



Water 2020
Ofwat – 4th floor
21 Bloomsbury Street
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10 February 2016

Dear Water 2020 team

Water 2020 Consultation

SSE has a subsidiary company - SSE Water Limited (SSE Water) - that participates in the water markets under the New Appointments and Variations (NAV) framework and is sometimes known as a “new appointee”. The consultation covers many aspects of the design of the regulatory framework for the incumbent regulated water companies from 2020. However, there are two specific areas where the consultation discusses areas of significant interest to the existing NAV model of competition in the water industry. These are the topics of: access pricing, discussed mainly in relation to market design for water resources in chapter 4 and appendix 2; and the potential to improve the NAV framework, where views are invited in Appendix 4. We set out comments on both these areas in turn below – considering specific questions from the consultation in the appendix to this letter, where these are particularly relevant.

Access Pricing

SSE Water took part in Ofwat’s stakeholder engagement activity in relation to water trading, summarised in Annex 1 to Appendix 2, and raised the matter of visibility of transportation and access charges as a pre-requisite for encouraging water trading. We therefore welcome Ofwat’s consideration of access pricing in the consultation. We consider that NAV companies are an ideal user of an access pricing framework for water resources, as this could be used to establish economic sources of treated water for NAV areas as an alternative to supply from the relevant incumbent. SSE Water has already been able to source alternative water for one of its appointed areas, where the alternative supplier had a contiguous boundary with our NAV site but we could see this extending to more geographically distant alternative sources, if a regulated access pricing framework was in place, as water could then be transported across the incumbent network from other water resource providers. This would help towards increasing competitive pressures and establishing a more economic system of water supply overall.

We certainly consider that Ofwat should set rules for access pricing and on the process issues surrounding their provision, as noted at the end of Appendix 2. In the energy industry, network access quotations have to be provided within regulated timescales to any 'person' who asks. We urge Ofwat to reproduce this framework in the developing water resource market design. Some statements in the consultation suggest that access prices are being considered only in relation to new water resource providers reaching non-household retailers. NAV companies are part of the potential supply chain between water resource providers and non household customers and should be similarly able to use appropriate access prices provided by the incumbent. In terms of the activities shown in figure 23 of the consultation, NAV companies undertake local treated water distribution and sewage collection and are hence upstream from pure retail entities – appropriate access prices should therefore be less than those proposed by incumbents for water transportation from source to non-household retailers. We would welcome greater visibility of the position of NAV companies in the various diagrams and descriptions of the context and potential interactions in the water resources market model.

We also very much support the transparency that Ofwat proposes for water resource costs and access prices. This would enable the economics of potential NAV sites to be more readily explored and the likelihood that more such sites could be feasibly developed. We have no comments at this stage on the detail of how access pricing should be developed but set out in the appendix the consultation questions of most relevance to this area and our comments in response to some of these.

Continuation and improvement of the NAV framework

In Appendix 4: Direct procurement for customers, Ofwat discusses the existing NAV framework, compares this to the development of competition for gas connections in Great Britain and notes that it is considering the potential scope to improve the current NAV framework. SSE welcomes Ofwat's continuing attention to the NAV framework, following on from the topic being raised in a discussion paper on promoting markets that accompanied the July call for inputs on the water 2020 project. SSE responded to that policy paper setting out the main areas of difficulty that NAV companies face compared with the competitive connections framework in energy, where SSE has already gained significant experience.

In brief, the areas where we believe the NAV framework can be improved are as follows:

- Regulatory control on pricing and processes for wholesale charges to NAVs at boundaries with incumbent water companies (the discussion on access pricing above is also relevant to this point);
- Criteria for allowing a NAV appointment are too restrictive, leading to the need for time-consuming scrutiny of applications – as recognised in the current consultation;
- Site by site application process is burdensome and lengthy – as also recognised in the consultation; and
- An underlying anomaly in the Water Industry Act framework allows incumbents to take different charging approaches to developer 'requisitions' compared with NAV company 'applications for connection' of the same site characteristics – a situation that we believe could be remedied through the development of appropriate charging rules for incumbents.

These are brief statements, summarising points made in earlier correspondence with Ofwat, including in response to the call for inputs. We would be very pleased to have the opportunity

to discuss potential improvements to the NAV framework at an appropriate time in the development of the Water 2020 project.

