PR16 business retail price review: Data tables workshops held on 14 and 15 April

Summary of the main points made at the workshops

Draft data tables were published alongside our draft method statement in March with the intention that they would be finalised in May and incumbent companies would complete and return by 20 July 2016. The information will then be used to assist us in formulating draft and final price control determinations. The following points emerged in discussions of the draft data tables at the workshops on 14 and 15 April.

- There were no significant objections to the overall content and structure of the data tables
- A suggestion was made that Ofwat should specify an inflation assumption to be used by companies in completing the data tables

Post meeting clarification – inflation has turned out lower than we expected at PR14 both in 2014/15 and 2015/16 and is expected to continue lower than PR14 assumptions during 2016/17. This may have benefitted companies as the non-household retail operating cost allowances were fixed in nominal terms but companies will have received less cash than was expected from the net margin (as this is applied to wholesale revenue which is indexed by the RPI). We do not intend to revise the price controls because of differences in inflation.

In relation to the data tables there seems to be no particular advantages in reporting variances that arise simply because the RPI has turned out to be different than expected at PR14. So if wholesale revenue is lower and this is explained by lower RPI increases than were forecast at PR14 then companies should not report this variance. In effect this would be equivalent to using the same RPI assumptions as were used at PR14 (for the avoidance these are summarised below).

PR14 RPI inflation assumptions

Year	RPI inflation assumption
2014-15	2.88%
2015-16	2.70%
2016-17	2.80%
2017-18	3.40%
2018-19	3.50%
2019-20	3.30%

Likewise we would not expect companies to change estimates of costs simply because overall price levels have turned out differently to that expected. The opportunity to re-balance allocations between tariff caps is designed to capture the circumstances where there is evidence for supporting a significant rebalancing of tariffs based on underlying drivers, where appropriate supported by customer engagement and Board assurance.

- A suggestion was made that Ofwat should set a materiality threshold for changes in customer numbers arising from eligibility – so companies can retain their existing price caps if they expect changes arising from eligibility are small and are content to do so.

Post meeting clarification – this will be left to the discretion of companies and if they are content that changes in eligibility are such that there is no compelling reason to change customer numbers in their NHH price control they can make proposals and provide assurance on this basis.

As well as the comments on data tables companies made a number of other comments at the workshops, including the following.

- A number of companies said they agreed with the principle of simplification but felt that the timetable for the review was relatively tight and there would be insufficient time to allow for the orderly introduction of a new form of control.
- Nonetheless, if Ofwat were to proceed with proposals for simplification some companies thought it would be helpful to be able to see indicative caps on the bands for larger customers in the Final Method Statement. Other companies said that calibration can only be made in a meaningful way after company proposals for reallocation of costs and margins are submitted in July.
- The Welsh companies would also need to understand whether they would be included in the banding associated with simplification, given the different circumstances applying to Welsh companies.

- Further thought needs to be given to the administrative/compliance burdens of the simplification proposal (especially in respect of customers moving between bands).
- Requirements for and the level of engagement with CCGs should be proportional – in particular in the circumstances where company proposals for NHH price caps will not have a significant impact on charges to customers.

If you have any comments on the above and in particular on the post meeting clarifications please do not hesitate to contact Phil Griffiths on 0121 644 7615 or by email using the dedicated address: NHHRetailPriceReview@ofwat.gsi.gov.uk

PR16: the review of NHH retail default tariff price caps

Data tables workshops

14 and 15 April 2016

Agenda for today

1. Welcome by Ofwat (5 mins)

2. Opening presentation by Ofwat (15 mins)
    - background to the data tables
    - key features
    - revenue neutrality and water fall charts
    - implications of simplification for data tables

3. Questions and answers

Data tables published on 23 March alongside draft methodology statement.

Bespoke spreadsheet pre-populated for each company.

Primary purpose of the data tables: to capture companies proposals for re-balancing costs and margins between default tariff cap bandings in a consistent and structured format

Guidance for completion:

- Tables should be completed assuming the same overall level of costs and margins as in the PR14 FDs
- No need to update and submit the tables if companies consider their existing allocations between default tariff price cap bandings remain robust (but as per the Draft Method Statement a Board assurance statement that original allocations remain appropriate will be required)
- Further guidance will be provided if the proposal for simplification is adopted

Timetable for submission – no later than 20 July.

Two key sheets :

