

# Approval of charges 2015-16 – information and requirements for large and small companies

## About this document

This document sets out further information about our approach and the information we require from companies for us to approve their 2015-16 charges. It supports and should be read alongside information notice [‘IN 14/17: Approval of charges 2015-16 – our approach, process and information requirements for large and small companies’](#).

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## 1. Risk-based approach

Throughout the 2014 price review process we have sought to take a risk-based approach, where companies that demonstrate that they are producing robust and customer-focused plans are subject to less regulatory scrutiny.

We recently published a [‘Consultation on regulatory reporting’](#). The consultation set out a graduated assurance model for future reporting, and we will set out the implications for affected companies in the final determinations.

In the spirit of the risk-based approach to date and the future graduated assurance model, we have put companies into three different categories based on their 3 October charging submissions. The category determines the level of additional assurance we require companies for 2015-16 charges approval. To be clear, these categories do not indicate the assurance category for the overall company under the graduated assurance framework. The quality of 2015-16 charging submissions is just one factor we will take into account when determining the (initial) overall assurance category. And for the avoidance of doubt, these categorisations are separate from the risk-based assessment we have undertaken of companies’ business plans as part of the price review process.

We have grouped companies into three tiers. The first consists of companies where through our high-level assessment of their charging submission we identified no material issues. The second consists of where we identified some fairly material issues, but consider these are likely to be addressed through a few relatively minor changes/additions. The third category consisted of companies that submitted charging information that contained some material and widespread issues. So, where the issues are greater, we will require a greater level of assurance from companies in advance of approving their charges.

Table 1 sets out the categorisation of companies.

**Table 1 Charging assurance company categorisation**

Submission high level assessment	Company
Tier 1 – No material issues identified at this stage	<ul style="list-style-type: none"> <li>• Affinity</li> <li>• Anglian</li> <li>• Severn Trent</li> <li>• South West</li> <li>• United Utilities</li> <li>• Wessex</li> </ul>
Tier 2 – Some fairly material issues identified	<ul style="list-style-type: none"> <li>• Dŵr Cymru</li> <li>• Northumbrian</li> <li>• Sembcorp Bournemouth</li> <li>• South East</li> <li>• South Staffs</li> <li>• Southern</li> <li>• Sutton &amp; East Surrey</li> <li>• Thames</li> <li>• Yorkshire</li> </ul>
Tier 3 – Material and widespread issues identified	<ul style="list-style-type: none"> <li>• Bristol</li> <li>• Dee Valley</li> <li>• Portsmouth</li> </ul>

Our review of companies' charges has not been definitive in scope and detail. For example, in many cases we have not checked the validity of the charging multipliers companies have proposed. This has simply not been possible in the timeframes available to us, and is not in keeping with a risk-based approach. So, it should not be taken for granted that even a company placed in tier 1 will necessarily comply with the price controls, competition law, and/or its other duties and obligations if its final proposals reflect the draft proposals that we have reviewed. It is ultimately for the companies to ensure that they comply with these obligations (and where appropriate we will consider ex post enforcement). Our categorisation has been a risk-based assessment of any observable pitfalls in terms of managing bill incidence, price control compliance, and other observed and material issues.

Table 2 sets out the tiered information requirements.

**Table 2 Information requirements**

Tier	Requirements
Tier 1	<ul style="list-style-type: none"> <li>• Companies' charges schemes.</li> <li>• Statement of assurance.</li> <li>• Statement of any changes.</li> <li>• Average bill data.</li> </ul>
Tier 2	<ul style="list-style-type: none"> <li>• As for tier 1, plus the following.                             <ul style="list-style-type: none"> <li>– A statement that sets out how each of the issues we have identified have been addressed.</li> <li>– An updated version of the charging template.</li> <li>– Proportionate impact assessments and handling strategies where appropriate.</li> </ul> </li> </ul>
Tier 3	<ul style="list-style-type: none"> <li>• As for tier 2, plus the following.                             <ul style="list-style-type: none"> <li>– An independent letter of assurance.</li> <li>– A progress report by 12 December detailing how the company is seeking to address each of the issues we have identified.</li> </ul> </li> </ul>

These are minimum information requirements, and companies in each tier are free to provide greater levels of assurance if they wish – and to engage with CCWater and their customers as appropriate.

We give further details of each of these requirements in section 5. Section 6 sets out how we reached our decisions on placing each company into the relevant tier.

