



South Staffs Water

Green Lane, Walsall WS2 7PD
www.south-staffs-water.co.uk

Phil Griffiths
Ofwat
City Centre Tower
7 Hill Street
Birmingham
B5 4UA

By email: NHHRetailPriceReview@ofwat.gsi.gov.uk

Dear Ofwat,

We welcome the opportunity to respond to Ofwat's consultation on the 2016 price review of non-household retail. This is an important milestone for the industry and its timing, prior to the opening of the non-household retail market, is critical. This review has significant effects on the success of the retail market in 2017 and to the future of non-household retail price controls.

We have set out our response to the consultation questions below.

Yours faithfully,

Philip Saynor,
Director of Finance and Regulation.

Responses to consultation questions.

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

Yes, we agree that the review should only focus on the non-household retail price control and default tariffs. This was part of the PR14 final determinations and is therefore what companies and investors are expecting. We also do not believe it would be in the best interests of household customers to reopen aspects of the wholesale or household retail price controls mid-term.

In Ofwat's consultation document, the benchmarking information contained in the appendix does reveal that there are inconsistencies across companies' tariff structures, gross margins and net margin allocations. We agree with Ofwat that this inconsistency is undesirable from a customer and retailer point of view when the non-household market opens in 2017. We believe that there is scope for improvements in companies' non-household tariff structures and allocation of costs and margins within the constraints of the total price control caps in the PR14 final determinations.

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, we do agree with Ofwat's proposed approach. We believe that allowing companies to restructure their tariffs and to reallocate costs and margins will go some way to removing the inconsistencies in non-household tariffs. However maintaining the total revenue cap from the PR14 determination will ultimately constrain the level of standardisation that can occur between companies. In the context of the 2016 review and the working timescales, we think that this is an appropriate balance.

From a retailer perspective, some of the gross margins within tariff bands look very low, possibly to the extent that they create barriers to entry and competition. We understand that retailers have already set out their views that the overall allowed margin (2.5%) is lower than in other sectors and raised concerns about how they can compete. This situation may benefit from further investigation.

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

South Staffs Water does not currently operate any alternate tariffs to the default tariffs. The default tariffs set out in our final determination for non-household retail are those we directly use in our non-household charges schemes.

As tariffs become more complex and varied, mapping to the overall cap will become equally complex. Rather than disclosing this complexity in difficult to follow published documents, it may be more appropriate for companies to give Board assurance that caps are adhered to.

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?

We believe that for smaller business users (i.e the smaller tariff consumption bands), it would be beneficial for companies to work towards more consistency in tariff structures. This will benefit customers by allowing easier comparability between existing and new retailers in the

market, and improve on cost reflectivity in that end of the market. For the smaller business users, it is possible that companies alone will not reach the level of standardisation that Ofwat is looking for and it may be necessary for Ofwat to set out its expected tariff granularity for this end of the market. We would suggest an appropriate scope for this to be the <50 Ml/year tariffs, as many companies have this as a boundary point.

For larger users above 50 Ml/year we believe that the ability to provide flexible and innovative tariff structures is likely to be welcomed and should not be overly constrained. Larger users are likely to value more custom tariffs which suit their consumption patterns (for example seasonal tariffs), and having different choices available in the market is likely to drive the switching decisions of these users.

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?

We believe the two suggestions within the consultation cover the necessary scope of publication for the 2016 review.

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 the evidence from the benchmarking suggests that changes would be necessary in most cases. It may be correct for a company to retain its existing tariff structures but we believe the case for retention would need to be made in the same way as a case for change would need to be made, through appropriate review and customer consultation.

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

Yes, we agree that a three year duration is most appropriate for the non-household price control. A shorter duration would not give the market time to reveal how it is operating, and a longer duration would pass by the PR19 price review which would be the main opportunity to solve any fundamental issues observed in the new market.

If the non-household market opens successfully, and the 2016 review has a positive impact on tariff consistency, then it may be the case that only a limited review is needed at PR19. At this time, simple regulatory mechanisms could be introduced which adjust the price control, for example by tracking an inflation index.

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?

The timescale of the 2016 review is already challenging, including tariff design, cost allocation and customer engagement work streams. If further tariff standardisation is desired, then we are concerned with the short timescale between the publication of the statement of method and data requirements on 8 April, and the submission on 15 June. It would be therefore be helpful if the methodology principles were released earlier (ideally February), ahead of the data table requirements, to allow companies the time to design the appropriate tariffs and to gain customer support.