

South East Water's
Response to
Consultation on the
review of non-
household retail price
controls

December 2015

1 INTRODUCTION

This document provides South East Water's response to the consultation on the review of non-household retail price controls issued in November 2015.

Overall we welcome the approach set out by Ofwat and in addition to the answered questioned below we make the following summary points:

- Agreement that the review should focus purely on the non-household function and not alter the agreed PR14 allocation principles between household and non-household.
- With the above agreement in place that aggregate levels of cost for non-household remain consistent with existing controls the review should allow companies the opportunity to alter their allocation of cost and margins within the non-household default tariff caps, if appropriate. We consider this appropriate given allocation principles are likely to have been refined given the experience of time and analysis that companies may have undertaken since the original review.
- Setup and running costs associated with the Market Operator for non-household retail remain under review and are potentially greater than assumed in the December 2014 Final Determination. We believe that Ofwat should consider the potential to allow companies to reflect these allocated non-household cost increases as part of the price control process.
- We agree with Ofwat's view that the current suite of tariffs offered by the industry show little consistency and too much diversity, and an objective of the price control review should be to achieve a greater level of consistency. To ensure this adequately takes place we believe that each company should published a methodology charges statement outlining the drivers (or approach) used to construct each tariff. We believe this document would facilitate best practice that would lead to alignment for the majority of tariffs, whilst providing a level of transparency to justify unique/diverse tariffs.
- A further issue is regarding the length of the subsequent price control for the non-household function from 2017. The consultation sets out a range of suggestions covering two, three, and five years. Our response would support three years to bring the price controls back into alignment with PR19, and allow the flexibility of re-visiting and setting the allocation of cost across all price controls.

2 ANSWERS TO SPECIFIC CONSULTATION QUESTIONS

Below are responses to the specific questions raised.

Q1. Should this review focus only on issues relating to the non-household retail price controls and the default tariff price caps?

Yes.

Q2. In considering non-household retail issues, should this review allow for the reallocation of costs and margins between default tariff price caps, but with the constraint that aggregate levels of non-household retail costs and margins remain the same as in the existing controls, consistent with the expectations set out in our final determinations??

Yes. The approach should allow companies to submit a re-allocation of cost between default tariff caps if an improved and more robust mechanism of doing so has been developed.

Q3. How can the transparency in the mapping of tariffs to the default tariff caps be improved?

For the account separation process an accompanying methodology statement is a requirement of the regulatory and statutory accounts. A similar approach could be adopted where a published methodology non-household charges statement from companies outlining the approach adopted and cost allocation drivers used to design tariffs could be made available to aid best practice and justify the company position.

Q4. Do you consider it appropriate to encourage companies to increase the consistency in default tariff cap structures and consider carefully whether the diversity in the present levels of default tariff caps is properly justified?

Opening of competition in 2017 should begin the process of ensuring that only suitable and rational tariffs remain in the industry. Incorrect and badly designed tariffs should fall away as market forces will not support these tariffs. Therefore competition, applied correctly, will ensure consistency of tariffs offered will move in a positive direction and will likely reduce the diversity offered currently.

However, it does remain clear that consumers should be given a level of protection – particularly in the early stages of the process. Improving the transparency (detailed in question 3) of tariff design should provide suitable encouragement for companies to reach a level of consistency, and provide a means of explaining where diversity or outlier tariff exists (for example specific to local environmental factors, etc).

Q5. What information should companies be asked to provide and publish in support of any proposals (including for no change) they make in respect of their default tariff caps?

Referring to question 3, we believe a methodology statement should be published to support the default tariff caps.

Q6. Do you consider it appropriate to allow companies the option not to update their cost and margin attributions and allocations, and so retain their existing default tariff price caps?

We believe it prudent that all companies should take the opportunity to review their cost allocations. Should their review conclude the original position remains robust, or no material change is warranted then the company should be allowed to retain their existing default tariff price caps. Where no change is offered, the company could support this decision with evidence to demonstrate the allocation methods remain appropriate and robust

Q7. Is a three-year duration appropriate for the next non-household retail price control and if not what is the most appropriate duration and why?

Yes we agree that a three year duration is the most appropriate duration. A three year duration will allow all price controls to be again aligned and provides the opportunity for companies to address this issue of cost allocation across all functions to ensure the correct result is delivered.

Q8. Do you agree with the proposed timetable for this review, with a statement of method in April 2016, draft determinations in September 2016 and final determinations in December 2016?

We are in general agreement with the overall timetable with the exception of the 16th June 2016 submission of data tables and evidence. We consider this deadline conflicts with our requirements to submit our regulatory accounts and does not offer sufficient time for analysis, internal review and external audit. We therefore propose that the 1st July provides a more reasonable deadline.