## 2. Standard wholesale charging schedule

In May 2014, we published our [‘Consultation on wholesale and retail charges for 2015-16 and charges scheme rules’](#). In the consultation we confirmed that to provide a degree of transparency to existing retailers, and to help progress the debate on the extent and form that charging standardisation could take in the future to support effective markets, we would require companies to populate a ‘standard schedule’ with their charges so that they all present them in the same way.

In response to the consultation, we received a large number of proposed changes by various different companies, including companies that were on the initial working group that developed it.

We sought to update the template for the feedback we received, and re-issued it to companies alongside the draft determinations. However, as part of the 3 October submission we received a large number of further proposed changes from companies.

The changes the companies proposed are varied and often in conflict with other proposed changes. Also, changes made for one company affect the schedule for all other companies. So we will re-issue an amended template following an industry workshop.

## 3. Special agreements

On 14 July 2014, section 33 of the Water Act 2014 (WA14) came into force. This section amends sections 142 and 195 of the Water Industry Act 1991 (WIA91) in relation to the reporting of information on special agreements to Ofwat and the publication of such information by Ofwat.

In relation to the reporting of information, water companies are now required to notify Ofwat of the provisions of any new special agreements they enter into with their customers. Ofwat has been given the power to take formal enforcement action to enforce this new requirement, such as making an enforcement order under section 18 of WIA91, or imposing a financial penalty under section 22A of WIA91.

### 3.1 Implications of new amendments

What this means is that, as and when companies make new special agreements, they must proactively notify us of the full provisions of those agreements. We take new special agreements to include existing special agreements where new terms are agreed on or after 14 July 2014.

Companies should send the provisions of new agreements to [special.agreements@ofwat.gsi.gov.uk](mailto:special.agreements@ofwat.gsi.gov.uk).

### 3.2 Process for 2015-16

Water companies last provided us with special agreement information in February 2014. For 2015-16, we require companies to provide us with the usual information about their existing special agreements by the end of February 2015 so that we can update the special agreement register. For the avoidance of doubt, the submission should include details about all new special agreements entered into since February 2014, including those agreed on or after 14 July (when section 33 of WA14 came into force). We have published the [template for special agreements](#) alongside this notice.

## 4. The approach for small companies

As well as the 18 largest water and sewerage and water only companies, there are six 'small companies' – Cholderton & District Water and the five 'new appointees' – that provide water and (or) sewerage services to a small number of customers.

Because these companies are very much smaller than the 18 largest companies, we have historically taken different approaches to approving their charges. We intend to continue with a lighter-touch risk-based approach for the small companies.

For example, while the small companies are not required to publish a separate wholesale charges scheme, they will need to have developed an approach to providing prices if they are approached by a retailer.

Small companies must also send us special agreement information.

### 4.1 New appointees

As with previous years, new appointees do not need to send their charges scheme to us. Instead, we require them to send us a statement of assurance. This should be signed by the company's Board or a Director of the company, authorised by their Board. The assurance statement should include the following provisions.

1. The statement must assure us that the company's charges scheme:
  - complies with its legal obligations;
  - offers levels of service at least comparable to the previous appointee's charges scheme;
  - offers prices that do not exceed those in the previous appointee's charges scheme for similar services; and
  - offers prices equivalent to those specified in the new appointee's application for each individual appointment or variation area.
2. The company must also state that it has consulted CCWater in a timely and effective manner on the introduction of any new charges. It does not need to wait for approval of the previous appointee's charges scheme before doing this.

## **4.2 Cholderton & District Water**

As with previous years we will approve Cholderton & District Water's charges scheme based on a statement of assurance provided by the company. The statement must assure us that the company's charges scheme complies with its legal obligations and that the company has consulted CCWater in a timely and effective manner on the introduction of any new charges.

## 5. Details of information requirements

In keeping with a risk-based approach, we will require a greater level of assurance from companies that had more material issues with their draft charging submissions, and apply a lighter touch to companies that have demonstrated that they are capable of producing robust charges. This additional scrutiny reflects the issues we have identified with specific companies' draft charges schemes. This scrutiny does not replace that which companies and their Boards themselves are required to undertake to satisfy themselves that their charges are appropriate, but provides us with greater certainty that companies and their Boards have indeed effectively undertaken such scrutiny.

The tiered information requirements for the 18 largest companies are set out below.

