



Non-household Retail Price Review

Strategy & Regulation

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Dear Phil

Consultation on the review of non-household retail price controls

We welcome the opportunity to respond to Ofwat's consultation on the review of non-household retail price controls.

We highlight below our comments on the more significant points raised in the consultation, and include our detailed responses to the consultation questions in the appendix.

1. We agree that the focus of the review should be limited to the retail non-household control.
2. We propose that the default tariffs should be rebased to actual 2014-15 data for non-household customers. This would bring the default tariffs in line with more up-to-date cost data, and help to mitigate the risk that default tariffs are set at a level which could constrain the development of competition.
3. Ofwat's analysis demonstrates that applying a net % margin for NHH retail to each statutory undertakers' wholesale charges gives rise to variations in the £ per annum NHH retail margin across the country. For example, applying a 2.5% margin in South West Water's area means that there is a much bigger £ per annum margin in the South West than in, say, Thames Water's area where wholesale charges are significantly lower. This approach risks distorting competition (e.g. new entrants might be artificially drawn to areas where the wholesale charge is highest) or restricting competition (e.g. new entrants might choose not to enter the market at all if they are they believe that the current pattern of margins is unsustainable, and prone to change). Against this background, we would strongly encourage Ofwat to set default tariffs by reference to the average industry-wide wholesale charge, so that margins are uniform in £ per annum terms across the country.

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4. We agree that three years seems sensible for the duration of the next non-household retail price controls, and – from 2020 – we would expect the retail NHH control to be for a shorter period than the wholesale controls.
5. We would be grateful if Ofwat could produce its statement of method and data tables earlier than 8 April 2016 to allow companies sufficient time to understand the scope of the review, collect data, prepare responses, complete data tables and undertake appropriate assurance. The current proposal of only allowing a little over two months we consider to be insufficient. We also consider that 15 June 2016 is too early to incorporate data from the 2015-16 accounts, given the assurance that will be necessary for the completion and sign-off of the data tables.
6. We assume that the outcome of the NHH retail review would be subject to a CMA appeal, if required, and for this to be reflected in the timetable. It would be helpful if Ofwat could confirm this.

I hope these points are clear. If there are any points that require clarification or elaboration, then please do not hesitate to contact me.

Yours sincerely



Nick Fincham
Director of Strategy & Regulation

Appendix 1 – Detailed responses

Consultation questions:

Key Consultation questions

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

The scope of the review should be limited to the retail non-household price control.

Q2 In considering non-household retail issues, should this review allow for the reallocation of cost and margin 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?

To facilitate competition and allow efficient entry by retailers we do not believe that the aggregate level of cost and margin should remain at the same level as in the existing controls. There are two pieces of new information that should be taken into account:

- Actual 2014-15 data for retail non-household shows that on average costs have increased, supporting the argument from companies at PR14 that input price pressures will exceed the potential for efficiency improvements. We believe that the default tariffs should be updated and use 2014-15, the last year of AMP5, as the base rather than 2013-14.
- It has become clear through the development of MAP credit terms that WSSL retailers are likely to pay in advance for wholesale services or fund escrow accounts. The assumption underpinning the PR14 default tariffs was that payment would be made in arrears. Our view is that the default tariffs should be increased to reflect the associated working capital cost.

Ofwat's analysis demonstrates that applying a net % margin for NHH retail to each statutory undertakers' wholesale charges gives rise to variations in the £ per annum NHH retail margin across the country. For example, applying a 2.5% margin in South West Water's area means that there is a much bigger £ per annum margin in the South West than in, say, Thames Water's area where wholesale charges are significantly lower. This approach risks distorting competition (e.g. new entrants might be artificially drawn to areas where the wholesale charge is highest) or restricting competition (e.g. new entrants might choose not to enter the market at all if they are they believe that the current pattern of margins is unsustainable, and prone to change). Against this background, we would strongly encourage Ofwat to set default tariffs by reference to the average industry-wide wholesale charge, so that margins are uniform in £ per annum terms across the country.

The tables included in the consultation highlight the very significant differences in the allocation of the gross and net margins across companies' non-household customer bases, particularly in terms of:

- the relative sizes of the tariff bands that companies have adopted;
- the way that the net margins (%) have been allocated across those bands; and
- the average retail costs attributed to each band.

From a customer viewpoint, however, changes to tariff bands or reallocation of costs and margins, increases the scope for confusion particularly as default tariff bands were only introduced in 2015-16, so the benefits of major reallocations need to exceed the cost to customers of upheaval.

Other consultation questions

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

The structure of companies' non-household wholesale and end-user tariffs, which comprise both fixed and variable elements, make any mapping of tariffs to the default tariff caps difficult. This is particularly the case where companies have very wide default tariff bands.

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?

Increased consistency of default tariff cap structures may be helpful for the development of the market.

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?

The requirement to publish further information should not be onerous, unreasonably costly (e.g. require employing external consultants in any significant way) or require the disclosure of price sensitive information in terms of detailed information by cost driver in relation to costs and margins.

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?

As set out above we consider that Ofwat should set default tariffs by reference to the average industry-wide wholesale charge, so that margins are uniform in £ per annum terms across the country. Apart from reflecting this change, companies should have the option of retaining existing cost and margin allocations.

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?

We agree that three years seems sensible for the duration of the next retail non-household price controls, and – from 2020 – we would expect the retail non-household control to be for a shorter period than the wholesale controls.

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 would be grateful if Ofwat should produce its statement of method and data tables earlier than 8 April 2016 to allow companies sufficient time to understand the scope of the review, collect data, prepare responses, complete data tables and undertake appropriate assurance. The current proposal of only allowing a little over two months we consider to be insufficient. We also consider that 15 June 2016 is too early to incorporate data from the 2015-16 accounts, given the assurance that will be necessary for the completion and sign-off off the data tables.

Other Points

We would like confirmation from Ofwat whether the outcome of the review would be subject to a CMA appeal, if required, and for this to be included in the timetable.