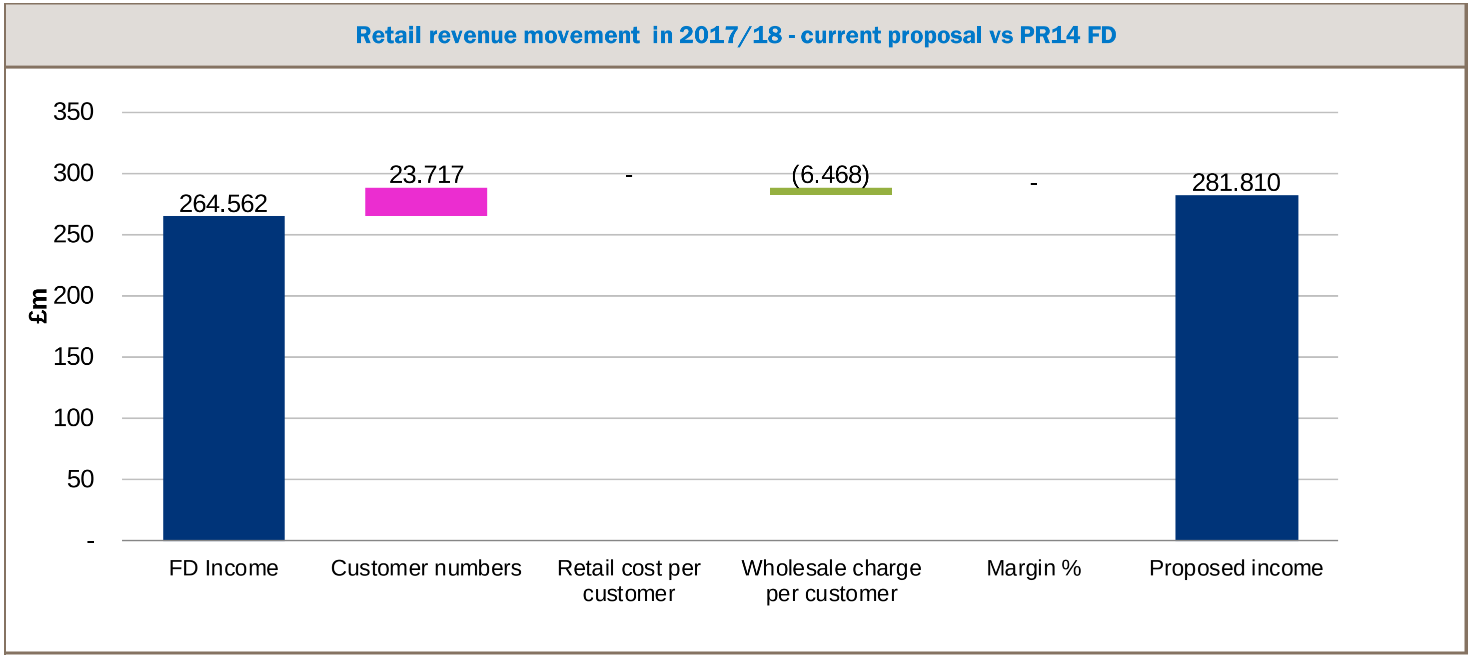
R4a PR16 – This is the only sheet where company input is required

- Simplified version of Table R4 used at PR14 to facilitate:
- Changes to customer numbers, retail costs, net margins and wholesale charges for the default tariff price cap bandings adopted at PR14, and
- Updates to the structure of default tariff price caps by adding new bandings and discontinuing some of those used at PR14

Output summary:

- Compares the aggregate costs and margins resulting from the revised inputs proposed for PR16 with the final determinations from PR14
- Summary table highlights variances in aggregate costs and margins
- Waterfall charts show the drivers of proposed changes to revenue in each of the three year from 2017/18.

We intend to interpret revenue neutrality as allowing for reasonable changes in customer numbers arising from changes in eligibility criteria and wholesale charges so total cost and margin allowances can change.



Proposals for upward revisions should be supported by evidence and assurance.

The waterfall charts highlight whether changes to retail cost per customer and retail net margin % are drivers of the overall revenue change.

Implications of simplification on data table requirements

Simplification	Advantages	Risks
1. Bands for larger customers 2. Companies retain ownership of tariffs 3. Companies retain ownership of managing any price disturbance	1. More transparent and consistent with backstop protection 2. Avoids getting involved in debates about allocating cost to tariffs 4. Less bureaucracy and low value analysis	1. Change to the approach used at PR14 2. Companies may not manage price disturbance combined with a slow start to competition

PR14 retail gross margin as % of wholesale charge Volume band Ml per annum	ANH	NES	NWT	SRN	SVT	SWT	TMS	WSH	WSX	YKY	
0 to 0.5	13.0%						20.1%				
0.5 to 0.75				22.2%					10.6%		Bespoke
0.75 to 1							10.4%				
1 to 2	6.0%				10.6%						
2 to 4		7.9%		6.4%			5.1%		2.7%		
4 to 5			7.7%			5.3%		6.7%		6.8%	
5 to 10	7.9%										
10 to 15				5.1%			3.5%				
15 to 20	4.8%								2.4%		6%
20 to 25					1.9%						
25 to 50		3.8%		2.8%			3.0%		1.7%		
50 to 100						2.6%		4.9%	1.8%		
100 to 150		3.6%									
150 to 175						2.4%	2.8%	4.8%	1.2%	1.4%	
175 to 250	1.3%		4.4%		1.6%						
250 to 350				1.2%							3%
350 to 500		1.3%						4.7%	1.0%		
500 to 1000						2.3%	2.8%	4.7%		1.3%	
> 1000								4.6%	0.8%		

Circa 1000 sites per price cap

Circa 50 sites per price cap

Implications for data tables associated with simplification

Default tariff cap structure – potentially 3 bands for WOC's and 6 for WASC's:

Volume band Ml per annum	Water	Wastewater
0 to 1	Bespoke gross margin or retail cost & net margin	Bespoke gross margin or retail cost & net margin
1 to 50	Common gross margin (say 6%)	Common gross margin
Over 50	Common gross margin (say 3%)	Common gross margin

- Water includes potable, non-potable and mixed use?
- Wastewater includes trade effluent and surface water drainage?
- Unmeasured / unassessed volume customers are allocated to the lowest volume band?
- Treatment of special agreements?

Calibration issues

- What further guidance would companies require to calibrate bespoke bands?
- Would there be advantages in Ofwat providing indicative calibration of the main bands when we publish the final method statement to help companies produce proposals for their bespoke bands/caps?

Treatment of Dŵr Cymru and Dee Valley Water if we adopt simplification?