



Note of the charging workshop held on 12 September 2014

1. Introduction and purpose

On 12 September following a request from some incumbent companies, Ofwat held a workshop on the setting of charges following the 2014 price review (PR14). This note accompanies the [published presentation materials](#) from that meeting and outlines the key clarifications that were made by Ofwat to companies in response to questions they raised during that meeting. It also addresses some outstanding queries that Ofwat agreed to respond to subsequently.

The workshop covered:

1. **a high level overview of charging** – information on some of the key changes that are happening to the charging process;
2. **charging publication** – what companies would need to publish and when;
3. **form of controls** – the form of the price controls and implications for charge setting;
4. **social tariffs** – dealing with social tariffs and surface water drainage concessions; and
5. **filling in the template** – guidance on the information Ofwat requires for 3 October.

This note discusses each of these areas in turn.

At the start of the meeting Ofwat commented on the scale of the changes affecting charges and the importance of setting them in a way that are compliant with the new price limits, and are cost reflective, while minimising any significant incidence effects on customer bills where possible. To the extent that there is uncertainty about the correct approach amongst companies we are happy to receive further queries on these issues – these should be raised through companies' portfolio representatives and copied to Tom.Rogers@ofwat.gsi.gov.uk.

2. A high-level overview of charging

Ofwat presented some materials (see slides 4 to 7). We explained that we had taken a lighter touch approach to approving charges in the last few years, relying on companies' own assurance processes. This is consistent with both recent changes to our charges approval process and the direction of travel with the Water Act, which ultimately seeks to remove the approvals process.

But we confirmed that in the shorter term, and for this year in particular, there would need to be an approvals process as the relevant section of the Water Act has not yet been brought into force. We have also confirmed this in ['IN 14/15: 2014 price review – timetable for setting charges for 2015-16 and making menu choices'](#).

We also confirmed that companies will need to set their charges in a way best calculated to comply with the 2014 price controls and other obligations, including competition law. Given the PR14 changes and the other reforms, we have requested some specific information from companies to understand bill effects and compliance with the price controls. The approach taken to charges approval and the assurance required to charges will be informed by the information submitted by companies on 3 October.

During discussion the following additional question(s) were raised.

What level of assurance should apply for the setting of 2015-16 charges? One company asked if the financial auditor requirements in the licence for charges schemes would remain going forward. We can confirm that the licence requirements will not apply, the licence conditions have already been revised and they specifically refer to the principal statement which will not exist in the future.

We stated that the extent of assurance required for 2015-16 charges schemes would be informed by the quality of the submissions received from companies on 3 October. We intend to issue these requirements in November (as early as is feasibly possible given the volume of information that needs to be assessed).

3. Charging publication

We presented some materials (see slides 8 and 9), reiterating when companies would need to publish their charges. We also reiterated the expectation for

companies to consult with CCWater, and to engage with their customers and their representative groups as appropriate.

During discussion the following additional question(s) were raised.

To what degree can charges change between the October submission and February publication? One company asked whether there would be any scope to change their charging proposals from the October submission. We confirmed that some degree of change was expected, as companies had not yet received their final determinations, November RPI has not yet been published, and companies may gain more up-to-date information on customer demand projections, for example.

There may also be some degree of opportunity for companies to refine their charging proposals, especially following any feedback from us on their October submission. But we are not expecting there to be widespread changes.

Companies asked if the October submission should be based on the draft determinations, or their view of the final determinations. We stated that companies could use either, but would need to clearly state which basis they have used.

Would multiple charges schemes provide transparency? One company asked whether it would confuse customers having separate retail and wholesale charges. We suggested that companies could either publish a single document setting out end-user charges and wholesale charges, or have separate documents for each to allow companies some flexibility in how they presented their charges.

Will Ofwat require companies to set out the metering differentials? One company asked whether we would require companies to set out their metering differentials as part of the approvals process. We stated that this would be confirmed one way or the other when we set out the information requirements for approvals following the October submission.

Would companies have to offer different payment types? One company asked whether they would be required to offer both payment in advance and payment in arrears. In line with the price review methodology, the standard payment between retailers to wholesalers is in arrears, and wholesalers must offer [standard terms](#). Companies should set out in their charges schemes the terms and conditions that they offer. In the spreadsheet, companies should provide figures that reflect their forecasts.

Should companies include infrastructure charges in their charges schemes?

One company asked whether their charges schemes should include infrastructure charges. At this time, we consider that companies can choose whether to include infrastructure charges in a consolidated charging scheme, or present them separately, as long as they are transparent to developers and other stakeholders.

4. Form of controls

Ofwat presented some materials (see slides 10 to 12) reiterating the form of controls.

We confirmed that there had been an error in the calculation of total allowed revenues in appendix A8 of the draft determinations, and that we would issue a correction notice shortly.

We confirmed that the wholesale form of control included both revenue and capital contributions from new connections.

We explained how the household retail modification factors could be used to calculate total allowed household retail revenue.

During discussion the following additional question(s) were raised.