We are encouraged that Ofwat is considering the possibility of development of the NAV framework and comment below on the final few bullet points set out in the section of Appendix 4 dealing with this.

‘this might imply that NAVs could develop further over time’

We certainly believe that the NAV framework can be developed, that the success of infrastructure competition frameworks in energy demonstrates that there is a demand for such services and that these can be economically provided by non-incumbent companies. If attention is paid to developing the framework for NAVs to overcome the difficulties outlined, there is every reason to expect that NAVs would become more widespread and innovative in their approach to network design and customer benefit.

‘the appropriate regulatory approach may need to evolve over time’

We are comfortable with evolution of the regulatory approach over time and note that Ofwat has already developed its NAV policy framework to some extent over the years since 2007. We note that Ofwat is able to draw on the competitive connection experience in energy, as this has a longer history than competitive infrastructure provision in water: for example, a ‘relative price control’ approach has been used from the inception of NAV competition in the water industry, while it was introduced relatively later in the developing energy framework for competitive connections.

‘we would need to consider how any approaches we adopt might help encourage standardisation where appropriate’

We suggest that the unique position of NAV companies should be recognised in the developing water markets from the outset: NAVs are downstream from incumbent water companies but, in providing local infrastructure in their own ‘inset’ areas, are upstream from retailers. Market processes and pricing structures that recognise this fact are likely to be more long-lived, stable and ‘standard’ than those which consider NAVs as mini incumbents or, alternatively, as equivalent to large user retail customers.

NAV companies have provided one of the few types of effective competition in the water industry to date. SSE considers that their impact could be maximised and the benefits they bring in terms of efficiencies, resilience and customer focus even greater if the framework within which they operate could be improved in the ways we have outlined. We look forward to working with Ofwat on this topic, as part of the Water 2020 project and beyond.

Yours sincerely

Aileen Boyd
Regulation Manager

Response to consultation questions on access pricing

Consultation questions: water resources market design

Q7 Do you agree with our proposal to have a separate binding price control for water resources?

We understand that this approach would also entail setting a binding control for the 'network plus' element of wholesale charges. We support this, as it appears to be a sound base from which robust transportation charges can be devised.

Q8 Do you agree with our proposal to implement an offset mechanism to ensure that entrants can recover the cost of new resources appropriately, while also ensuring that prices reflect average costs?

Yes.

Q9 Do you agree with our proposals to create a market information database and bid assessment framework to allow for the 'bidding in' of third party resource options on an ongoing basis – as set out in the Deloitte report?

We would welcome greater transparency of information on water resource costs.

Q10 Do you agree that a third party organisation may be best placed to manage the information database?

We agree that the independence brought by third party management (separate from companies actually trading in the market) of critical trading and market functions would encourage trust and confidence in the operation of those functions

Q11 Do you agree that measures should be introduced to increase transparency and certainty around security of supply for water trading? How can this objective best be achieved?

Consultation questions: access pricing framework

Q18 In relation to water resources, do you agree with our proposals to implement an approach based on the average cost of providing 'network plus' activities?

This appears to be a reasonable starting point but there should also be scope to distinguish access charges for different levels in the supply chain, as discussed in our covering letter.

Q19 In relation to access prices for water resources, do you agree with our proposal that companies should be responsible for calculating and publishing these? Do you agree they should be published by water resource zone, with network distribution and treatment costs separately identified?

We agree that incumbent water companies should be responsible for calculating and publishing access prices that separately identify different elements of cost such as network distribution and treatment so that only those elements involved in facilitating a particular trade across an incumbent network are chargeable in that situation.

Q20 In relation to water resources, do you agree with our proposals to implement a mechanism that offsets the difference between the LRIC (or potentially the AIC in the absence of LRIC data) of new resource and the prevailing average cost of resource?

Q21 Do you further agree that it is the incumbent's, rather than the entrant's LRIC, that should form the basis of the payment, to provide a stronger incentive for entry?

Q22 In relation to sludge, do you agree that price and non-price terms should be the outcome of commercial negotiation, supported by the cost or price and capacity information previously set out?

Q23 Do you support our proposals to develop high-level guidelines as to how rival offers in relation to sludge treatment, transport and disposal should be evaluated?