Tier	Requirements
Tier 1	<ul style="list-style-type: none"> <li>• Companies' charges schemes.</li> <li>• Statement of assurance.</li> <li>• Statement of any changes.</li> <li>• Average bill data.</li> </ul>
Tier 2	<ul style="list-style-type: none"> <li>• As per the above.</li> <li>• A statement that sets out how each of the issues we have identified have been addressed.</li> <li>• An updated version of the charging template.</li> <li>• Proportionate impact assessments and handling strategies where appropriate.</li> </ul>
Tier 3	<ul style="list-style-type: none"> <li>• As per the above.</li> <li>• An independent letter of assurance.</li> <li>• A progress report by 12 December detailing how the company is seeking to address each of the issues we have identified.</li> </ul>

We give further details of each of these requirements below.

These are minimum information requirements, and companies in each tier are free to provide greater levels of assurance if they wish.

## 5.1 Charges schemes

Companies' charges schemes are documents that:

- fix the charges that customers (including third parties) have to pay for any services provided by that company in the course of carrying out its regulated duties;
- set out the terms and conditions of those charges; and
- set out the times and methods of payment that customers (including third parties) can use to pay their charges.

As well as their end-user charges schemes, companies will also be required to provide us with their wholesale charges schemes by 16 January 2015. The wholesale charges scheme must include charges for wholesale activities associated with both households and non-households that have the effect for the same period as the end-user charges scheme. Companies can choose to set out their charges schemes in any format they consider appropriate (as long as they provide suitable transparency), but the wholesale charges publication will must include the standard wholesale schedule we will issue (see section 2). Companies will need to publish these schemes on their website each year no later than 2 February for 2015.

## 5.2 Statement of assurance

All companies are required to provide us with a charging statement of assurance. The statement should contain the following provisions.

- a. The company complies with its legal obligations (including competition law) relating to the charges set out in its charges schemes.
- b. The Board has assessed the effects the new charges have on customers' bills for a range of different customer types, and approves the impact assessments and handling strategies developed in instances where bill increases for particular customer types exceed 5%.
- c. The company has appropriate systems and processes in place to make sure that the data and information contained in the charges scheme, and additional information is accurate.
- d. The company has consulted CCWater in a timely and effective manner on their charges schemes.

The statement should also make it clear how the Board has assured itself of the above conditions. We remain committed to transparency; therefore companies will need to publish their assurance statements.

The statement of assurance should be signed by the company's Board or a Director of the company, delegated by its Board.

### **5.3 Statement of changes/how issues have been addressed**

All companies are required to set out a statement of any other changes that they have made to their charges from their 3 October draft proposals, and how these may affect bill levels and revenue recovery. This should include how any issues from the 2014-15 approvals process have been addressed, confirmation of the November RPI figure used, and the forecast infrastructure charge revenue and capital contributions deducted from the wholesale revenue. The statement will also set out companies' performance against their tariff differential targets.

Companies in tiers 2 and 3 will also be required to provide a statement that clearly sets out how they have addressed each of the issues we identified in our risk-based assessment (see section 6).

### **5.4 Average bill data**

Companies are required to provide us with a summary of their average household bills. Figures should be included for measured and unmeasured customers. For water and sewerage companies, the information must be split by the service the customer receives (water and wastewater).

For the avoidance of doubt, we are not collecting this data for validation, assurance, or verification purposes; this is purely for our information.

### **5.5 Charging template**

Tier 2 and 3 companies are required to provide an updated version of the charging template (see appendix A8 of the draft determinations) that they populated for 3 October.

## 5.6 Proportionate impact assessments and handling strategies

In our consultation on wholesale and retail charges for 2015-16, we confirmed that we expect companies to undertake proportionate impact assessments for where it is expected for customers' bills to increase by more than 5% in nominal terms (for a given customer type assuming a constant level of consumption). As part of the 3 October submission, companies were required to provide us with a minimum of 30 sample customers comparing their bills from 2014-15 to their hypothetical 2015-16 based on companies' proposed charges.

A number of companies' submissions showed bill increases for certain customer types above 5%. A number of these companies provided supporting information explaining why this was the case and stating how they intended to manage incidence effects. However, a number of other companies did not provide any comment on the significant bill increases they were proposing.

For all tier 2 and 3 companies we require them to update the bill effects analysis for their final charges, and to provide us with their proportionate impact assessments and handling strategies. These assessments and strategies need to be assured by companies' Boards. It is vital that companies understand the impact on their customers that changes to their charges may have, and that they manage significant increases carefully.