How should other single-till income be treated? One company queried how other forms of revenue, such as bulk supplies should be treated. We confirmed that such revenue is already netted off the allowed wholesale revenue under the form of control. So, no additional adjustments were required in reaching the revenue to be recovered through charges (provided companies had no business plan updates to provide in their representations on the August draft determinations).

How is RPI+K applied? One company queried whether RPI+K should be applied each year to the previous year's allowed revenue, or to outturn revenue. We stated that the licence answered this question, but would confirm in the meeting note. The licence states that it should be applied to the allowed revenue. So in the future, RPI+K should be applied on a compound basis to the wholesale revenue figures set out in the final determinations (the equivalent figures to the ones included in appendix A8 of the draft determinations). That is, if we set £100 million in the final determination, the allowed revenue for year two will be $£100 \text{ million} \times (RPI_{y1} + K_{y1}) \times (RPI_{y2} + K_{y2})$.

What results in a breach of licence condition B? Companies asked how non-compliance with retail controls would be assessed. We stated that the extent to which they would intervene in the event of a breach would depend on the extent of the breach and the reasons behind it (for example, there may be extenuating circumstances such as an unforeseeable weather event).

Does the revenue forecasting incentive mechanism enable companies to recover additional wholesale revenue in the latter years of the control period if they under recover in the former? As stated in the consultation on the wholesale revenue forecasting incentive mechanism for AMP6 (section A2.1) companies will be able to recover from customers (redistribute to customers) any shortfall (over-recovery) with a two-year lag, determined by the annual reporting and charging cycles. This will be subject to any penalties/bespoke investigations for going outside the cap and collar.

5. Social tariffs

Ofwat presented some materials (see slide 13) on how social tariffs and surface water drainage concessions should be treated given the new form of controls.

We reiterated that social tariff subsidies (including Watersure, and Welsh Water assist) should be allocated to the household retail control, and that surface water drainage concessions should be allocated to the wholesale wastewater control.

6. Filling in the template

Ofwat presented some materials (see slides 15 to 23) on filling in the charging spreadsheet for 3 October.

We reiterated the core purpose and intention of each tab within the spreadsheet.

We confirmed that the standard schedule of wholesale charges should cover the vast majority of companies' charges. But, if companies had a few exceptionally bespoke arrangements, it may not be appropriate to change the structure of the template to fit these few exceptions.

We confirmed that there may need to be a further iteration of the schedule ahead of the 2 February publication. We requested that if companies required any further

changes, for them to propose them by 3 October, identifying the issue and clearly stating how it should be addressed in the standard schedule.

During discussion the following additional question(s) were raised.

Should companies populate the charge for market costs in the standard schedule? We confirmed that companies should. As one of the UK Government's charging principles is to ensure that households do not pay for the costs of competition, we previously confirmed in the consultation on wholesale and retail charges for 2015-16 and charges scheme rules, that Open Water costs should be recovered through a ring-fenced charge within wholesale charges made to non-household customers. We included a specific allowance for these costs in the draft determinations¹.

Such a charge does not necessarily need to be shown as a separate component on bills (it will be for retailers to design their bills). But, such a charge does need to be entered in the standard wholesale schedule.

When will Ofwat provide feedback? Companies asked how we would be feeding back on the quality of the October submissions. We stated that we would seek to feed back as early as possible (especially around the more material issues), and would provide an overall summary in the final determinations.

Should special agreements be included in the spreadsheet? One company asked whether special agreements should be included in the spreadsheet. We confirmed that they should be included in the total revenue tabs, but they may be omitted from the standard wholesale schedule if they are exceptionally bespoke and do not fit the overall structure.

What is the interaction with the 15 October access prices? Companies asked how the bottom-up wholesale charges would interact with the 15 October publication of access prices.

We wrote to companies in [England](#) and [Wales](#) on 18 August setting out how we would set access prices in the event of having to make a determination relating to

¹ For further details see ['Consultation on Ofwat's section 13 proposal to modify the licences of all appointees in England and Wales – condition R1'](#).

non-household retail access to wholesale services (to any objectively justifiable reasons to the contrary), and clearly setting out the expectation for companies to consider moving away from a retail-minus approach. The letter also set the expectation for companies to use their draft wholesale charges (charges based on their draft determinations) as the starting point for setting access prices prior to the final determinations, and for these to be reflected in their access codes, which are due to be published on 15 October.

Some companies stated that they were intending to keep the standard format of access prices, but change the methodologies used to calculate them.

One company suggested that we should remove the requirement for companies to publish indicative access prices this year given the timing of the price control. We do not consider that the requirement should be removed for this year. Companies will increasingly be asked for access prices, and so it is important that companies have access prices ready to be offered.

How should leakage allowances be treated? One company asked whether allowances for leakage (including customer-side leakage) should be made at a wholesale or a retail level. Both wholesalers and retailers should forecast end-user demand in forecasting charges.

7. Next steps

Companies will submit the completed spreadsheet for 3 October. We will then review submissions and set out the required information/assurance requirements for the January assurance process.

Companies will submit their charges, assurances, and any (to be defined) supporting information to Ofwat for 16 January.

Companies will then publish both their wholesale and retail charges on 2 February.