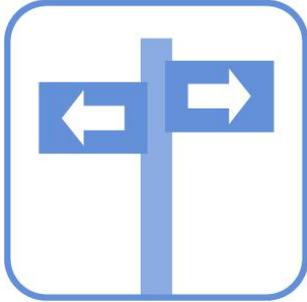
Are there any specific issues relating to bulk supplies that we should take account of?



As part of the price review we will be setting separate retail and wholesale controls. For 2015-16 companies will produce wholesale charges.

Can working group members envisage any situation where the retail access price would not simply be the wholesale charge?

Actions and next steps



What is the best way to progress the workstream?

What is the best forum(s) to progress the work?

Are there any key issues that need to be addressed upfront?

Thank you for your time