### **Proportionate impact assessment and handling strategies**

It has been a part of our governance process for charges schemes for a number of years that companies must carry out proportionate impact assessments and develop strategies for handling any incidence effects relating to significant changes.

While companies should ultimately own the content of the assessments and strategies, we expect them to broadly cover:

- an identification of the extent that different types of customers are affected by any change;
- an assessment of whether it would be more appropriate to phase changes in over a number of years, and what the implications of doing so would be; and
- an assessment of the different ways change could be managed – for example, increased customer engagement in advance/an information campaign on the different payment schemes available.

We note that some companies have raised concerns about the regulatory burden associated with producing proportionate impact assessments; however, we remain committed to this approach (at least for 2015-16). Bill stability is extremely important to customers, and where bills may need to change, we consider it essential that companies understand the effects of such changes and have clearly considered how to handle these.

We have not placed a requirement on tier 1 companies to provide us with their proportionate impact assessments for review, but where these companies anticipate significant bill increases, we would expect them to carry out impact assessments.

## **5.7 Independent letter of assurance**

Tier 3 companies are required to get an independent third party with appropriate charging expertise to provide a statement of assurance covering the same key areas as the companies' own statement of assurance (see above).

This does not replace the companies' own statement of assurance, but should sit alongside it. The third party should highlight any areas of concern. Also, if the third party were to consider that any of the provisions set out above are definitely not met, it should clearly detail why it considers this to be the case.

## 5.8 Progress report

Tier 3 companies are also required to provide us with a progress report by 12 December detailing how they are seeking to address each of the issues we have identified (see section 6).

From 12 December there will only be five weeks until companies will be required to submit their charges for approval. So we expect the tier 3 companies to have made substantial progress in addressing the issues we have identified.

Tier 3 companies should also use this update report as a means of highlighting any other material changes they will be making to their charges from their 3 October submission.

## 6. Details of categorisation

Each company was assessed on how it completed each of the four main tabs within the spreadsheet.

- The bill effects tab – this shows a comparison of bills from 2014-15 with 2015-16 proposals for a number of different customer types. We mainly use this to assess whether there are any potentially significant incidence effects. Note that these are draft numbers, and significant increases may not be observed in reality, as companies may seek to revise their proposals given our feedback and updating for the final determinations.
- The wholesale revenue tab – this shows how a company is proposing to recover its allowed wholesale revenue through its wholesale charges. We mainly use this to see if the company is forecasting to comply with the wholesale revenue limits.
- The household revenue tab – this shows how a company is proposing to recover its allowed household revenue through its household charges. We mainly use this to see if the company is forecasting to comply with the household revenue limits.
- The non-household revenue tab – this shows how a company is proposing to recover its allowed non-household revenue through its household charges. We mainly use this to see if the company is forecasting to comply with the non-household revenue limits.

Scoring guides for the tabs are shown below.

### Bill effects

Assessment	Criteria
Low risk	The company shows no bill increases above 5%. Alternatively, if bill increases are present, then there is evidence that the company has undertaken a proportionate impact assessment and developed an appropriate handling strategy.
Medium risk	The company shows some bill increases above 5% but there is evidence that the company is in the process of developing proportionate impact assessments and appropriate handling strategies.
High risk	The company shows bill increases above 5% with no evidence of proportionate impact assessments and appropriate handling strategies being undertaken.

## Revenue compliance

Assessment	Criteria
<b>Low risk</b>	The company presents charges that comply with the allowed revenues as set out in the draft determinations. Alternatively, the company may provide charges that comply with business plan projections or representations, providing it clearly states any assumptions.
<b>Medium risk</b>	While showing overall compliance, there are some unexplained issues that have the potential to lead to significantly inaccurate charges.
<b>High risk</b>	The company is forecasting significant non-compliance with the allowed revenues, and/or the spreadsheet contains a significant structural error, and/or erroneous data.

Companies have many other duties and obligations regarding their charges. For example, companies showing undue discrimination in their setting of charges may be subject to ex post licence breach investigations. Through our assessment we have not sought to assess all features of compliance – it is ultimately companies' responsibility to ensure that they comply with their duties and obligations – but rather undertake a risk-based review to identify areas where there are clear issues before companies submit their charges for approval.

We assessed which tier to place each company into within the round across all four tabs of the spreadsheet. Table 3 shows the issues we identified for each of the four key components of the charging spreadsheet that companies provided.

Where we assessed a company to be 'medium' or 'high' risk, we have provided commentary below as to the reason. As stated above, these categorisations are not fixed indications of future reporting requirements within the 2015-20 period; these relate to the production of 2015-16 charges.

Table 3 Issues identified in companies' 3 October draft charging submissions

Company (tier)	Bill effects analysis	Revenue compliance – wholesale	Revenue compliance – household	Revenue compliance – non-household
Anglian (1)	<b>Medium risk</b> – some increases above 5%, but evidence that handling strategies are being developed.	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>
Dŵr Cymru (2)	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>	<b>High risk</b> – an additional customer type was presented that was not included in the company's business plan, this suggests a potential lack of understanding of the form of control.
Northumbrian (2)	<b>High risk</b> – some increases above 5% with no evidence of handling strategies being developed.	<b>Low risk</b>	<b>Low risk</b>	<b>Medium risk</b> – while customer numbers may vary from business plan projections to reflect more up-to-date information, there were large differences in customer numbers from the business plan submission with no explanation provided.
Severn Trent (1)	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>

Company (tier)	Bill effects analysis	Revenue compliance – wholesale	Revenue compliance – household	Revenue compliance – non-household
South West (1)	Low risk	Low risk	Low risk	Low risk
Southern (2)	Low risk	Low risk	Low risk	High risk – incorrect allowed cost per customer figures were used, this suggests a lack of understanding of the form of control.
Thames (2)	High risk – some increases above 5% with no evidence of handling strategies being developed.	Low risk	Low risk	High risk – the spreadsheet provided does not show compliance, as the company grouped revenue received from a number of different customer types.
United Utilities (1)	Medium risk – some increases above 5%, but evidence that handling strategies are being developed.	Low risk	Low risk	Low risk
Wessex (1)	Low risk	Low risk	Low risk	Low risk
Yorkshire (2)	High risk – some increases above 5% with no evidence of handling strategies being developed.	Low risk	Low risk	Low risk

Company (tier)	Bill effects analysis	Revenue compliance – wholesale	Revenue compliance – household	Revenue compliance – non-household
Affinity (1)	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>
Bristol (3)	<b>High risk</b> – some increases above 5% with no evidence of handling strategies being developed.	<b>Low risk</b>	<b>High risk</b> – the company used revenue figures that did not reconcile to the draft determinations or their business plan. Therefore we could not confirm whether the company understood the form of control.	<b>High risk</b> – the company used revenue figures that did not reconcile to the draft determinations or their business plan. Therefore we could not confirm whether the company understood the form of control. Spreadsheet shows over-recovery. Additional customer types were presented that were not included in the company’s business plan, this suggests a potential lack of understanding of the form of control.
Dee Valley (3)	<b>High risk</b> – some increases above 5% with no evidence of handling strategies being developed.	<b>Low risk</b>	<b>High risk</b> – the company used incorrect revenue figures, this suggests a potential lack of understanding of the form of control.	<b>High risk</b> – incorrect allowed cost per customer figures used, this suggests a potential lack of understanding of the form of control.

Company (tier)	Bill effects analysis	Revenue compliance – wholesale	Revenue compliance – household	Revenue compliance – non-household
Portsmouth (3)	<b>High risk</b> – some increases above 5% with no evidence of handling strategies being developed.	<b>Low risk</b>	<b>High risk</b> – revenue figures used slightly different from the draft determination with no explanation. Unmeasured customers appear to be receiving volumetric charges.	<b>High risk</b> – the spreadsheet provided shows over-recovery.
Sembcorp Bournemouth (2)	<b>Low risk</b>	<b>Low risk</b>	<b>Low risk</b>	<b>High risk</b> – the spreadsheet provided shows over-recovery.
South East (2)	<b>High risk</b> – some increases above 5% with no evidence of handling strategies being developed.	<b>Low risk</b>	<b>Low risk</b>	<b>Medium risk</b> – some charges were presented without multipliers.
South Staffs (2)	<b>Low risk</b>	<b>Low risk</b>	<b>High risk</b> – incorrect revenue figures used, this suggests a potential lack of understanding of the form of control.	<b>Low risk</b>
Sutton & East Surrey (2)	<b>Medium risk</b> – data not provided for the minimum 30 sample customer requirement and hence the bill effects analysis is not sufficiently robust.	<b>Low risk</b>	<b>Low risk</b>	<b>High risk</b> – incorrect allowed cost per customer figures used, and additional charges presented as customer types, this suggests a potential lack of understanding of the form of control.



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November 2014

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